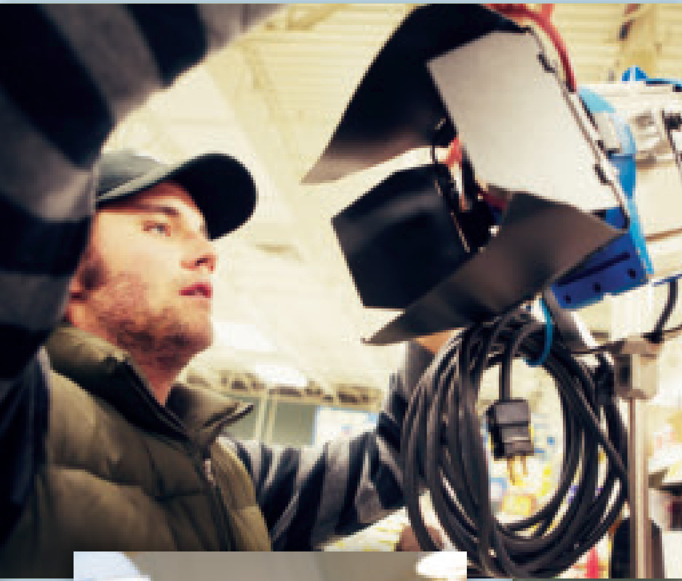
Multiemployer Pension Plans: Main Street's Invisible Victims of the Great Recession of 2008



The Results of the NCCMP 2009 Survey of the Funded Status of Multiemployer Defined Benefit Plans

www.nccmp.org

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Introduction

Multiemployer defined benefit pension plans have provided retirement income security to tens of millions of retired American workers for more than 60 years. A product of the collective bargaining process, they provide a model through which small employers, especially those in industries characterized by mobile workforces, can provide reliable benefits on a scale comparable with much larger firms. They do so by taking advantage of economies of scale and centralized administration. With 10.4 million participants, they provide pension coverage to nearly one in every four Americans who participate in the nation's private defined benefit system[1].

Multiemployer plans traditionally have been conservatively managed and well funded. In fact, in the 35-year history of the Pension Benefit Guaranty Corporation's (PBGC) multiemployer guaranty fund, only 57 funds covering 122,000 participants have received any financial assistance from the agency. That assistance has totaled just $418 million dollars[2], all of which has been funded by premiums paid by the funds on behalf of each covered participant. Until 2002, the multiemployer guaranty fund was in a surplus position, falling into a deficit in 2003, following the abrupt investment market declines from 2000 to 2002. In the most recent data reported by PBGC, assets of the multiemployer guaranty fund totaled approximately $1.5 billion, while liabilities totaled $2.3 billion.[3]

Prior to 2000, most multiemployer plans were overfunded, although the peculiarities of the tax code prevented them from being reported as such, as discussed below. As a result, these plans were forced, as a practical matter, to increase benefits in order to protect the current deductibility of contractually required contributions made by contributing employers. Despite suffering losses between 15% and 25% when the "tech bubble" burst in the early part of this decade, the resilience of these funds and the commitment of plan sponsors to their success was evidenced by the fact that over 75% of all multiemployer defined benefit plans were once again more than 80% funded as recently as 2007. Nevertheless, the investment losses suffered in the 2008 global financial collapse now threaten the financial viability of a small, but significant minority of these plans, as they have threatened portions of virtually all aspects of our nation's financial infrastructure. Coming in the first year of the new, more aggressive funding requirements under the Pension Protection Act of 2006 (PPA), the recent losses have pushed compliance with those rules out of reach for many plans unless they impose crippling additional contribution increases, deep benefit cuts, or both.

In response to the financial crisis, in the spring of 2009 the National Coordinating Committee for Multiemployer Plans (NCCMP) initiated the most detailed and comprehensive survey of these plans ever conducted, with a total of 392 plans (out of a universe of approximately 1,500 total plans) providing responses. The survey covered areas such as the assets, liabilities, participants, investments, and contributions to these plans both before and after the 2008 market crash. The purpose of this survey was to assess the impact of the market contraction and gather information that would be helpful to members of the multiemployer community, lawmakers, federal regulators, and the public as a whole in better understanding these plans and the events which led to their current condition.

While the facts and circumstances of particular plans will differ, the conclusions of this analysis clearly demonstrate the challenges currently facing the multiemployer plan community are the direct result of the worldwide financial crisis.

Background on Multiemployer Funding

Statutory and Regulatory Environment

Multiemployer plans have had separate and distinct statutory and regulatory structures dating back to the 1940s, with the passage of the Labor Management Relations Act of 1947 (more commonly referred to as the Taft-Hartley Act). Among its sweeping labor law provisions, that law prohibited employer contributions directly to unions or union funds (as had become the practice). Instead it requires that any contributions to support employee benefits must be made to a trust established and maintained for the "sole and exclusive benefit" of the participants, rather than furthering the interests of either labor or management. Furthermore, while the misnomer "union funds" is still often incorrectly applied, the Act requires equal representation by employers and labor in the joint management of these collectively bargained employee benefit plans – a model and a requirement that continues today.

The differences between single-employer and multiemployer plans and the obligations of the plan trustees were further codified with the passage of two laws in the 1970s and 80s. The first, the Employee Retirement Income Security Act of 1974 (ERISA), expanded on the common law fiduciary responsibilities of plan trustees, introduced the concept of non-forfeitable (vested) benefits and required the pre-funding of benefits. The second was the Multiemployer Pension Plan Amendments Act of 1980 (MPPAA), which created the multiemployer guaranty fund of the Pension Benefit Guaranty Corporation[4] and introduced the concept of "withdrawal liability" that requires sponsoring employers who depart from plans to pay an exit fee related to their proportionate share of any unfunded vested benefit obligations. These assessments were deemed necessary to prevent such obligations from being unfairly shifted either to the

remaining employers or to the taxpayers; thereby providing a double competitive advantage to the departing employers: first, by no longer having any obligation to make contributions to the plan; and second, by shifting liabilities for service earned with the departing employers to those who remain. Although both laws were the subject of legal challenges, they and the multitude of ensuing regulations have been subsequently enforced by numerous court decisions.

This structure, and the notion of shared responsibility behind it, has proven to be an effective means of delivering quality pension and health care benefits to workers. All such benefits are funded by contributions that are required to be made to independent trust funds pursuant to collective bargaining (or other written) agreements between more than one employer and at least one union. Pension benefit levels have traditionally been modest. At the initiation of ERISA's pre-funding requirements, employer contributions were the only source of revenue for payment of benefits, the costs of administration and for the accumulation of assets to pre-fund benefits owed to future retirees as they become due. Over time, however, the monies set aside for such future benefits grew substantially, and the investment earnings on those funds provided an additional source of revenue. These earnings became an increasingly important source of income to the funds, quickly equaling and then surpassing contribution income as the primary source of income. Today, most mature funds derive as much as 70% or 80% of their income from their investments.

These pools of worker capital have a history of conservative, professional management. Most boards of trustees utilize professional investment managers to manage their portfolios as permitted under the law, and retain outside investment consulting firms to help select and monitor the performance of the managers. Furthermore, consistent with guidance received from the Department of Labor, they have diversified asset allocations, almost universally adopting a "modern portfolio theory" approach to investing; again with a generally conservative inclination that held closely to the more traditional asset classes of fixed income, domestic equities and real estate. This approach, coupled with the generally favorable economic conditions during the 1980s and 1990s, proved particularly successful in helping to fully fund the plans' obligations. Unfortunately, rather than providing a comfortable cushion against adverse markets, conflicting tax policies helped set the stage for the consequences these plans must face following the two consecutive market contractions they have experienced since 2000. Specifically, two converging developments combined to contribute to this phenomenon: the increasing leveraging of plans; and the tax code limitations on the accumulation of reserves through contributions to plans that were "fully funded". However, in order to understand why these concepts are more problematic for multiemployer plans than for single-employer plans, it is first necessary to compare the differences in their funding patterns.

