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Assessing the Challenges Facing Multiemployer Pension Plans

Chairman Roe, Ranking Member Andrews and Members of the Subcommittee, thank you for the opportunity to participate in today's hearing. I am honored to appear before you today.

By way of introduction, I am a partner with the law firm of Morgan Lewis & Bockius in the Washington D.C. office where I practice in the Labor & Employment and Employee Benefits Practice Groups. As part of my practice, I serve as management co-counsel to a number of multiemployer pension plans, and the Firm and I represent dozens of multiemployer plans in traditionally-unionized industries, including food, mining, maritime, trucking and entertainment. In representing these plans, we have been actively involved in all aspects of their operation and administration. In addition, my practice focuses on collective bargaining, particularly multiemployer bargaining, and I have been involved in the negotiation of numerous labor agreements, many of which determine employer participation and contributions to multiemployer pension plans.

Before I begin my testimony, I want to thank full Committee Chairman Kline and Subcommittee Chairman Roe for scheduling this important hearing, and the entire Subcommittee membership – both Republicans and Democrats – for participating here today. If it is not already evident to you, I suspect that after listening to the testimony from this panel of witnesses, you will join a very small – but important – group of legislators who understand and appreciate the serious challenges facing multiemployer plans and the employers that contribute to them.

I. Introduction

To start, it might be useful to review where we've been and how we got to where we are today.

Multiemployer pension plans are collectively bargained, jointly administered plans that are generally organized by industry and/or region. Unlike single employer plans, where the company sponsoring the plan has decision-making authority concerning plan design and administration, multiemployer plans are administered by an independent board of trustees – half representing management and half representing the sponsoring union.

Mr. Chairman, that bears repeating because there is a common misperception – often seen in the media – that these plans are "union" or "union-run" plans. That simply is not the case. Neither the union nor the contributing employers have the ability to control these plans. They are run by separate and autonomous boards of trustees representing both labor and management. By law, each trustee must act independently as a fiduciary and in the best interest of the plan's participants. At the trustees' table, we often talk about trustees wearing two hats, and that trustees, when dealing with trustee matters, must take off their company or union hat and wear only their trustee hat. Of course, this means that trustees must make decisions that may not be preferred by their company or union. For instance, management trustees sometimes must vote to increase employer contributions to the plan, something their companies probably would rather not see. Similarly, union trustees sometimes must vote to reduce benefit accruals, making their constituency unhappy. Regardless, trustees must make decisions based on what they believe is in the best interest of the plans participants and beneficiaries. Failure to do so would put trustees at significant legal risk of breaching their fiduciary duty.

For more than fifty years, multiemployer plans have played an important role in the overall pension/retirement scheme of this country. Millions of men and woman look to these plans for their retirement security, and multiemployer plans have provided billions of dollars in pension benefits. As we look at these plans, however, their long-term sustainability affects not only the current pensioners and beneficiaries. It also affects the companies that contribute to these plans and the current employees of those companies. In assessing the challenges facing multiemployer plans, Congress needs to be mindful of three immediate constituencies and one potential constituency. The immediate constituencies are: current retirees and beneficiaries, the current contributing employers, and the current employees of these contributing employers. While there is a tendency to focus exclusively on the plans and their beneficiaries, attention needs to be paid to the companies that participate in – and pay for – these plans. Without them, these plans will be history. And, if that happens, then the liabilities become the responsibility of the Pension Benefit Guaranty Corporation ("PBGC") and potentially the taxpayer.

Unfortunately, the number of companies that contribute to these plans has dwindled significantly over the past several decades, resulting in an ever-increasing, and in some cases, unsustainable, burden on those companies that remain. Many of these companies already face significant competitive disadvantages because of their relatively high costs as compared to their non-union competition. For some of these unionized employers, increasing contributions in order to better fund these plans is simply not an option, particularly as an increasing portion of the contribution goes to pay benefits to individuals who never worked for the company. There is a growing recognition even among union leadership that increasing contributions is just no longer possible and that doing so only exacerbates the current problems.

