

MULTIEMPLOYER PENSION REFORM ACT OF 2014: A CATALYST FOR BROADER REFORM?

JANUARY 2015

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On December 16, 2014, President Obama signed into law sweeping changes to the rules governing multiemployer pension plans as part of the Omnibus Budget and Continuing Resolution spending bill.¹ In a major policy shift, the Multiemployer Pension Reform Act of 2014 enables multiemployer plans to reduce benefits for all participants, including retirees, if essential to avoid plan insolvency. This policy realignment reflects the critical need for pension reform as we are at an unfortunate juncture where, in certain circumstances, promises that were made to employees can no longer be upheld. In this paper, we outline the challenges the legislation is intended to help solve, summarize the legislation's key provisions and analogous approaches municipalities are adopting to address public pension plan funding shortfalls, and explore potential implications for the future.

Background

Multiemployer plans (also referred to as Taft-Hartley Plans) are union worker pension programs that receive contributions from multiple employers in a given industry and/or geographic region. Multiemployer pension plans were first introduced under the Labor Management Relations Act of 1947, as amended, also known as the Taft-Hartley Act.² Taft-Hartley plans are subject to the Employee Retirement Income Security Act of 1974, as amended (ERISA), which governs plan operation and funding. According to the Pension Benefit Guaranty Corporation (PBGC), there are approximately 1,400 multiemployer pension plans in the United States covering approximately 10 million US workers and retirees.³ The National Coordinating Committee for Multiemployer Plans estimates that defined benefit multiemployer pension plans represent approximately \$450 billion in assets.⁴

Over time, union membership and employment patterns have changed and the fortunes of companies contributing to multiemployer plans have diverged. In certain industries, the ratio of active employees to retired workers has declined dramatically and the benefit payments exceed new contributions, sometimes by a substantial amount. Additionally, as the number of employers participating in multiemployer plans has declined, the remaining employers bear an increased financial burden for funding benefits.⁵ A survey of 220 multiemployer plans conducted by Segal Consulting in Spring 2014 found that one-third of multiemployer plans surveyed were less than 80% funded and 12% of plans surveyed were less than 65% funded.⁶

HIGHLIGHTS

- ▶ Multiemployer Pension Reform Act of 2014 enables multiemployer plans to reduce benefits for participants, including retirees, in order to avoid plan insolvency.
- ▶ This legislation also raises PBGC premiums for multiemployer plans and facilitates plan mergers and partitions.
- ▶ While this legislation is specific to troubled Taft-Hartley plans, numerous state and local public funds have also implemented and/or proposed pension plan changes.
- ▶ Senator Hatch has proposed a plan that would enable public employers to adopt a plan that would purchase annuity contracts for employees on an annual basis.
- ▶ Given pension underfunding challenges and retirement needs, additional changes are anticipated in pension plan designs and benefits.



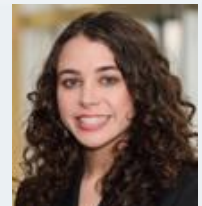
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The funding status of many multiemployer plans combined with annual net shortfalls point to looming insolvency for many of these plans. If these plans become insolvent, the PBGC would in theory step in to provide financial assistance in the form of loans (but with no expectation of repayment). However, the PBGC trust fund for Taft-Hartley plans is also severely underfunded and at significant risk of running out of funds. The PBGC's financial projections show that the risk of its multiemployer program's insolvency "rises over time, exceeding 50 percent by 2022 and reaching 90 percent by 2025."⁷ In its 2014 Annual Report, the PBGC reported an increase in its net deficit for the multiemployer program to \$42.4 billion – an all-time record high and an increase of \$34.1 billion from the prior year.⁸

“the math just doesn't add up anymore...”