Comparison of Multiemployer and Single-Employer Funding

While it may seem natural to compare the funding levels of single employer and multiemployer plans, the mechanisms for funding these two types of plans are fundamentally different, making these comparisons inappropriate. To understand these differences, it is useful to look at both the patterns of employer contributions and the issues that arise with each type of plan following periods of strong market returns, and periods of poor market returns.

Contributions and the Influence of Investment Returns

In a typical single-employer plan, contributions are determined by the firm's management, in consultation with the plan actuary, with the company making sufficient contributions by the end of each year to meet the plan's minimum funding requirement. This model has historically been followed by larger single-employer plans, even when the covered employees are represented by a union. Typically, the amount of contributions is not specified in the plan or any related documents; but if there is collective bargaining the obligation to provide a defined benefit plan (and perhaps periodic benefit increases) is codified in the bargaining agreement. As discussed below, this approach resulted in many corporations making no contributions for many years during the 1980's and 1990's when the investment returns were exceptionally strong.

In the multiemployer model, however, contribution rates are negotiated in the collective bargaining process, usually for terms of three to five years. Typically contributions are made to the plan based on a unit of work (usually hours worked, but daily, weekly or monthly contributions or a percentage of compensation are not uncommon in certain industries). These contributions are remitted regularly, usually monthly, to the trust fund. If the contributions are not made, they are vigorously pursued through legal collection efforts that will also usually include recovery of interest and liquidated damages on the unpaid amounts. Funds also typically employ audit programs to provide both a real verification of contribution amounts that are due, and to provide a "sentinel" effect to encourage employers to make their contributions when they become due.

An alternative to directly negotiating contribution rates may also be used, in which the parties bargain the cost of the wage "package" which includes wages and all fringe benefits, with the union (usually in consultation with the fund trustees and their own membership), making an independent allocation of portions of the package across wages and all fringe benefits to ensure they are adequately funded. The primary difference is that contribution rates negotiated for multiemployer plans are not affected by investment returns because the employer has no discretion over the amounts contributed. The main point, however, is that there is a regular flow of contractually obligated employer contribution income to multiemployer plans regardless of the funded position of the plan.

Plan Funding in Strong Markets

Historically, during periods of strong market performance, it has been common for single-employer pension plans to be fully funded, or even over-funded. As discussed below under 'The Current Challenge', the overfunding of a pension plan can cause the contributions to the plan to be non-deductible to the contributing employer. However, because a single-employer sponsor has direct control over the amount of contributions, when strong returns create overfunding, the sponsor can respond to the deductibility issue by suspending contributions to the plan. During periods of sustained strong investment returns, it is not unusual for single-employer plan sponsors to not contribute to the plans for many years.

The assets of single-employer plans were historically viewed as corporate assets and until the plan asset reversion rules were strengthened in the late 1980s, actually made companies with over-funded pension plans the target of corporate "raiders". Nevertheless, investment gains are still viewed that way and in bull markets, usually accumulate to offset any future contribution requirements. Unlike multiemployer plans, post-retirement benefit increases are virtually non-existent for most corporations.

Multiemployer plans have historically taken a much different view of investment gains. First, the legal prohibition against asset reversions from Taft-Hartley plans makes it abundantly clear they belong to the participants. Additionally, because of the joint management of these plans and for the contribution deductibility issues described below, it is common for plan trustees to allocate a portion of such gains to increase accruals for active employees and to post-retirement benefit improvements, especially when plan assets approached or exceeded the full funding limit.

For these reasons, when the financial markets produced sustained strong returns, it was common for single-employer plans to remain overfunded for many years, however, the regular contribution nature of multiemployer plan funding made overfunding (above 100%) problematic due to the maximum deductible contribution rules. As a result, single-employer plans were able to use favorable investment experience to build up a buffer against future adverse experience, while multiemployer plans were simply not in a position to use the investment gains in this way.

Poor Market Returns and Plan Stability

Since the passage of ERISA, pension funding law has recognized the fact that multiemployer plans are funded pursuant to multi-year bargaining agreements which are somewhat inflexible in terms of their ability to respond to rapidly changing conditions. Predictability of contribution rates is a cornerstone to multi-year agreements. This characteristic has injected a greater level of stability in funding by virtue of the parties' tendency to err on the side of conservatism in terms of their contribution rates. This stability is reinforced by the shared funding responsibility of contributing employers, making multiemployer plans inherently less dependent on the fortunes of any single contributing employer. While these stabilizing features protect the plan from excessive volatility, it is important to understand that they also dampen the plan's ability to rapidly rebound after a period of adverse investment markets dramatically reduces the plan's investments, because any needed contribution increases must come about through the bargaining process.

When a sponsor of a single-employer plan becomes insolvent and its pension plan terminates, any unfunded pension liabilities transfer immediately to the PBGC, up to the single-employer guarantee limits. When an employer contributing to a multiemployer plan becomes insolvent, its share of the unfunded liabilities in the plan, after payment of withdrawal liability, transfers to the remaining employers. Multiemployer plan liabilities only transfer to the PBGC when an entire industry is distressed, rather than an individual employer.

The Current Challenge

As noted above, to understand how, despite the relative stability of the multiemployer system, pension plans came to be in distress, it is necessary to first understand two concepts:

a) The increased leveraging of plans; and

b) The tax code limitations on the accumulation of reserves through contributions to fully funded plans that prevailed until the passage of the Pension Protection Act of 2006[5].

Leveraging

Unlike other economic references in which leveraging relates to the practice of using assets as collateral, the term "leveraging" in this context applies to the growing reliance on achieving regular investment returns rather than contributions to fund future benefits. Based on historical rates of return when the pre-funding rules of ERISA were enacted in 1974, most actuaries then set assumed rates of return on such investments between 4.5% and 5.0%. Converting from a "pay-as-you-go" to the new pre-funding system necessitated that benefit payments remain relatively modest and investment policies be conservative, since benefit payments, the costs of administration and the new pre-funding obligations all had to be met from employer contributions alone.

As time progressed, the pool of monies set aside for pre-funding benefits provided an additional and increasingly important portion of the funds' total income. Actual returns on these investments consistently exceeded assumed rates during most of the 1980s and 1990s, and a strong economy produced higher than expected hours of contributions. The combination of these two factors built larger and larger fund balances and eliminated the threat of unfunded vested benefits (and the corresponding withdrawal liability) for all but a few plans. As a result, multiemployer plan actuaries gradually increased their assumed rates of return to their present levels that range between 7.0% and 8.0%.[6] These rates were quite conservative when compared to their single-employer defined benefit counterparts, whose rates often exceeded 10%. By the end of the 20th century, most mature plans, many of which were created in the 1940's and 50's, looked to investment income as the primary source of funding for the plan.

Consistent with the plan fiduciaries' "sole and exclusive" statutory obligation to manage multiemployer funds for the benefit of plan participants, each time the rates of return were increased, plan trustees were advised that it would be prudent to increase benefits. Therefore, based on the advice of the funds' professional advisors, trustees gradually did so[7].

