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Multiemployer Plans

Four Reforms to Save Multiemployer Plans

BY GEORGE M. KRAW

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Multiemployer pension plans are one of the great triumphs of labor relations of the past century. Sponsored by unions and employers, multiemployer plans have helped provide dignity to workers in retirement and stable workforces for employers in construction, trucking, entertainment, coal, retail, food, and other industries. There are more than 10 million participants nationwide in nearly 1,500 multiemployer plans.

However, the future of those plans is bleak unless reforms are made now to change the governance rules and financial obligations of multiemployer plans. The Pension Protection Act of 2006 (Pub. L. No. 109-280) and more recent legislative efforts have been insufficient to repair the plans' deteriorating financial conditions. Some large multiemployer plans are teetering on the brink of collapse.

There are many causes for the underfunding, and every underfunded plan is unhappy in its own way. But most frontline pension fund trustees would point to investments that have failed to meet expected returns during the past decade, fewer new participants in plans, and aging workforces as major causes. In some cases, policies designed to safeguard workers' pensions and improve benefits have had the unintended effect of making bad situations worse and have left many pension plans under crushing debt that will be impossible to pay off. Some plans felt pressure to increase benefits

in better economic times, leaving them with no reserves for getting through the current economic crisis.

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Moody's Investors Service estimated the total unfunded liability of 126 of the nation's largest multiemployer pension plans exceeded $165 billion in 2008. A 2009 survey by the National Coordinating Committee for Multiemployer Plans found that 80 percent of the plans reviewed were in "endangered" or "critical" underfunded status, which put those plans under increased regulatory constraints.

Meanwhile, the Pension Benefit Guaranty Corporation's insurance program for multiemployer plans has insufficient funds to cover insured benefits, even though the PBGC-guaranteed maximum monthly benefit of $1,320 per participant and median monthly benefit of $820 are relatively low. PBGC's multiemployer plan program has reported a deficit every year since 2003. At the end of fiscal year 2009, the program had assets of $1.46 billion and total liabilities of $2.33 billion. A reported $2.30 billion of those liabilities represented nonrecoverable future financial assistance to distressed plans. A May 2010 report to Congress from the Government Accountability Office summed up the situation by saying that multiemployer plans face "ongoing funding and demographic challenges that have the potential to place an additional financial burden on the PBGC."

Suggested Reforms

Several changes in the rules governing multiemployer pension plans could help save those plans, whose distress has been well-documented. Four reforms are necessary:

- Cutting vested benefits if plan trustees deem it necessary and plan sponsors agree;
- Capping or eliminating withdrawal liability to bring more employers into multiemployer plans;
- Allowing plans greater flexibility to reduce investment assumption rates below current levels and to "immunize" or hedge part or all of their assets and liabilities; and
- Creating a Chapter 11-type bankruptcy procedure for severely distressed plans.

The common element in all of these reforms is that of giving plans and participating employers and unions greater flexibility to address their specific needs. None of the reforms would be mandatory. The principle underlying each of the proposed reforms is that troubled pension plans should balance the interests of active and retired participants by preserving pension plans while preserving jobs and industries.

Allow Plans to Cut Vested Benefits

The PPA created new funding requirements for plans just as the nation was entering the most severe economic crisis since the depression of the 1930s. The law allowed multiemployer plans whose underfunded status was deemed critical to cut some vested benefits for plan participants. That authority to cut vested benefits should be expanded and extended to all multiemployer plans. The plans should have the means to revise and restructure vested benefits in ways that ensure the survivability of individual multiemployer plans and the industries that sponsor them. It is best to allow plans to act sooner rather than later when they are on the brink of insolvency.

The guiding principle here should be that plans must not be forced to adopt contribution rates from active participants that result in uncompetitive and unsustainable labor costs and loss of jobs. Plans should be allowed to ask what actions will provide the greatest good for the greatest number of participants and act accordingly. As a safeguard for participants, sponsoring unions and employer groups should be given the right to veto any cutbacks greater than those currently allowed under the PPA.

Allow Plans to Waive or Cap Withdrawal Liability

Withdrawal liability for employers has crimped the ability of multiemployer plans to attract new employers more than any other provision of the Employee Retirement Income Security Act. Withdrawal liability requires an employer that withdraws from a multiemployer plan to pay a share of the plan's unfunded liability. In its 2010 report to Congress, GAO said the PBGC views withdrawal liability as an incentive for employers, participants, and their collective bargaining representatives to avoid insolvency and to collaborate in trying to find solutions to a plan's funding problems.

In reality, however, withdrawal liability has interfered with collective bargaining and exacerbated the difficulties that unionized industries have had in maintaining industry market share because the liability is a significant financial disincentive for new employers to join multiemployer plans. In the worst cases, rather than strengthening multiemployer plans, withdrawal liability has led to a death spiral in which market share and competitive wages have been traded for increased contributions to pension plans.