— PBGC, *Retirement Matters*, “*Troubled Multiemployer Plans Put Benefits in Jeopardy for 1.5M People*”⁹

Over the past few years, some people have floated the idea of a Federal government bailout for the PBGC trust fund and, in effect, for these pension plans. Congress has indicated that there is little appetite for a Federal bailout, thus requiring a different solution.¹⁰

Benefit Changes under the Act

The new legislation, modeled on a report by the National Coordinating Committee for Multiemployer Plans,¹¹ seeks to balance and further multiple objectives: (i) prevent or reduce multiemployer plan insolvency, (ii) protect benefits to the extent possible for active and retired employees, and (iii) support long term viability of the PBGC trust fund. To facilitate the survival of multiemployer plans that are in severe financial distress, the act authorizes a suspension or reduction in benefits for participants and beneficiaries, including those already in payment status. George Miller (D-CA) and John Kline (R-MN) led the bi-partisan effort, reflecting the importance of finding a solution that is financially viable and politically feasible.¹² Democrats and Republicans support the reforms, as they are intended both to protect union members' retirement security and to protect small businesses from pension funding obligations that could lead to financial ruin. The bipartisan majority recognizes that a fair solution balances the needs of multiple constituents. Although some critics are concerned about the precedent of reducing benefits, and the potential spill-over into other types of plans, the legislation appears to have found a reasonable balance and enjoys the support of at least some union leadership.¹³

The new rules create a new plan label called "critical and declining status." A plan may receive this label if either a) the plan is projected to become insolvent within 14 years,

or b) the plan is projected to become insolvent within 19 years and it meets one additional condition, either the plan is less than 80% funded or the ratio of inactive to active participants is greater than 2 to 1. Plans in a critical and declining status are eligible to suspend or cut benefits using the process outlined below, subject to certain limitations.¹⁴

The Multiemployer Pension Reform Act of 2014 sets out a multi-step process for plan sponsors proposing benefit reductions and suspensions. First, the plan's actuary needs to certify that the plan is projected to avoid insolvency if the proposed benefit suspensions are approved, and the plan sponsor must determine that this benefit suspension is necessary. Second, the plan sponsor must apply to the US Department of the Treasury with a request to suspend benefits. Simultaneously, the plan sponsor needs to notify participants, beneficiaries, contributing employers, and the respective union representatives of the application. Treasury has 225 days to approve or deny the application after consultation with the Department of Labor (DoL) and PBGC. If Treasury takes no action, the application is deemed approved. Additionally, there is a judicial review process to challenge a rejection of the application. Third, the proposal for benefit suspension must be voted on by the participants and beneficiaries within 30 days of Treasury's approval. In this vote, the proposal can only be rejected if the majority of *all* participants and beneficiaries in the plan vote to reject. If a proposal is rejected, the plan sponsor can start again with a modified proposal. In certain circumstances, a rejection vote may be overridden. This final step in the process is reserved for plans that are deemed to be "systemically important." In this step, Treasury, DoL and PBGC consider the plan's potential impact on the PBGC if the plan becomes insolvent. Plans projected to create a liability for the PBGC of \$1 billion or more will be deemed systemically important and the rejection vote may be overridden.¹⁵

The legislation balances the need to create financially viable plans with the need to protect participants' and beneficiaries' retirement income. Benefit payments cannot be reduced below 110% of the PBGC guaranteed benefit amount. For multiemployer plans, the guaranteed benefit amount varies based on years of service. The guarantee structure has two tiers, providing 100% coverage up to a certain level and 75% coverage above that level, subject to a maximum annual payment in 2014 of \$12,780.00.¹⁶ Participants and beneficiaries who are 80 years or older and those who are receiving disability pensions are exempt from benefit suspensions under the new legislation. Benefits of participants and beneficiaries who are 75 years or older are partially protected.¹⁷ In developing a benefit suspension proposal, plan sponsors need to consider age, number of years to retirement, and participants' benefit histories.