Tax Code Limitations

Theoretically, taking a long-term view of pension funding, this approach was reasonable. However, inherent in this approach is the understanding that during the years in which the actual rate of return exceeds the assumed rate, these gains must be "banked" to offset years in which actual investment performance lags the assumption. In practice, however, this theoretical model was constrained by a competing federal tax policy that had been intended to prevent certain employers (typically small professional corporations) from sheltering income in retirement plans by applying sanctions to plan sponsors that make contributions to strongly funded plans.

Employers who made contributions above the "maximum deductible" limit, even those who were legally required to do so by the terms of their collective bargaining agreements, ran the risk of losing their current tax deduction for those contributions and of being assessed an excise tax on top of such contributions. When plan contributions approached that limit, trustees were advised that to avoid having these penalties apply to contributing employers, they had two choices:

stop contributions (which in most cases was outside their authority[8]); or increase the plan costs by making additional benefit improvements that would increase the cost of the plan sufficiently to protect the deductibility of their legally required contributions[9]. Since the employers were legally bound by their collective bargaining agreements to make the required contributions, as a practical matter the trustees of these plans had no choice other than to increase costs by improving benefits to a level that would immediately eliminate the overfunding. By contrast, sponsors of single-employer plans could respond to overfunding by simply suspending their contributions to the plans until they were again tax deductible.

Had lawmakers and regulators objectively evaluated the logic of applying this standard to collectively bargained plans, it would have become abundantly clear that the last thing on the minds of the bargaining parties representing the average worker was to shelter income that would otherwise be paid in wages. The multiemployer community argued repeatedly that applying the "maximum deductible limits" to multiemployer plans made no sense and pointed out that the tax code has a special rule that protects the employers' tax deductions if the contribution rates were expected to be within the limits when they were negotiated.[10] Nevertheless, until 2003 the IRS insisted on a rigid interpretation that threatened to deny employers' tax deductions unless the plans spent what IRS actuaries viewed as the "excess" on benefit increases.[11] As a result, plans that complied with the rules by increasing benefits only compounded their future funding problem, making plans increasingly dependent on realizing the higher rates of return.

For those closest to the plans, questions of the sustainability of these benefit improvements were raised by some boards of trustees and plan professionals even before plans began to feel the first stock market declines early this decade. Although some modest relief was granted in EGTRRA, when the tech bubble burst and the markets suffered a crisis of confidence fueled by the collapse of companies like ENRON and WorldCom from late 2000 through 2002, the day of reckoning arrived and, without the "rainy day" reserves, plans were unable to absorb market losses that averaged 15% to 25%.

Instead of being concerned with the maximum deductible limits, for the first time since the

days immediately following the passage of ERISA and MPPAA plans faced the likelihood of failing to meet their minimum funding requirements as plan trustees were told of projections of near term funding deficiencies. Under ERISA's funding rules, the consequences of such failures included a requirement for employers to pay their proportionate share of the shortfall (deficiency) and pay an excise tax on top of those additional contributions.

The Response From the Multiemployer Community

The reliance on investment income by mature, highly leveraged, plans meant that in order to meet their minimum funding requirements the required additional employer contributions could total several times their annual contributions under their bargained rates. In industries such as construction, trucking and retail food, which typically have razor thin profit margins, significant numbers of contributing employers faced the very real possibility of bankruptcy were these additional contributions and excise taxes to be assessed. If that had happened the remaining employers would then be required to fund the increasing shortfall amounts that were not paid by the bankrupt companies, causing additional bankruptcies and in some circumstances, eventual plan failure.

For unions and participants, the prospect of plan failure would mean that future generations would have no reliable source of retirement income. Even more troublesome was the prospect of the significant loss of benefits for current pensioners and beneficiaries, many of whose ben-

efits would be reduced to the amounts guaranteed by the PBGC[12]. The convergence of interests by all of the stakeholders resulted in a coordinated effort by labor and management through a broad-based coalition (the Multiemployer Pension Plans Coalition, or "Coalition") of more than 50 international unions, employer associations, large employers, plans, and trade and advocacy groups who jointly devised a proposal for multiemployer funding reform that would prevent the destruction of the plans. Patterned after the collective bargaining process from which multiemployer plans were created, the group negotiated for months, across industry after industry, to develop a plan to address the plans' collective ***needs*** rather than the respective parties' ***desires***. Underlying these negotiations was an unanimous consensus that for any specific fund only the bargaining parties themselves and not a distant government agency could best determine what solution was both affordable to the industry and acceptable to plan participants. Ultimately, the Coalition produced a set of proposals, many of which were ultimately incorporated into the multiemployer provisions of the PPA[13].

This Coalition's proposals contained tough medicine for all of the stakeholders. Once again, recognizing the problem was one in which all stakeholders were affected, the parties agreed to a package that included a notion of "shared pain" rather than having either group shoulder the full costs. For plans that are beginning to face funding difficulties (referred to as "Endangered status" or so-called "yellow zone" plans), the law requires the trustees to come up with a "Funding Improvement Plan" to reverse eroding funding levels, which may typically include a mix of benefit reductions and, if needed, contribution increases to be presented to the bargaining parties for negotiation. For plans with more serious funding problems ("Critical status" or so-called "red zone" plans), a "Rehabilitation Plan" is required to reverse the declining funding trend[14].

Recognizing that some industries and plans are so severely challenged that simply requiring additional contributions would be counterproductive, by forcing employers out of business and thereby out of the contribution pool, for the first time since the early 1980s, the PPA provides that critical status plans can reduce certain classes of "adjustable benefits" (including subsidized early retirement or subsidized survivors' benefits) in addition to reducing future accruals. It also imposes employer surcharges and, in limited circumstances, requires contribution increases if, after the application of all possible benefit adjustments, such increases are required to meet the plans' statutory funding targets. Furthermore, the PPA raised the maximum deductible limit for multiemployer plans to 140% of the previous limits. If the plans had had sufficient time after enactment with "normal" market performance, even a market contraction of the magnitude experienced from 2000 to 2002 could have been absorbed.

Following the enactment of the PPA, but before it became effective in 2008 plan fiduciaries began to take corrective action by increasing contributions and adjusting benefits to avoid falling into one of the "zones". Once the Act became effective in January of 2008, plans began to adopt funding improvement and rehabilitation plans based on recent experience and reasonably anticipated rates of return. The parties frequently adopted highly aggressive additional contribution rates that strained the wage package and the contributing employers' ability to compete. They were willing to do so because they now knew the rules going forward, and wanted to head off any potential funding difficulty as early as possible so that they would not have to cut back on promised benefits.

However, as 2008 progressed, the sudden and precipitous drop in investment markets that decimated financial institutions of all types around the world also wreaked havoc on multiemployer plans. Plans that had formulated their Funding Improvement or Rehabilitation Plans faced even deeper reductions in accumulated assets than had been experienced from 2000 to 2002. Unfortunately, some of the groups that had taken the most aggressive preventive measures now faced filling an even deeper hole to meet their PPA funding targets. Having previously exhausted their ability to increase contributions and remain competitive, plan trustees and the bargaining parties found themselves facing even more difficult choices. Above all, the magnitude of the recent losses demonstrated some of the shortcomings of the PPA to respond to such drastic market fluctuations.