Legal/Regulatory Background

Multiemployer pension plans, established under Section 302(c)(5) of the Taft–Hartley Act of 1947, are governed by the Employee Retirement Income Security Act of 1974, as amended ("ERISA") , the Internal Revenue Code of 1986, as amended, and a complex series of tax and benefits regulations and regulatory rules from the Internal Revenue Service (IRS) and U.S. Department of Labor ("DOL"). The PBGC also has oversight and enforcement capabilities as part of its responsibilities to provide an insurance safety net for defined benefit plans, including multiemployer plans.

This exclusively-federal legal and regulatory scheme sets the standards for plan participation, vesting, benefit accruals, pension eligibility and plan funding. The law defines how long a person may be required to work before becoming eligible to participate in a plan, to accumulate benefits, and to have a non-forfeitable right to those benefits. It establishes detailed funding rules that require boards of trustees to provide adequate funding for the plans they administer. And, as noted earlier, trustees are subject to fiduciary rules, including the duty to act prudently and to discharge all of their duties with respect to a plan "solely in the interest" of the plan's participants and beneficiaries. If anything, the administration of multiemployer pension plans is as complex as ever, and the requirements on and accountabilities of trustees are as great as they have ever been.

As someone who spends significant time working with trustees of multiemployer plans – both union and management trustees – who take their role and responsibilities as trustees very seriously – I am often surprised by reports that broadly portray these plans as mismanaged and poorly run. While there undoubtedly have been management issues, focusing on those isolated problems does not address the more fundamental and real challenges facing multiemployer pension plans. In many instances, these problems are the same problems that are confronting single employer plans. The trustees we deal with not only work incredibly hard and take their fiduciary responsibilities extremely seriously, they regularly engage the experts and professionals to advise and assist them with the complexities of administering these plans. For example, plans engage investment consultants who take on a fiduciary role to advise and make recommendations to the trustees about their investment decisions. They also engage the services of actuaries, accountants, legal and other professionals, who are

responsible to the trustees. ERISA permits, and even encourages, these types of engagements.

Multiemployer Pension Plan Amendments Act (MPPAA)

In 1980, Congress enacted the Multiemployer Pension Plan Amendments Act (MPPAA) with the goal of strengthening protections for multiemployer plans. Under MPPAA, companies that permanently cease to contribute to a multiemployer plan generally are liable to the plan for their share of the plan's unfunded vested liabilities for the employees the employer has left behind. This is known as withdrawal liability. It is difficult to quarrel with the purposes behind MPPAA, and when it was passed in 1980, it undoubtedly was done with the best of intentions.

Today, however, the reality is that when a company exits a multiemployer plan – often through a bankruptcy or other business closure – it usually does not pay its full withdrawal liability. Indeed, in most bankruptcies, plans collect withdrawal liability that is only cents on the dollar. Moreover, when an employer withdraws from a multiemployer pension plan, its retirees remain in the plan and continue to receive pension benefits, which are paid for by the remaining contributing employers. As a result, a substantial number and percentage of retirees in multiemployer pension plans are so-called "orphan retirees" of non-contributing employers.

Funding the retiree liabilities of non-contributing employers has added a significant economic burden on the employers remaining in these plans. In a number of industries, the burden is proving to be unsustainable for the remaining employers. In many plans, 50 percent or more of an employer's contributions now fund these liabilities. It is difficult to imagine how any plan can sustain that burden, or how any contributing employer can pay for that liability over the long term. It is worth noting that sponsors of single employer plans, in contrast, use their corporate resources for plan contributions that benefit only their own employees.

Additionally, while the "orphan" liability left behind in many of these funds is enormous, the withdrawal liability amounts attributable to each existing employer have become overwhelming. In many instances, companies' withdrawal liability from multiemployer plans greatly exceeds their entire market capitalization. Most companies could never pay a fraction of their current share of the withdrawal liability. Not only does this mean that the plans will never collect this money, but the staggering amount makes it very difficult for plans to attract new employers. And, without new employers to replace those that are exiting, the problem continues to get worse. In these plans, part of their design is based on the ability to continue replacing exiting employers. The staggering withdrawal liability also is detrimental to those companies that participate in these plans. Already disadvantaged by the costs of these plans, contributing companies have significant difficulty obtaining credit or financing or otherwise attracting investment with the specter of this enormous contingent liability.