Other Key Provisions of the Act

In addition to permitting reductions in benefits, there are other important provisions of the Multiemployer Pension Reform Act of 2014. First, the legislation raises PBGC premiums beginning 2015, from \$12 per plan participant to \$26 per plan participant, and in subsequent years is subject to adjustments based on the national average wage index. The PBGC is also required to provide Congress, by June 1, 2016, with an analysis of the sufficiency of premium levels and, if the premiums are deemed insufficient to meet its benefit guarantee obligations over the next 20 years, a proposal to further increase premiums.

The legislation gives the PBGC increased authority to merge multiemployer plans. The PBGC can step in to facilitate a merger, including providing financial assistance, if it believes the merger would be in the best interests of the individuals covered by at least one of the plans and the merger is not expected to adversely impact the interests of both plans. Finally, the legislation makes significant changes to the current requirements to partition a plan. Partition is intended to facilitate survival of a portion of a plan, by severing the liabilities attributable to a severely distressed plan sponsor. Under prior law, a plan sponsor needed to be in bankruptcy for partition to be available. The legislation eliminates the requirement that a plan sponsor be in bankruptcy and makes other changes intended to provide plan sponsors with greater flexibility. The change is intended to provide an additional tool to facilitate at least partial survival of a plan in critical and declining status.¹⁸

Finally, the new law extends the Pension Protection Act of 2006 multiemployer funding rules that were scheduled to sunset at the end of 2014 and made a number of other technical corrections.¹⁹

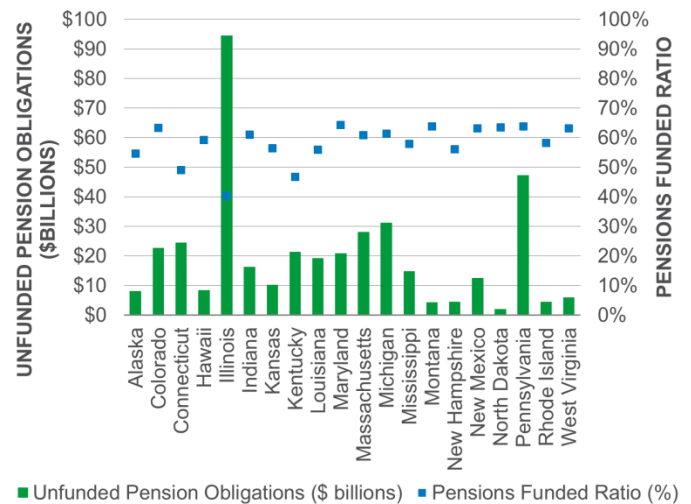
Most single employer corporate defined benefit plans are in substantially better condition, and thus, the act does not make any changes to funding rules for these plans. The average funded status of corporate defined benefit plans as of 2013 was 87.9% according to the Milliman Corporate Pension Funding Study.²⁰ Many corporate defined benefit plans are partially or fully frozen, meaning the sponsors are no longer accruing new liabilities. In addition, the PBGC's single-employer program's net financial position increased by approximately \$8 billion in fiscal year 2014, due, in part, to increases in premium and investment income, which decreased the program's deficit to roughly \$19.3 billion.²¹

Municipal Pension Challenges

Public state and local pension plans, which are not subject to ERISA or covered by the Multiemployer Pension Reform Act of 2014, are also facing serious funding challenges.

Government Accounting Standards Board (GASB) rules, issued in June 2012, standardize the calculation and disclosure of public pension liabilities.²² The rules, which were fully in effect as of June 2014, shed more light on the funding status of state and municipal pension plans by standardizing the assumptions used to determine a discount rate and requiring net pension liabilities to be reported on balance sheets. Unlike private multiemployer or single employer defined benefit plans, public plans have additional mechanisms, including the ability to raise taxes, to fund their plans. Further, since they are not subject to ERISA's anti-cutback rules, they generally have additional flexibility to modify benefits. However, in some states there are barriers to altering or reducing benefits, including state constitutional issues.²³

Figure 1: TOP 20 STATES' UNDERFUNDED PENSION OBLIGATIONS



Source: Pew Charitable Trusts, "Fiscal 50: State Trends and Analysis, Debt and Unfunded Retirement Costs," 10 November 2014. Available at <http://www.pewtrusts.org/en/multimedia/data-visualizations/2014/fiscal-50#ind4>.

