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RESEARCH MEMO

GAO Releases Report on Multiemployer Pension Plans

The Government Accounting Office (GAO) recently released a report to the Committee on Education and the Workforce, House of Representatives – *PRIVATE PENSIONS: Timely Action Needed to Address Impending Multiemployer Plan Insolvencies.* We will take a look at some of the highlights of this Report. Notably, the pension reform proposal by the National Coordinating Committee on Multiemployer Plans (NCCMP) received considerable attention in the GAO report.

The GAO Report is available by "*clicking here*." The NCCMP proposal is available at *http://www.solutionsnotbailouts.com/* or by "*clicking here*." Both reports focus on multiemployer defined benefit plans.

Why GAO Did This Report

The Report noted that multiemployer defined benefit pension plans cover more than 10 million workers and retirees, and are insured by the PBGC. But, in recent years, as a result of investment market declines, employers withdrawing from plans, and demographic challenges, many multiemployer plans have had large funding shortfalls and face an uncertain future.

In order to better understand these challenges and the associated possibilities, the GAO examined: (1) actions that multiemployer plans in the weakest financial condition have taken to improve their funding levels; (2) the extent to which plans have relied on PBGC assistance since 2009, and the financial condition of PBGC's multiemployer plan insurance program and (3) options available to address PBGC's impending funding crisis and enhance the multiemployer insurance program's future financial stability.

What The GAO Recommends

The recommendation of the GAO was that Congress should consider comprehensive and balanced structural reforms to reinforce and stabilize the multiemployer system. The GAO noted the PBGC generally agreed with its findings and analysis.

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What the GAO Found

The Report found most severely distressed multiemployer plans have taken significant steps to address their funding problems and while most plans expected improved financial health, some did not.

According to the Report, the Pension Benefit Guaranty Corporation's (PBGC) financial assistance to multiemployer plans continues to increase, and plan insolvencies threaten PBGC's multiemployer insurance fund's ability to pay pension guarantees for retirees.

The GAO Report

The Report is structured as follows:

Background

I. Severely Underfunded Plans Have Cut Benefits to Current Employees and Increased Employer Contributions, but Financial Outlook for Some Plans Remains Bleak

II. PBGC Provides Financial Assistance to a Greater Number of Plans Each Year, Endangering the Multiemployer Program and Guaranteed Retiree Benefits

III. Key Options to Reduce Liabilities and Change Plan Designs Could Help Improve Financial Stability, but Pose Trade-offs

IV. Conclusions

V. Matters for Congressional Consideration

(Plus, Three Appendixes, Eight Tables and Thirteen Figures)

The Report stated that experts and stakeholders which the GAO interviewed cited <u>two key policy options</u> to avoid the insolvencies of severely underfunded plans and the PBGC multiemployer insurance fund. (see Figure 12 below).

Figure 12: Key Federal Policy Options and Possible Effects on Key Stakeholders

Steps to address impending insolvencies of severely underfunded plans	Employers	Active participants	Retirees	Federal government
Allow plans to reduce accrued benefits	May alleviate need for further contribution increases	Accrued benefits may be reduced May alleviate need for further reductions in accrual rate	Accrued benefits may be reduced	No direct effect[a]
Financial assistance	May alleviate need for further contribution increases; plan costs may rise if assistance is funded through an increase in premiums	May alleviate need for further reductions in accrual rate	Possibly offset significant reductions in accrued benefits	Costs of financing partitions or other financial assistance; costs would be reduced to the extent that the assistance is funded through an increase in premiums
Steps to help improve long-term financial stability				
Flexible benefit plan design	May stabilize the amount of employer contributions	May entail some marginal adjustments in benefit accruals	May entail some marginal adjustments in benefits for future retirees	No direct effect[a]
Changes to withdrawal liability policy	Impact varies for various changes suggested	Impact varies for various changes suggested	Impact varies for various changes suggested	No direct effect[a]
Promotion of mergers and alliances	Could lower costs and should help alleviate need for further contribution increases	May alleviate need for further reductions in accrual rate	No direct effect[a]	Cost of PBGC financial assistance may be partially offset by helping plans avoid insolvency

Reason groups/entities bear the majority of impact from that policy option

Source: GAO analysis of documentation and interviews with experts and stakeholders.

To address the impending insolvency crisis, the Report noted the experts proposed allowing severely troubled plans to reduce accrued benefits, including benefits of retirees, and providing PBGC with additional resources to prevent insolvencies that might otherwise threaten the fund. Longer term options would provide plans with flexibilities and resources to help attain financial stability in the future. These include encouraging the adoption of flexible benefit designs and reforming withdrawal liability policies.