These problems are only exacerbated for plans in industries where there has been a significant decline in union employment. In the trucking industry, for example, 1980 marked not only the passage of MPPAA, but also deregulation of the industry under the Motor Carrier Act of 1980. Prior to 1980, something on the order of 90 percent of the 100 largest trucking companies were unionized and thus paying into multiemployer pension plans. Twenty years later, that percentage had dropped to under 10 percent. Today, there are essentially two trucking companies, one package company, and a handful of car haul companies for the pension liabilities of that original 90 percent. This significant decline in the number of unionized companies supporting multiemployer pension plans is present in other industries as well. In short, it puts an enormous and unsustainable economic burden on the few, remaining contributing employers.

Pension Protection Act

Recognizing that there were serious funding issues facing multiemployer pension plans, Congress significantly revised the rules governing these plans in the Pension Protection Act of 2006 (PPA). The PPA was designed to shore-up the financial health of these plans by accelerating funding requirements and creating more transparency with classifications based on each plan's funding status. Importantly, the PPA also gave trustees certain tools – and imposed certain legal mandates to adjust benefits and employer contributions – to ensure plans were on firm financial footing or at least headed in that direction.

There were three funding levels established under the PPA for multiemployer plans that are at risk: Endangered Status ("yellow zone"); Seriously Endangered Status ("orange zone"); and Critical Status ("red zone"). A plan that is not endangered, seriously endangered, or critical is said to be in the "green zone." A plan's status is generally based on funding percentages and projected accumulated funding deficiencies. A plan that is less than 80 percent funded, or has an accumulated funding deficiency in the current year or in any of the next six years, is in endangered status; if the plan meets both criteria, it is in seriously endangered status. Generally, a plan is in critical status if it is less than 65 percent funded or will experience a funding deficiency within four years.

For a plan in endangered status, the Trustees must adopt a Funding Improvement Plan, which consists of schedules showing revised benefit structures, contribution structures, or both, that are designed to bring the plan's funding up to certain benchmark levels by the end of a certain period. Under a Funding Improvement Plan, Trustees may require increased contributions and/or a reduced rate at which benefits are earned in the future, but nothing further.

If a plan is certified to be in critical status, the Trustees must adopt a Rehabilitation Plan. In addition to including the possibility of increased required contributions and a reduced rate at which benefits are earned in the future, Trustees also may reduce or eliminate "adjustable benefits." "Adjustable benefits" include such benefits as: (1) post-retirement death benefits and disability benefits not in pay status; (2) any early retirement benefit or retirement-type

subsidy and any benefit payment option (other than the qualified joint and survivor annuity); and (3) benefit increases adopted or effective fewer than 60 months before the plan entered critical status.

Since the PPA was enacted in 2006, Congress has also passed the Worker, Retiree, and Employer Recovery Act of 2008 (WRERA), and the Pension Relief Act of 2010 (PRA 2010) in order to provide relatively minor relief to multiemployer plans to help them get through the stock market crisis from 2008.

Pension Benefit Guaranty Corporation

Under the PBGC's multiemployer program, each multiemployer plan pays the PBGC an annual insurance premium of $9 per participant. In return, the PBGC provides financial assistance through loans to plans that are insolvent (i.e., unable to pay benefits when they are due). When a plan becomes insolvent, benefits must be reduced to the level that can be paid out of the plan's available resources. Benefits, however, are not reduced below the level of basic benefits; that is, the level of benefits guaranteed by the PBGC (a monthly benefit equal to the sum of 100 percent of the first $11 of monthly benefits and 75 percent of the next $33 of monthly benefits for each year of service). For a participant with 30 years of service, the maximum PBGC-guaranteed benefit is $12,870 per year.

The PBGC only becomes responsible for funding the pension obligations of multiemployer plan participants when the plan becomes insolvent. Unlike when a company sponsoring a single employer plan goes bankrupt, the PBGC does not take over a multiemployer plan. A multiemployer plan's remaining contributing employers play the role of the PBGC in the single employer world, paying contributions as the plan becomes insolvent. Even then, the PBGC's responsibility comes only in the form of "loans," although when a plan is truly insolvent, there cannot be any reasonable expectation that these loans will ever be repaid.