The Magnitude of the Problem

In order to determine the extent of the losses and the effects of the market contraction on the funded position of multiemployer plans, and to assess the relative effectiveness of possible recommended corrective measures, the NCCMP conducted a detailed survey of the funded position of multiemployer plans over the period from 2007 through May 31, 2009. With input from Committee staff in both the Senate and the House in formulating the questionnaire, the NCCMP sought to determine the funded position of plans prior to the PPA's effective date; the number of covered participants; assets and liabilities (both on a market value and actuarial basis); changes in funding levels subsequent to the market contraction; contribution rates per hour and as a percentage of compensation; asset allocation to determine the level of risk inherent in the composition of the plans' investment portfolios and actions taken to address funding difficulties.

The following sections present summary findings from that study.

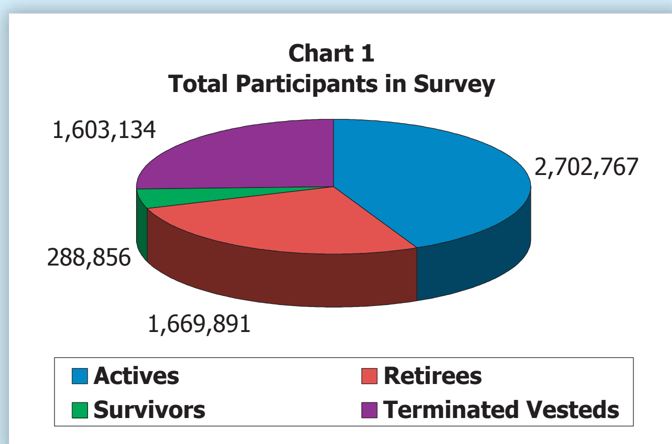
Scope of Multiemployer Plans

According to the latest PBGC data, there are currently approximately 1,500 multiemployer defined benefit plans covering 10.4 million participants. This represents approximately 25% of all participants in defined benefit plans. Multiemployer plans are prevalent in virtually every area of the economy where employment patterns require mobility within an industry, including the airline maintenance; automobile sales, parts and service; building services; clothing manufacturing, retail and wholesale; communications; construction; department store; entertainment; food production and sales; health care; hotel and hospitality; longshore & maritime; manufacturing; mining; newspaper; office and professional; printing; retail food; shipping; and transportation industries.

Scope of Survey Respondents:

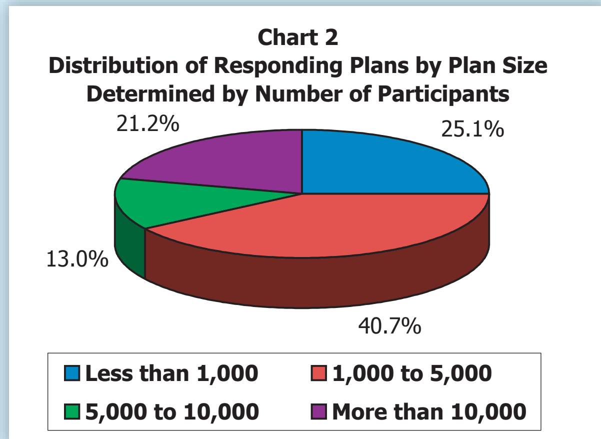
By Employment Status

Chart 1 *indicates that plans responding to the NCCMP survey cover 6.3 million participants, which represents approximately 60% of all participants in multiemployer pension plans.*



By Plan Size

***Chart 2** shows that the plans that participated in the survey represent a wide range of plan sizes, with neither large nor small plans dominating the results.*



Number of Responding Plans by Industry

The latest PBGC *Data Book* shows that construction industry plans represent slightly more than 50% of all multiemployer pension plans. Plans which responded to the survey represent an over-sampling of construction industry plans as shown in Chart 3, which is consistent with NCCMP membership statistics.

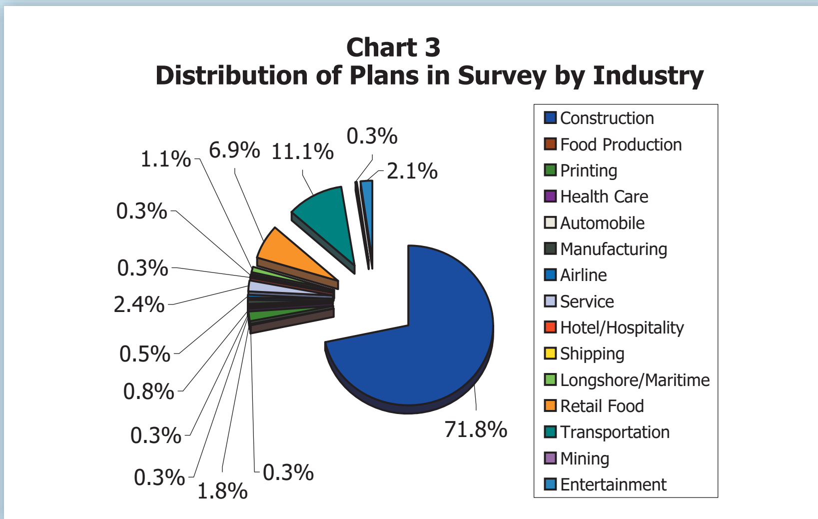
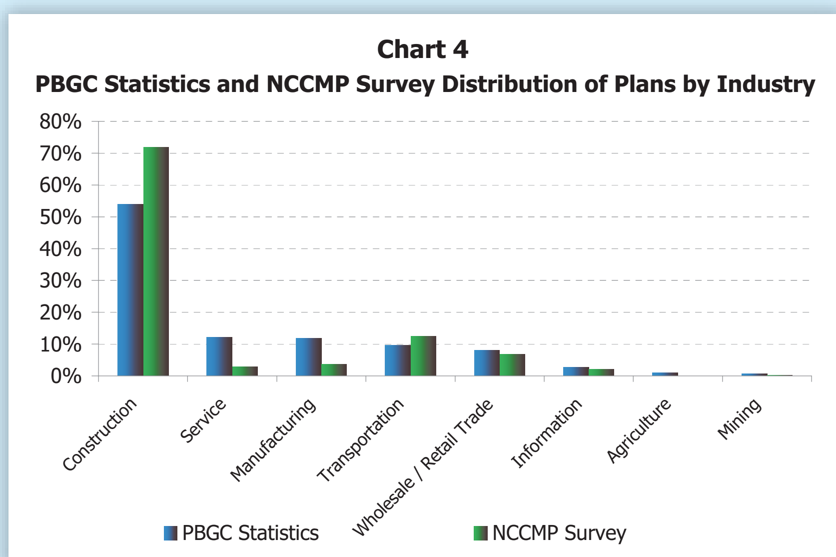


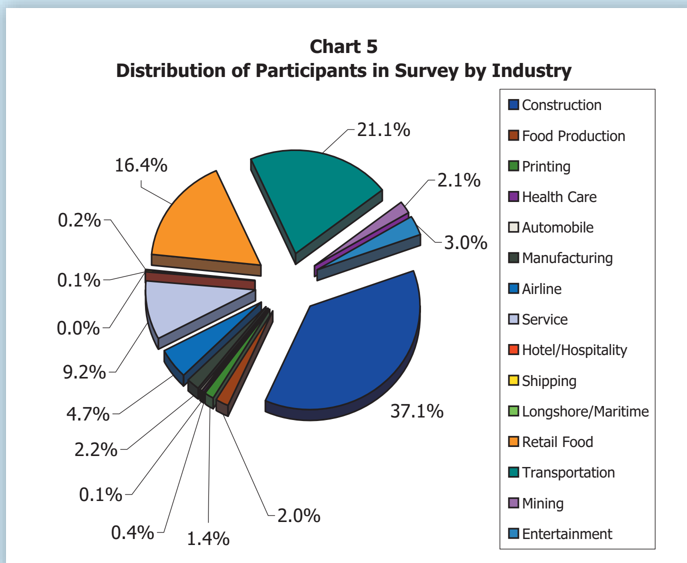
***Chart 4** compares the number of plans broken down by industry between the PBGC statistics and the NCCMP survey.*