The NCCMP's Reform Proposals

The GAO Report also highlighted the NCCMP's February 2013 report which offered a series of recommendations that address some of the proposals discussed in this section. The GAO Report said the three primary areas of action recommended by the NCCMP report can be summarized as follows:

1. Preservation: Proposals To Strengthen The Current System
2. Remediation: Measures To Assist Deeply Troubled Plans
3. Innovation: New Structures To Foster Innovative Plan Designs

In addition, the GAO noted, the NCCMP report at pages 21, 22 also includes a series of recommended technical refinements to the *Pension Protection Act (PP*A) that were beyond the scope of the GAO report but which can be accessed by "*clicking here.*" For example, the NCCMP report advocates that plans that reasonably expect to enter critical status in the next five plan years be permitted to enter critical status in the current plan year.

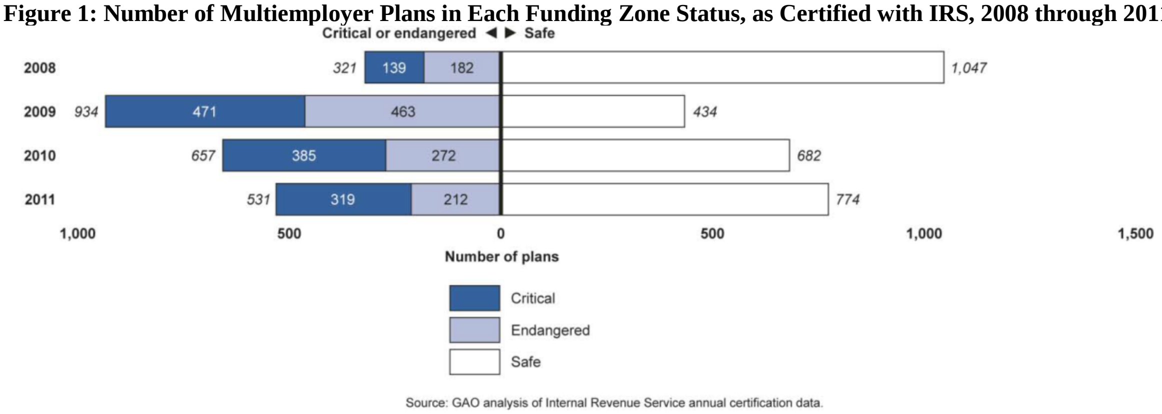
The GAO Report provided this overview of the NCCMP's work:

> NCCMP is an organization representing multiemployer plans and practitioners. In August 2011, NCCMP convened a commission to review and propose options for addressing challenges facing multiemployer plans. NCCMP's report "*Solutions not Bailouts: A Comprehensive Plan from Business and Labor to Safeguard Multiemployer Retirement Plan Security, Protect Taxpayers and Spur Economic Growth*" was released in February 2013. The commission members include representatives from plans, employers, and unions. Participating industries include construction, trucking, retail food, entertainment, machinists, mining, bakery and confectionary, and service.

The Funding Status Of Multiemployer Defined Benefit Plans

Overall, according to the GAO Report, since 2009 multiemployer plans have experienced improvements in funding status, but a sizeable portion of plans are still in critical or endangered status. According to plan-reported data - current through 2011 - from the IRS (see Figure 1 below), while the funding status of plans has not returned to 2008 levels, the percentage of plans in critical status declined from 34% in 2009 to 24% in 2011. Similarly, the percentage of plans in endangered status also declined, and to a greater extent, from 34% in 2009 to 16% in 2011. However, the GAO Report observed that based on the 2011 data from the IRS, despite these improvements, 40% of plans still have not emerged from critical or endangered status.

Figure 1: Number of Multiemployer Plans in Each Funding Zone Status, as Certified with IRS, 2008 through 2011



Note: The total number of plans filing a zone-status certification declined from 2008 to 2011. According to IRS, the decline may be attributable to plan mergers or terminations and plans' failure to file a certification.

The GAO Report added that the large majority of the most severely underfunded multiemployer plans - those in critical status - have, according to a 2011 survey, both increased required employer contributions and reduced participant benefits in an effort to improve plans' financial positions. Plan officials explained that these changes have had or are expected to have a range of effects, and in some cases may severely affect employers and participants. While most critical status plans expect to recover from their current funding difficulties, about 25% do not and instead seek to delay eventual insolvency[1].

The Effect of Funding Problems on the PBGC

As a result of these funding problems, the PBGC's financial assistance to multiemployer plans has increased significantly in recent years, and projected plan insolvencies may exhaust PBGC's multiemployer insurance fund. In fact, PBGC expects that, under current law, based on plans currently booked as liabilities (current and future probable plan insolvencies), the multiemployer insurance program is likely to become insolvent within the next 10 to 15 years, although the exact timing is uncertain and depends on key factors, such as investment returns and the timing of individual plan insolvencies.