The PBGC's multiemployer program has reported a deficit every year since 2003. At the end of 2011, the program's deficit was $2.8 billion (up from $1.4 billion in 2010). According to the PBGC, more of those liabilities represent "non-recoverable" future financial assistance to the 41 plans currently receiving financial assistance and to other plans expected to receive such assistance in the future. In addition, the PBGC estimated that its "reasonably possible" obligations to multiemployer plan participants were $23 billion at the end of fiscal 2011. Notably, the PBGC's multiemployer program is funded and maintained separately from its single employer insurance program.

Unfortunately, under current law, there is little the PBGC can do to assist troubled plans – even those clearly headed towards insolvency – until the plan runs out of money. As the Agency noted in its 2011 Annual Report, it "cannot step in until plans are already insolvent, by which time other remedies are no longer possible."

II. Today's Challenges

The last decade ravaged most defined benefit pension plans – both in the public and private sectors – and multiemployer plans were no exception. Although there has been significant focus on the problems facing other types of plans, such as government and municipal plans, many multiemployer plans are facing a similar or worse fate. Indeed, there are a significant number of them that are beyond resuscitation, at least under the current legal framework. The combination of investment losses, rising liabilities due to low interest rates, demographic issues and the spiraling liability left by withdrawing employers has put many multiemployer plans on an irreversible path towards insolvency. And, for some plans, insolvency is less than five years away.

Let me first talk about investment losses. For most multiemployer plans, the investment losses have been catastrophic. As the markets dropped, multiemployer plans, which are major institutional investors, lost billions of dollars and their overall assets declined substantially. I note that while the market losses were devastating from a dollar perspective, for pension plans, these losses were far worse because plans count on a certain investment return each year. When a plan expecting to earn 7 percent in investment returns loses 10 percent in the market, the actuaries tell us that the plan has sustained a loss of 17 percent because it is 17 percent behind where it was expected to be. When a plan loses 10 percent in the market one year, it can't make up that 10 percent loss the next year with 10 percent returns.

Investment losses are only part of the problem. Interest rates have declined to the lowest level in decades. Much like a bond, as interest rates decline, pension liabilities increase. Rising liabilities at a time when investments are underperforming would be bad enough, but these plans have had to contend with more bad news.

What is important to understand is that many of these funds were in good shape a little more than a decade ago. Many were over 100 percent funded and on sound actuarial footing before the economic collapse. Indeed, back in the 1990s, some multiemployer plans actually were forced to increase benefits in order to avoid being overfunded to an extent that employers' pension contributions to these plans would not have been tax deductible.

These investment losses and the economic downturn that caused them only exacerbated the significant demographic issues facing multiemployer plans in a number of industries. As the size of the country's unionized workforce has shrunk and continues to do so, the ratio of retirees (who are receiving pension payments from the plan) to active participants (those still working and for whom contributions are made by the contributing employers) continues to grow. In one example that has been cited by the PBGC and others recently, a large pension fund in the mining industry has a ratio of 12 retirees to every active employee. Although this might be an extreme example, there are many multiemployer plans where the ratio of retirees to actives exceeds three or four retirees for every one active.

Additionally, not only are there increasingly more retirees than actives in these plans, but many of these retirees worked for companies who have withdrawn and are not contributing for their retirees who remain in the plan. As such, the benefits of these retirees must be paid for by remaining employers. This means higher and higher employer contributions, particularly as plans are unable to rely on investment returns to fund these benefits. Higher employer contributions further threaten the financial viability of these last remaining contributing employers. It has become a vicious cycle.

Unfortunately, the situation seems to be getting worse. For plans in a number of industries, the overall demographics continue to look bleak. Many plans have been forced to reduce benefits as required by the PPA such that current participants are not accruing much in the way of a future pension benefit. In some situations, to comply with the PPA would require the remaining contributing employers to pay to the multiemployer plan $20 per hour worked by their active employees. That obviously is not sustainable. As a result, employers continue to look for any way to get out of these plans, and certainly none are signing up to get in. The financial health of many contributing employers cannot sustain additional contribution increases, and, in fact, some plans have capped their highest employer contributions for fear of driving the remaining companies out of business.