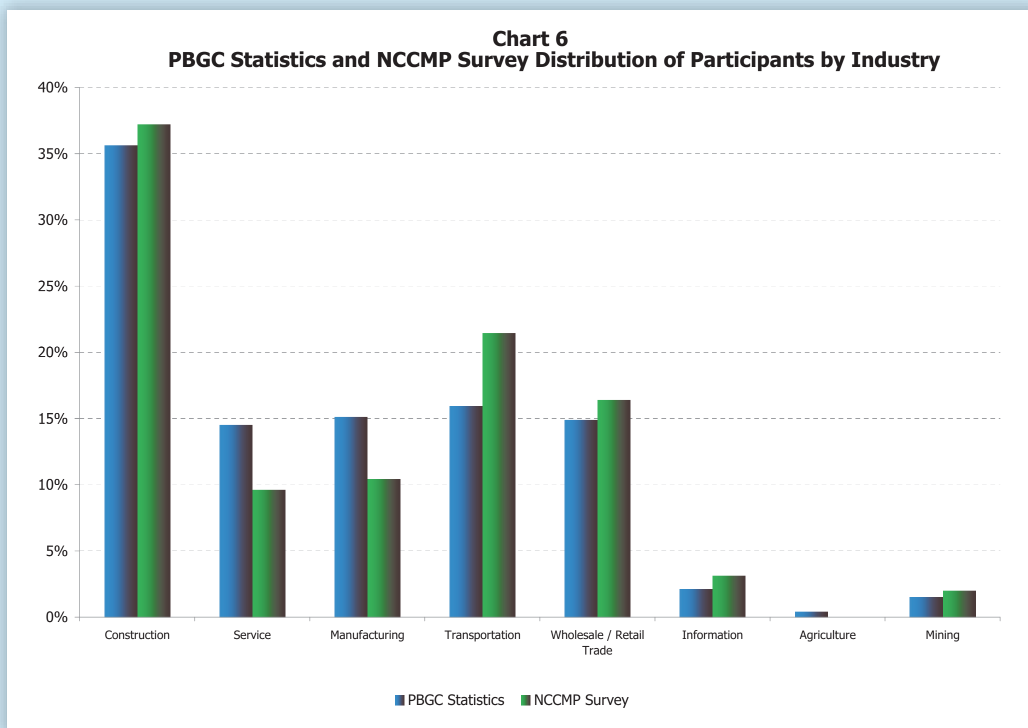


Distribution of Participants in Respondent Plans by Industry

When the respondents are examined on the basis of the number of participants, rather than by the number of plans, the representation of construction industry participants at 37.1% of the population, is comparable to the PBGC figure of 35.6% (see Charts 5 and 6).

Charts 5 and 6 *illustrate that on a number of participants basis, the survey population is highly correlated with the multiemployer population universe as reported by PBGC.*



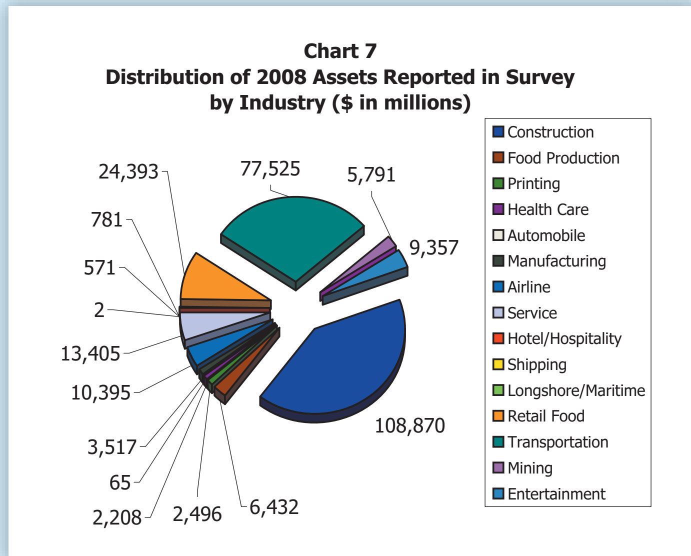


Respondent Plan Assets

By Industry

In the aggregate, the plans that responded to the survey reported a market value of assets of $266 billion as of the beginning of their 2008 plan years. Due to the timing of the survey, many plans did not have final year-end asset data available at the time of the survey.

Chart 7 *shows the distribution of the asset values at the beginning of 2008 by industry among the responding plans, with construction and transportation comprising the two largest pools of assets, followed by the retail food and service industries.*



Asset Allocation

Asset allocation is perhaps the single most important determining factor in the success of a plan's investment program. Multiemployer plans have been guided by Department of Labor rules that plans be invested in diversified portfolios. Although one school of thought encourages a lower risk profile with greater exposure to alternative investments, most multiemployer plans have a traditional asset mix.

Looking at the portfolios from 2007 through 2009 for plans reporting their asset allocations, equities comprised about 50% of the average portfolio, with fixed income at about 30%, real estate 8% and "other", cash, hedge funds and private equity all comprising less than 10% in total. The reduction in equity exposure from 2007 to early 2009 appears to be primarily due to the reduction in value of the underlying assets, rather than a deliberate decision to rebalance portfolios or reduce equity exposure.

Chart 8 *shows the average 2007 asset allocation for plans responding to the survey.*

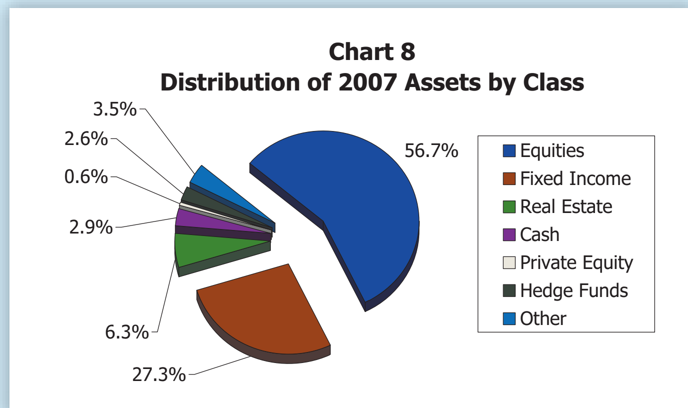
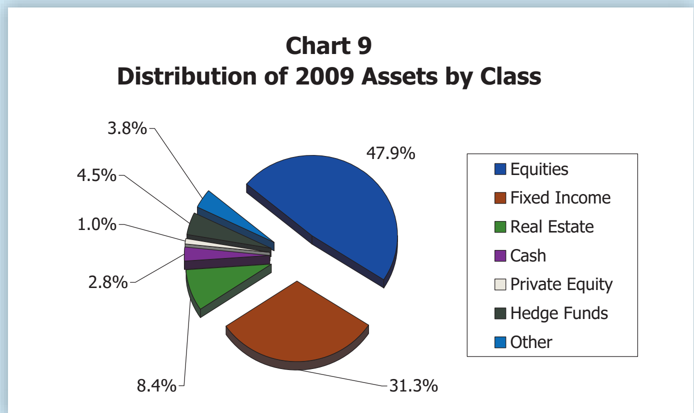
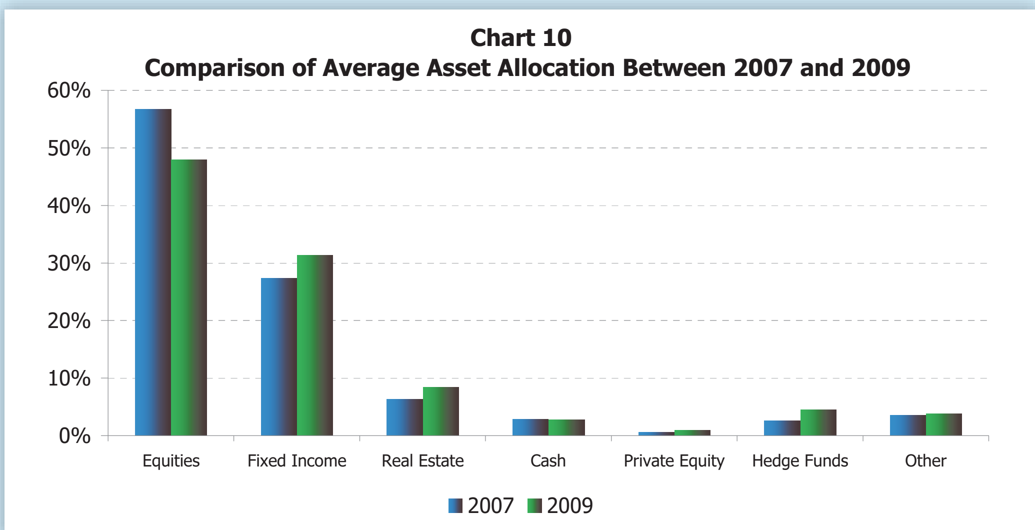