Additionally, PBGC estimates that if the projected insolvencies of either of two large multiemployer plans were to occur, the insurance fund would be completely exhausted within 2 to 3 years. While retirees of insolvent plans generally receive reduced monthly pension payments under the PBGC pension guarantee, this amount would be further reduced to an extremely small fraction of what PBGC guarantees, or nothing, if the multiemployer insurance fund were to be exhausted.

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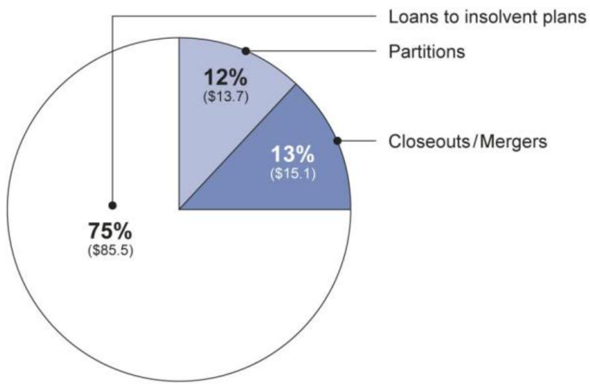
[1] Critical status (red zone) plans that have taken "all reasonable measures" yet are still headed to insolvency are referred to by some as "*black zone*" plans, a term coined by UAS actuary Paul Bullock. Somewhat like "black holes" in outer space suck in matter and allow no light to escape, such "black zone" plans suck in contributions but do not allow plans to escape from critical status.

Endangered plans are often referred to as "yellow zone" plans and plans that are neither endangered or critical are referred to as "green zone" plans.

GAO Report Figure 8 illustrates the PBGC's assistance to multiemployer plans:

Figure 8: PBGC's Financial Assistance to Multiemployer Plans, by Type and Amount, Fiscal Year 2011 (dollars in millions)



Source: GAO analysis of PBGC data.

Proposal To Reduce Accrued Benefits For Critical Status Plans

In light of the challenges facing plans in critical status, the NCCMP and other industry experts have offered proposals to allow such plans to reduce accrued benefits as an option to avoid insolvency.

Table 6: Key Features of Proposals to Allow Severely Underfunded Plans to Reduce Accrued Benefits

	NCCMP Commission proposals	Plan representatives and industry experts proposals
Eligibility criteria	• Actuarial determination would be needed to show that benefit reductions avert plan insolvency.	• Plans should demonstrate the financial necessity of benefit reductions, e.g., certification that plan is headed for insolvency or a cash flow test.
Nature and extent of reductions	• Accrued benefits may be reduced at most to 110% of the PBGC guarantee.	• Reductions in accrued benefits should be limited to a level tied to the PBGC guarantee (suggested level varied from 100% to 125% of the PBGC guarantee).
Implementation	• Benefit reductions would be determined by plan trustees in concert with the collective bargaining process. • Any future benefit increases would be accompanied by a comparable restoration of accrued benefits that were reduced.	• Plan trustees are best placed to decide how benefit cuts should be implemented. • Protections for vulnerable populations should be considered (e.g., oldest or disabled participants, those with lower benefits).
Oversight	• PBGC could review proposed cuts to ensure established criteria are met (e.g., benefit reductions are equitably distributed and protections are in place for most vulnerable populations).	• PBGC, Labor, or IRS could perform oversight.

Options to Address Challenges Associated with Withdrawal Liability

The GAO Report also discussed changes to plan design and other options that could address the challenges of withdrawal liability and improve long-term financial stability of multiemployer plans. These options are highlighted in Table 7 below.

Table 7: Options to Address Challenges Associated with Withdrawal Liability

Option	Benefits	Tradeoffs / Limits on Effectiveness
Increase assets recovered by plan		
Improve status of plan in bankruptcy proceedings	Plan would be better positioned to collect a higher share of the liabilities owed by the bankrupt employer	Amount of withdrawal liability collected may still be far short of total unfunded liabilities
Eliminate 20-year cap on withdrawal liability payments	Plan may be able to collect a greater share of liabilities owed by a withdrawing employer	• Unclear how many employers would be able to continue making payments beyond 20 years • Increased amount of withdrawal liability a plan can collect may also deter employers from joining the plan
Reduce deterrent effect on contributing employers		
Exclude increased contributions required by funding improvement or rehabilitation plans from withdrawal liability calculations	Plan may improve its funded status by eliminating a disincentive for employers to increase contributions	Plan sacrifices the amount of withdrawal liability it can collect
Clarify that withdrawal liability will not be assessed to employers that voluntarily remain in the plans	• Mitigate impact of potential withdrawal liability on employer's credit rating and ability to obtain loans • Encourage employers to remain in the plan	Because this is a clarification of current law, no tradeoffs were identified
Design and manage plan to minimize or eliminate withdrawal liability	Without withdrawal liability, a plan will be better able to attract new employers and expand its contribution base	• Plan may need to lower benefit accrual rate and/or increase contributions to ensure plan is adequately funded, such as with a flexible benefit design (see next section) • Does not address legacy costs so this strategy may only help plans prospectively
Protect newly joining employers by placing them in a separate "pool" in which they only accrue liability prospectively, and do not assume liabilities of existing employers; employers from the "old" pool may move to the new pool if they pay withdrawal liability	• Permissible under current law • Tool for plan to encourage new employers to join the plan and healthy employers to continue to participate • Withdrawal liability payments to move to the new pool increases plan assets	• Some employers may not be able to afford paying withdrawal liability to move to the new pool • Employers in the new pool could still be faced with unfunded liabilities from the old pool