Situations like the one playing out in the current Hostess bankruptcy will only make matters worse. There, the bankruptcy judge may allow the company to walk away from all the multiemployer plans in which they previously contributed, and to do so with no withdrawal liability. For a number of bakery funds, this will mean certain insolvency, and leave the remaining employers with substantial liability.

For private employers in the multiemployer plans, there is little they can do. When they look at their overall labor costs, the cost of pensions is the piece that is completely out of step with their competition. In many cases, these pension costs are 30 and 40% greater than their competitors. Unlike their non-union competition, however, they cannot simply switch to a defined contribution or other less-risky pension program. Some employers are paying whatever it takes – huge sums of money – to get out of the plans, figuring the price is worth it to relieve themselves of the burden and uncertainty of these plans. On the other hand, there are many employers that could not afford to pay their withdrawal liability even if they could negotiate a collective bargaining agreement that allowed them to do so.

What is important to understand is that in certain sectors of the economy and industries, the extent of the multiemployer pension plan problem is much worse than has been widely reported. There are a number of smaller, but significant plans that face projected insolvency within the next five years. It also is important to understand that for plans in critical status that have reduced future benefits to the maximum extent possible, there is nothing that trustees can do legally to avoid a slide toward insolvency. Moreover, there is nothing in the current law that gives the responsible government agencies any ability to provide assistance to these plans.

What also is important to understand is that doing nothing means the government ends up taking on a portion of the liabilities of these plans when they become insolvent. Under current law, when a multiemployer plan becomes insolvent, the PBGC ends up paying benefits to participants at a reduced level. Although no one that I am aware of has done any precise calculations, it is fair to say that even the insolvency of some of these smaller plans over the course of the next five years will quickly deplete the PBGC's multiemployer insurance program.

III. Where Do We Go From Here?

A recent op-ed in the *Wall Street Journal* suggested that multiemployer plans needed more oversight and greater transparency. While it's hard to argue with greater oversight and transparency for most issues, in this case I believe it is the equivalent of placing a band-aid on a broken arm. It can't hurt but it surely will not cure the patient.

Given the wide range of industries and significant differences among plans today, however, it would be difficult to say that there is a single answer or a one-size-fits-all solution to the problems facing multiemployer plans. Although relatively minor tweaks of existing funding rules may be sufficient for some plans, there are a number of plans that will not survive without significant change in the current law. For these plans, there needs to be major reform and, frankly, a fundamental change in the way we approach pension plans. Clearly, we need to give trustees additional tools – tools that should cost the government nothing – to address the fundamental fact that revenues can never meet the obligations of these plans. Failure to act, as I mentioned earlier, will mean that these insolvent plans will end up at the PBGC and, under current law, the federal government will be obligated to fund benefits for participants of these plans.

While the focus of today's hearing is on assessing the challenges facing multiemployer plans, I would be remiss if I did not indicate that a number of stakeholders are attempting to identify potential solutions and developing legislative proposals. Without endorsing or commenting on the merits of any of these ideas, I thought it might be useful to summarize several of the legislative reform concepts that I am aware are being discussed:

- Increase PBGC premiums for multiemployer plans to strengthen the Agency's insurance program.

- Provide multiemployer plans a "fresh start" with respect to withdrawal liability, and essentially eliminate some or all of the current unfunded liability.

- Promote Mergers/Multiemployer Plan "Alliances."

- Allow for partitioning of certain participants and beneficiaries whose employer failed to pay its full withdrawal liability or are not contributing for its beneficiaries who are or will receive benefits from the plan.

- Permit reduction of vested benefits under certain limited circumstances.

- Change the PPA to avoid the imposition of employer contribution rates that are not sustainable.

- Change the bankruptcy laws regarding withdrawal liability.

Mr. Chairman, thank you for giving me the opportunity to testify this morning. I will be happy to answer any questions from the Subcommittee members.