Chart 9 *shows the average 2009 asset allocation for plans that responded to the survey. The decrease in equity holdings between 2007 and 2009 is clearly visible in* ***Chart 10*** *below.*

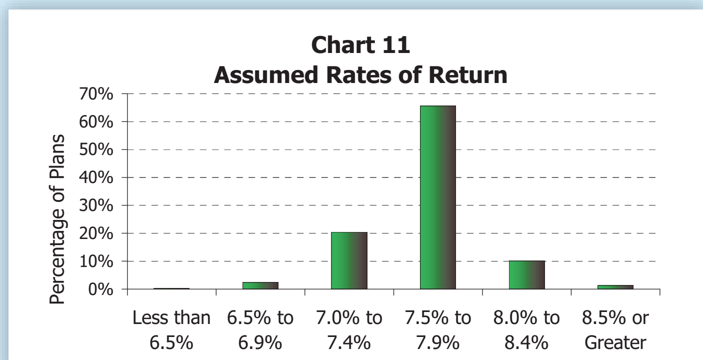




Assumed Rates of Return

The assumed rate of investment return has a significant impact on the calculation of the value of a plan's liabilities. As the assumed rate of investment return increases, the actuarial determination of the value of the liabilities decreases. The Pension Protection Act specifically requires the actuary to set each assumption at a level that reflects his/her best estimate. The determination of the appropriateness of the plan's assumed rate of return is most heavily influenced by the plan's asset allocation. Typically, higher allocations to fixed income products will result in a lower assumed rate of return, while higher equity allocations generally result in higher assumed rates. It is important to note that these actuarially assumed rates are based on a long-term view of investing even though the market value of assets may fluctuate over the short-term. Historically, in the single-employer and public plan sectors, assumed rates of return of 8.0% or higher have been common, while as Chart 11 illustrates, very few multiemployer plans use an assumed rate above 8.0%.

Chart 11 *shows that over 85% of multiemployer plans responding to the survey use an assumed rate of investment return that is below 8.0%.*



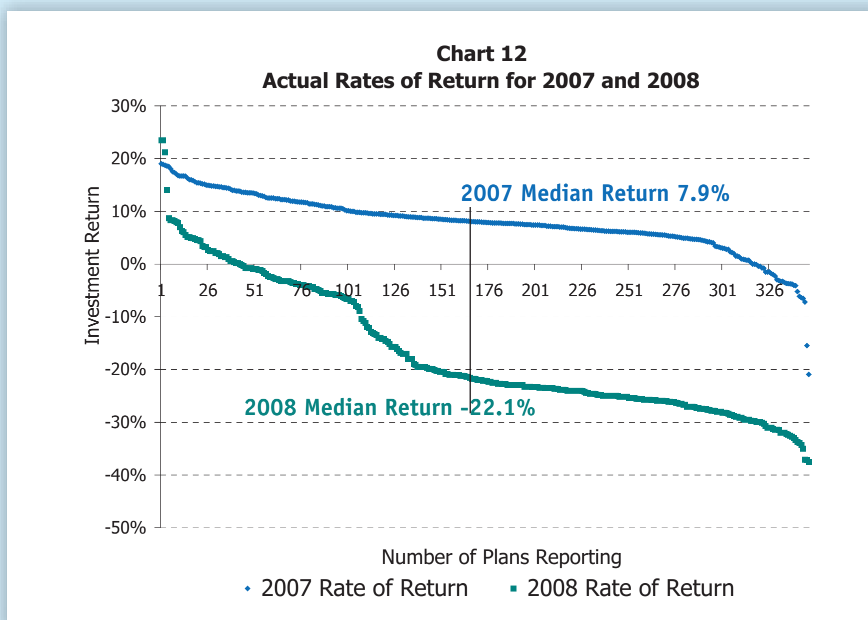
Investment Performance

When the actual rate of investment return in a given year exceeds the assumed rate, an investment gain results, and when the actual investment return is below the assumed rate, a loss results.

During 2007, the largest percentage (nearly half) of the plans responding to the survey reported an actual investment return of between 5% and 10% with a median reported rate of return of 7.9%. Since the assumed rate of investment return is in this range for nearly all responding plans, 2007 did not generate large investment gains or losses for most plans.

The 2008 investment return results were substantially less favorable than 2007 for most plans. More than 50% of the responding plans recognized a 2008 asset return of -20% or worse, with a median reported loss of -22.1%. Since an average plan anticipates annual returns of 7.5%, when a plan's assets lose 25% the plan actually has 32.5% less assets at year end than expected. To put these figures in perspective, a typical plan that is 100% funded will be approximately 70% funded after experiencing a -25% return year.

Chart 12 compares the actual rates of returns for 2007 and 2008 for the plans that provided both figures.



Funded Ratios

The funded position of a pension plan is most commonly expressed as the ratio of the value of the assets held by the plan, to the value of the liabilities of the plan. The guidelines established by PPA typically classify plans below 80% funded as endangered, and plans below 65% funded as critical (with exceptions for plans facing near- or intermediate-term funding deficiencies).

PPA specifies that for the purpose of this classification, the smoothed actuarial value of assets should be used to determine the funded percentage. The actuarial value of assets typically recognizes investment gains and losses gradually over a period of up to five years. This method of gain and loss recognition is essential for plans that are funded through long-term contractual agreements that cannot be easily adjusted. Following a period of strong investment returns, the actuarial value of assets will tend to be below the true market value of the assets, since the

gains will be subject to delayed recognition. Following substantial asset losses, the actuarial value of assets will tend to be higher than the true market value, due to the delayed recognition of the losses.

Chart 13 illustrates that at the beginning of 2008, the average plan responding to the survey was approximately 90% funded on a PPA basis, while by the beginning of 2009 this figure declined to approximately 77%.