Numerous public funds have been in the news over the past few years as many face significant funding shortfalls as illustrated in Figure 1. For example, the bankruptcy and benefit cuts to the public pension system by the City of Detroit, Michigan were widely publicized. In the case of Detroit, the City's two public plans were closed to new employees, existing employees and pensioners will receive a 4.5% cut in retirement benefits,²⁴ and cost-of-living-adjustments (COLAs) were eliminated.²⁵ This represented a compromise to reduce pension liabilities while preserving a large portion of benefits for plan participants. In a similar situation, the City of Stockton, California finalized its restructuring to exit bankruptcy in October 2014. However, unlike in Detroit, Stockton ultimately did not alter pension benefits for existing plan participants, which are administered by the state employee retirement system, California Public Employees Retirement System (CalPERS).²⁶

The City of Chicago, Illinois is also facing financial concerns related to the funded status of its public pension plans. In March 2014, Moody's downgraded Chicago's debt from A3 to Baa1, citing "massive and growing unfunded pension liabilities, which threaten the city's fiscal solvency absent major revenue and other budgetary adjustments" as the primary rationale for the downgrade.²⁷ When Moody's cut Chicago's rating to Baa1, the agency said that the city could be downgraded further if reforms are not implemented and the city fails to make required pension contributions.²⁸ In June 2014, Illinois governor, Pat Quinn, signed into law a bill intended to reform Chicago's municipal and laborer pension funds by increasing employee and employer contributions and reducing COLAs.²⁹ However, these reforms currently face a judicial challenge.³⁰

On a state level, Illinois lawmakers approved an overhaul of government worker pension systems in December 2013. The measure was promptly signed by Governor Quinn. This law would scale back and eliminate some COLA increases and would raise the retirement age for many state workers.³¹ In exchange, Illinois would guarantee making its full annual contributions to the state's five pension funds, which it has failed to do in the past, often by a significant amount. In November 2014, a state judge ruled the law unconstitutional on the grounds that pension benefits cannot be reduced under state law.³² The Illinois Supreme Court will hear the state's appeal in March 2015 and determine the future of the state's pension liability and financial welfare. Recognizing these liabilities, the state of Illinois has an A3 rating from Moody's – the lowest state credit rating in the country.³³

In 2011, Rhode Island passed legislation to restructure its state pension plan to improve the solvency of the plan. The changes would move most employees from a defined benefit plan to what is referred to as a "hybrid" plan that would include elements of both a defined benefit and a defined contribution plan. Specifically, the plan includes a reduced defined benefit plan and added individual retirement accounts for employees. Both employees and employers would be required to contribute to the individual retirement accounts.³⁴ Further, the legislation raised the retirement age for most state employees and reduced the amount and frequency of COLA adjustments.³⁵ The changes, which went into effect in 2012, have faced severe opposition including a coordinated lawsuit by unions, claiming that the new provisions violate employment contracts. Despite lengthy negotiations, including court-ordered mediation, state officials and union representations have been unable to reach a settlement. A jury trial to determine the future of the state's pension system is set for April 2015.³⁶

Implications for the Future

The Multiemployer Pension Reform Act of 2014 represents a major policy shift by permitting a reduction in benefits for retirees in an ERISA covered plan. As we explained in our April 2011 *ViewPoint* entitled "States Begin to Address Long-Term Pension Obligations in Era of Fiscal Austerity," many public plans have already implemented reforms, including reductions in benefits and changes in plan structures. Figure 2 provides an overview of the broad tools available to public plans.