As a plan's finances weaken, the plan's withdrawal liability increases. New proposals from the Financial Accounting Standards Board would require employers that participate in multiemployer plans to list their withdrawal liability on their audited financial statements even if they have no intention of withdrawing. The new requirements would further weaken the market competitiveness of large multiemployer plan employers by adding those contingent liabilities to their balance sheets.

Given the difficult financial circumstances of many multiemployer plans and the financial relief that expanded employer participation would bring, it would be reasonable in the future to let each multiemployer plan establish its own rules for withdrawal liability. Some plans and sponsors might decide to keep withdrawal li-

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ability. Others might waive it completely. Some might require it only for employers that already participate in a multiemployer plan. All options should be on the table.

The important point is that the survivability of multiemployer plans that are not fully funded depends on the survivability of the industries that pay into those plans. Withdrawal liability provides little protection for plans if participating employers are forced out of business and jobs are lost.

Provide Special Rules for Plans That Want to Reduce Their Investment Assumption Rates or Immunize Their Portfolios

Most multiemployer plans assume between 6 percent and 8 percent rates of return on their investments. Those rates are based on past history and are not realistic for the future. Many plans are reluctant to lower their assumed rates of return because doing so would increase the plans' liabilities. The lower the investment rate of return, the more assets plans must have on hand today to pay for future obligations. Believers in the so-called ''new normal'' expect institutional investors to garner returns of 5 percent or less, and yet many multiemployer plans are expected to continue trying to achieve 6 percent to 8 percent returns. Sophisticated investors like Bill Gross, cofounder of Pacific Investment Management Co. (PIMCO) and manager of PIMCO's Total Return fund, are telling plan trustees that they are unlikely to come close to such results.

Compounding the problem are lower returns from traditional fixed-income investments such as corporate and government bonds. One unfortunate response to this trend has been for multiemployer plans to invest in risky assets such as private equity, hedge funds, and the like in an effort to achieve their assumed rates of return.

Multiemployer plans should be permitted to assess whether their assumed rates of return are too high and to lower them without running into regulatory problems. Providing that flexibility also would require changing some portion of a plan's vested benefits into contingent benefits, which would be paid only upon improvements in the plan's finances and returns in excess of the new assumption rates.

Plans also should be able to immunize portions of their portfolio. The aim of such liability-driven investment strategies is to invest pension funds in assets that will increase or decrease in direct correlation with an increase or decrease in a pension plan's liabilities. Immunization strategies can be paired with investments in inflation-protected, fixed-income securities to provide protection against inflation.

Critics of immunization strategies argue that they result in lower investment earnings. However, a well-designed immunization strategy provides the best guaranty that pension promises can be fulfilled. When combined with inflation-protected securities, immunization also ensures that a pension's real value will be maintained throughout a pensioner's retirement.

Provide Chapter 11-Type Bankruptcy Procedures

Multiemployer plans that have suffered severe investment losses or that represent declining industries risk a gradual slide into insolvency. Under current law, a multiemployer plan's eventual collapse may be both inevitable and foreseeable. Recent legislative proposals to expand PBGC's partition authority so that multiemployer plans can apply triage strategies and save viable portions of multiemployer plans have been mischaracterized by some as taxpayer-financed union bailouts (101 PBD, 5/27/10; 37 BPR 1271, 6/8/10) and (102 PBD, 5/28/10; 37 BPR 1270, 6/8/10). Those proposals face significant political opposition because they are seen as a potential threat PBGC's solvency and ultimately a threat to taxpayers, notwithstanding the fact that PBGC's multiemployer insurance program is ultimately funded by sponsoring employers and unions through insurance premiums, not by the federal government.

Outlook for the Future

Clearly some multiemployer plans will not survive their current financial and economic problems without restructuring. A Chapter 11-type bankruptcy procedure would provide a more orderly and fairer approach to dealing with the problems on a case-by-case basis. It would allow courts to allocate losses by taking into account the interests of all stakeholders.

The current statutory regime places heavy burdens on employers that remain in troubled plans and in some cases threatens loss of jobs and industry survival. Bankruptcy proceedings, rooted in equitable concepts of the law, are the best way to handle multiemployer plans whose financial obligations greatly exceed their assets but that still have significant financial holdings.

Reforms such as those suggested here would significantly affect the PBGC and might require that participants in plans adopting these changes receive lower levels of insurance coverage for their pensions. Any change in the level of benefit guaranteed by PBGC would require a cost-benefit analysis that would weigh the specific concerns of PBGC against the interests of all multiemployer pension plans.

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The challenges facing some multiemployer plans require more aggressive action than a gradualist approach can provide. Substantial government financial aid for multiemployer plans is unlikely in the current economic and political environment. Future inflation could reduce plan debt, but it also would decrease the value of pensions.

Multiemployer plans are at a point where everyone involved must recognize that some troubled plans will be unable to meet all their promises to participants and that their collapse threatens to take jobs, employers, and whole industries out with them. Absent a politically unlikely government bailout or significant inflation that washes away the debts of private parties and government alike, there is no scenario in which these plans will be able to pay their full promised pensions under current rules.

If troubled multiemployer pension plans are to be left to their own devices to solve their funding problems, they must be given the means to do so.

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