Chart 13 *shows that the average PPA funded percentage (using the actuarial value of assets) declined by approximately 13 percentage points from 2008 to 2009.*

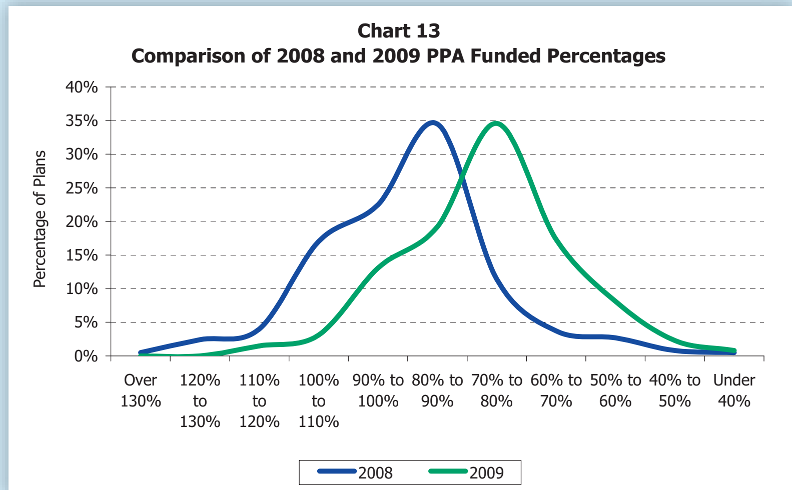


Chart 13 shows the decline in the average PPA funded percentage from 2008 to 2009. Since this calculation is based on the smoothed actuarial value of assets, the full extent of the 2008 market crash is not reflected in these figures.

To illustrate the full impact that the 2008 financial crisis had on multiemployer pension plans, Chart 14 graphs the ratio of the market value of assets to the actuarial liability. On this basis, the average 2009 funded percentage is approximately 65%, compared to 89% in 2008, which demonstrates the extraordinary effect that the broad investment market contraction had on multiemployer pension plans.

Chart 14 *shows the change in funded percentage from 2008 to 2009 using the market value of assets instead of the actuarial value of assets. Since the market value of assets fully recognizes all investment losses immediately, the 24 percentage point decline shown here is much more dramatic than in Chart 13.*

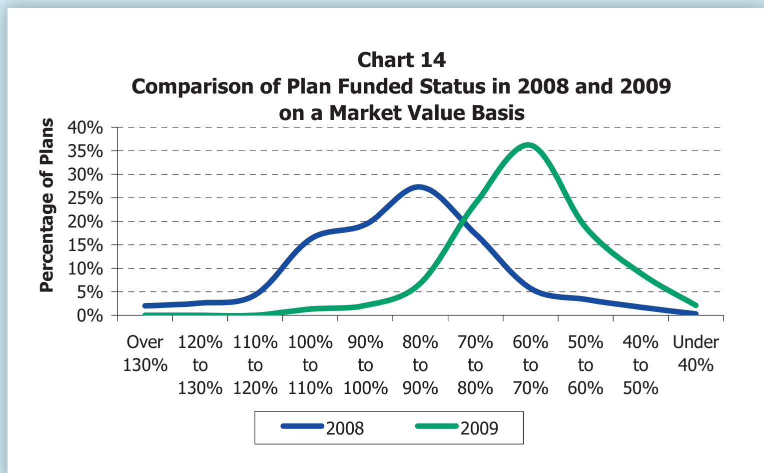
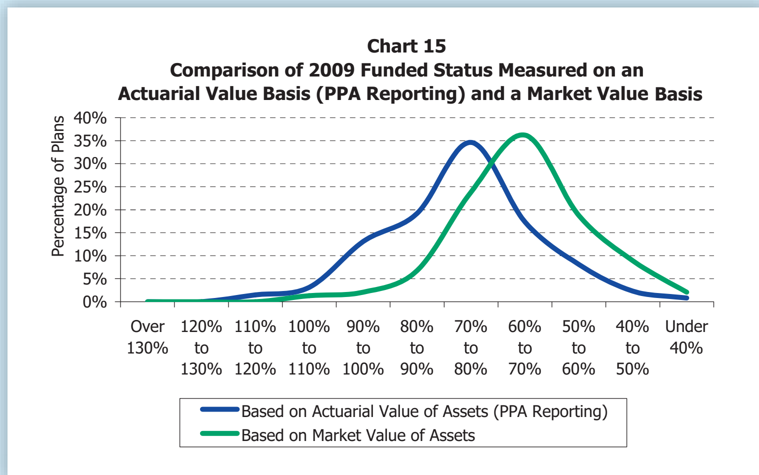


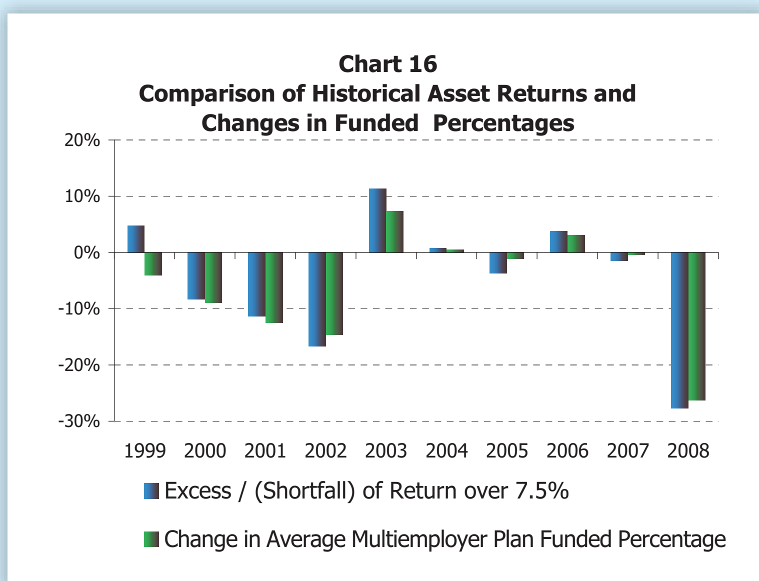
Chart 15 *shows the 2009 funded percentages using the actuarial value of assets and the market value of assets. The difference between the two lines represents the delayed recognition of the 2008 asset losses in the actuarial value of assets.*



The funded position of multiemployer pension plans is very closely linked to the performance of the financial markets. Historically, as the equity and bond markets have produced strong returns, the funded percentages of the plans have improved, while weak returns have reduced the funded percentages. To demonstrate this trend, Chart 16 compares the historical values of two figures:

- The excess or shortfall of a 60% / 40% blend of the S&P 500 Index return and the Barclays Capital Aggregate Bond Index[15] return over 7.5%. This figure represents the degree to which an average multiemployer pension plan exceeded or fell short of its assumed rate of return on a market value basis in a given year.
- The increase or decrease in the average funded percentages of multiemployer plans during the year. These figures were derived from a Segal Company database of approximately 175 plans. For this calculation, the funded percentage is the market value of assets divided by the present value of accrued benefits[16].

Chart 16 *shows how closely the funded percentages of multi-employer plans track the performance of the financial markets. In 1999 most plans were overfunded, which made it necessary for them to improve benefits to protect the deductibility of the employer contributions.*



Zone Status

PPA created the concept of zones to classify the funding strength of multiemployer pension plans. The traffic light analogy of these "Zones" has developed as shorthand for the technical categories referenced in the Pension Protection Act.