Figure 2: TOOLS FOR MANAGING PENSION OBLIGATIONS

Addressing Assets	Addressing Liabilities
<ul style="list-style-type: none"> ▶ Increase Contributions by Employers ▶ Increase Contributions from Employees ▶ Increase Contributions by Raising Taxes and Fees ▶ Adjust Asset Allocation Strategies 	<ul style="list-style-type: none"> ▶ Limit, Reduce or Eliminate Automatic COLAs ▶ Raise the Retirement Age ▶ Means Testing for Benefits and/or Taxing Benefits ▶ Curtail "Spiking" near Retirement (i.e. lower eligible increases in salary in the years just prior to retirement) ▶ Disallow "Double-Dipping" (i.e. prevent an employee from retiring and collecting a pension from one job while collecting a salary for a new role in the same system)
Other <ul style="list-style-type: none"> ▶ Bond Issuance (i.e. issue pension obligation bonds to help fund retirement systems) ▶ Freeze Defined Benefit Plans and Move to Mandatory Defined Contribution Plans 	

Source: BlackRock *ViewPoint*, "States Begin to Address Long-Term Pension Obligations in Era of Fiscal Austerity," April 2011. Available at <https://www.blackrock.com/corporate/en-be/literature/whitepaper/address-long-term-pension-obligations-apr-2011.pdf>.

Some of the tools available to public plans (such as increased employee contributions) may currently be used by private plans. Future Federal legislative change may make other public plan tools, which are not currently viable for ERISA plans, available to all private pension plans. Although single employer defined benefit plans overall are financially stronger than multiemployer plans, the new legislation and other solutions used by public plans may offer a useful model for those single employer plans that are facing imminent distress or involuntary termination.

Moreover, as the state initiatives demonstrate, it is important that programs or legislation that seek to resolve funding shortfalls through benefit suspensions or reductions consider plan design changes for the future. Over the past few years there has been increasing interest in hybrid and other alternative plan designs for public sector, multiemployer and single employer pension plans. For example, under legislation introduced by Senator Hatch (Secure Annuities for Employee Retirement Act of 2013 or “SAFE Act”),³⁷ public employers could adopt a plan that would purchase annuity contracts for employees on an annual basis. The amount of the annuity would be based on what the employer could afford, and the plan could not be underfunded. Employees would receive a fully vested and portable benefit with an income stream in retirement. The Retirement Security Review Commission of the National Coordinating Committee for Multiemployer Plans also described alternative plan models in their “Solutions Not Bailouts” report, including a variable annuity benefit plan and a target benefit plan.³⁸ Under a variable annuity plan, a participant’s benefit would be the greater of a “floor” that is calculated using a conservative rate of return or actual investment performance. A participant’s risk would be mitigated through reduced volatility and purchase of annuities or asset immunization at retirement. Target benefit plans are hybrid plans that combine retirement income security and efficiency of a defined benefit plan with predictable employer costs. In a target benefit plan, investment and longevity risks are pooled. However, the plan retains the ability to adjust benefits

downward for participants, if the funding levels fall below certain thresholds. Retirement benefits would be paid as an annuity and not subject to cutbacks unless necessary to prevent imminent insolvency.³⁹ Another already frequently used hybrid-plan option is a cash balance plan, under which employers contribute a set share of each employee’s salary on an annual basis to an account that earns investment return. The benefit is expressed in terms of an account balance, but the investments are pooled and professionally managed. These or other alternative plan designs should be evaluated, as they may provide more sustainable models for a secure retirement.

Conclusion

The Multiemployer Pension Reform Act of 2014 marks a significant shift in approach to multiemployer plans and evidences broad employer, union, employee, and Federal government recognition that our retirement system needs fundamental change. In addition to helping salvage critical and declining multiemployer plans, the legislation may be a useful model and provide a catalyst to propel broader reform of the public and private pension system in the United States. Correspondingly, states’ experience and efforts may provide a fertile ground for additional tools that could be made available to distressed ERISA defined benefit plans in the future. These initiatives, coupled with enhancement to defined contribution plans, can be used to stimulate research, exploration, and implementation of more sustainable plan designs for the future.

Notes

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