Proposals for Flexible Defined Benefit Plan Design

According to the GAO Report, numerous plan representatives, experts, and the NCCMP recommend the adoption of a more flexible DB model to avoid a repetition of the current challenges facing multiemployer plans. While the specific plan design can vary, in general, this model allows trustees to adjust benefits based on key factors - such as the plan's funded status, investment returns, or plan demographics - to keep the plan well-funded. Importantly, it reduces the risk that contributing employers would face contribution increases if the plan experiences poor investment returns or other adverse events. Investment risk is thus primarily shared by participants and the plan is designed to avoid incurring any withdrawal liability. Overall, the trustees of the plan would have greater flexibility than under a traditional DB plan to adjust benefits to keep the plan well-funded. See Table 8 for a comparison of two possible alternative flexible DB plan designs. In addition, the GAO Report noted the NCCMP proposal would also give more flexibility for traditional DB plans by allowing these plans to adjust the normal retirement age to harmonize with Social Security's normal retirement age.

Table 8: Options for a Flexible DB Plan to Address Risks Facing Multiemployer Plans

Flexible DB option	Key features
Cheiron Variable DB model	• Benefit at retirement is the greater of the: 1) floor defined benefit (e.g., career average pay formula based on an assumed rate of return of 5%) or 2) variable benefit accrued when investment returns exceed floor rate (e.g., greater than 5%) • Returns in excess of a cap (e.g., 10%) are used to establish a contingency reserve to mitigate effect of market downturns on the plan's funded status • Plan uses a relatively conservative investment strategy in line with floor rate of return • At retirement, the greater of the two benefits for a participant is converted into an annuity, which is purchased from a private insurer or managed by the plan using a conservative investment strategy • Contingency reserve fund and conservative investment strategy designed to minimize risk of withdrawal liability
NCCMP Target Benefit model	• Contributions are designed to attain a certain benefit level based on various assumptions, including investment rate of return • More conservative funding standards than current system • In the event of a funding shortfall, certain past and future benefits earned under the new model can be adjusted • No withdrawal liability • No PBGC coverage

Source: GAO analysis based on interviews with industry experts and documentation from Cheiron and NCCMP.

NCCMP's proposal highlights support for the Target Benefit model, as well as the Cheiron model, but does not endorse any specific model as exclusive.

Concluding Remarks

Despite unfavorable economic conditions, most multiemployer plans are currently in adequate financial condition and may remain so for many years. However, a number of plans, including some very large plans, are facing very severe financial difficulties. Many of these plans reported that no realistic combination of contribution increases or allowable benefit reductions - options available under current law to address their financial condition - will enable them to emerge from critical status. As a result, without Congressional action, the plans face the likelihood of eventual insolvency.

While the multiemployer system was designed to limit PBGC's exposure by having employers serve as principal guarantors, PBGC remains the guarantor of last resort. However, given their current financial challenges, neither the troubled multiemployer plans nor PBGC currently have the flexibility or financial resources to fully mitigate the effects of anticipated insolvencies. Should a critical mass of plan insolvencies drain the PBGC multiemployer insurance fund, PBGC will not be able to pay either current or future retirees more than a very small fraction of the benefit they were promised. Consequently, a substantial, and in some cases catastrophic, loss of income in old age looms as a real possibility for the hundreds of thousands of workers and retirees depending on these plans.

The GAO Report urges Congressional action to avoid this scenario. Some suggestions for action include, as a last resort to avert insolvency, legislation permitting plans (subject to certain limitations, protections, and oversight) to reduce accrued benefits of both working participants and retirees. In addition, some suggested that Congress could give PBGC the authority and resources to assist the most severely underfunded plans.

The GAO Report concludes that the scope and severity of the challenges outlined suggest that a broad, comprehensive response is needed and Congress faces difficult choices in responding to these challenges. However, unless timely action is taken to provide additional tools for the multiemployer plan trustees to stabilize the financial conditions of their plans, more costly and intrusive measures may later be necessary. Without a comprehensive approach, efforts to improve the long-term financial condition of the multiemployer system may not be effective.

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