- Green Zone – Plans that are considered healthy
- Yellow Zone – Plans that are considered endangered
- Red Zone – Plans that are considered critical

Charts 17 and 18 illustrate the effect that the financial crisis has had on the plans that responded to the survey. The portion of plans that PPA considers healthy declined from over 75% when the initial certification was done when the PPA became effective in 2008, to 20% in 2009. Since the PPA funded percentage relies on the smoothed actuarial value of assets, Chart 18 actually understates the impact due to the fact that the market losses have not yet been fully recognized in the PPA zone determinations.

*As demonstrated by **Chart 17**, over 75% of the plans that responded to the survey reported their 2008 PPA zone status as green reflecting the relative health of these plans and the seriousness with which the bargaining parties addressed the funding disruption caused by the first historic market contraction which occurred from 2000 – 2002.*

Chart 17
Breakdown of 2008 Zone Status

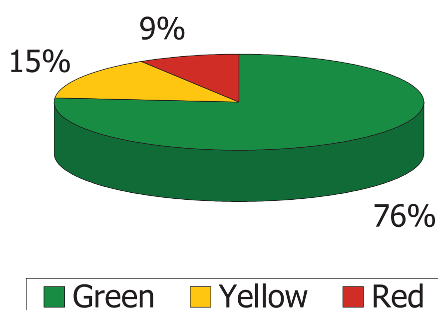
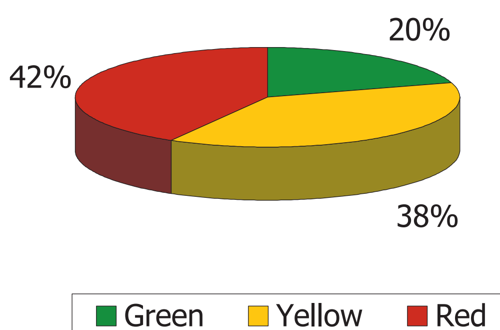


***Chart 18** shows a striking decline in green zone plans from 2008 to 2009, with only 20% of plans reporting their 2009 zone status as green, and more than 40% of the plans reporting their zone status as red.*

Chart 18
Breakdown of 2009 Zone Status



Pension Benefit Guarantees and the PBGC

The PBGC insures pension benefits against the insolvency of the plan sponsor, subject to a statutory maximum guaranteed benefit amount. For multiemployer plans, this guarantee level is determined according to a formula that pays 100% of the first $11 of a participant's accrual rate, and 75% of the next $33 dollars times that participant's years of service. The maximum annual guaranteed benefit of $12,870 is payable to a participant who retired with 30 years of service. In order to reach the maximum guaranteed PBGC benefit, a participant with 30 years of service would need to have earned a benefit of only $1,320 per month. Participants who retired with less than 30 years of credited service receive a proportionate reduction in that monthly guarantee. For benefits payable above that amount, the participant is fully at risk with no portion of that amount currently protected. This compares to the PBGC's single-employer program where the maximum guaranteed benefit is $4,500 per month (approximately $54,000 annually and is indexed to wage growth).

Charts 19 and 20 show the average pension payment and the average newly awarded pension payment for the plans that responded to the survey. The median pension payment is $872 per month, while the median newly awarded pension payment is $1,376 per month. While these amounts are clearly not exorbitant, Chart 20 shows that over half of the participants retiring from multiemployer pension plans in 2008 have earned benefits that exceed the PBGC maximum guaranteed benefit threshold for a 30-year participant. Therefore, in the event of a plan failure these participants would face benefit reductions that are significantly greater than those who retired in the past.

***Chart 19** shows the distribution of average monthly pension benefit amounts that responding multiemployer plans are currently paying to participants.*

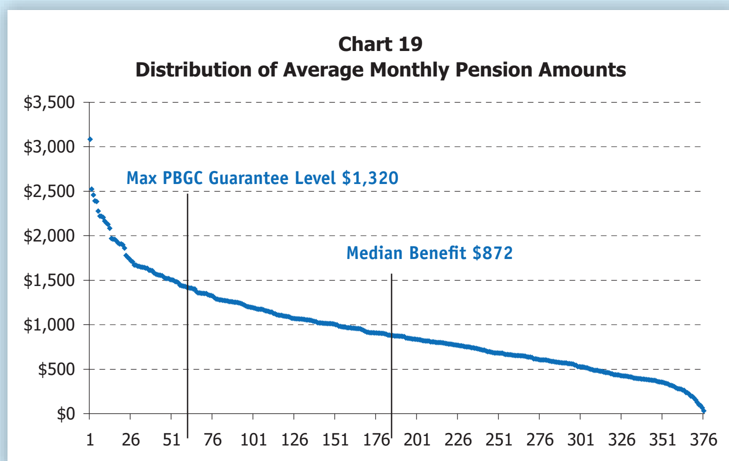
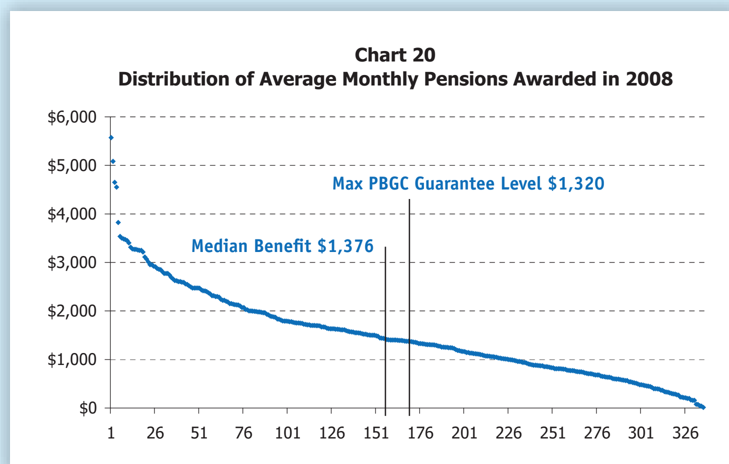


***Chart 20** is similar to **Chart 19**, except that it only includes new pension awards in 2008. This chart illustrates how more than half of the plans paid an average benefit to new retirees that exceeded the threshold for the PBGC maximum benefit for a 30-year participant.*

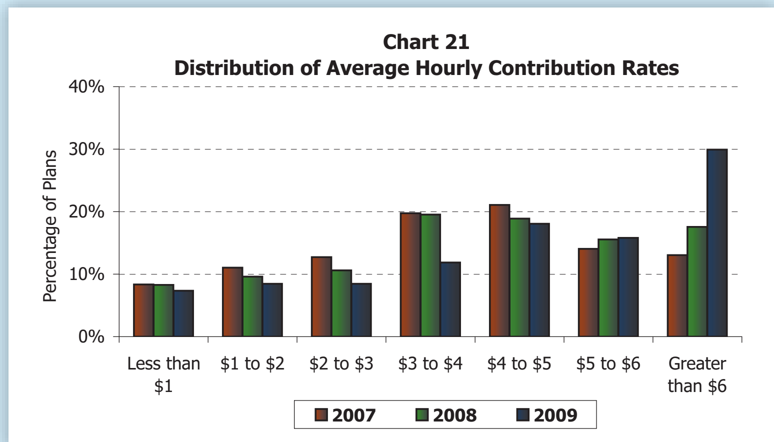


Contribution Rates

In the majority of multiemployer pension plans, contributions to the plan are a function of the number of hours their participants work multiplied by a negotiated rate per hour of work. Even before the effective date, and in many cases in anticipation of the PPA and its new funding requirements, employers and employee groups who sponsor multiemployer plans had taken decisive action to responsibly address the previous economic contraction from 2000 to 2002 by agreeing to both reduce benefit accruals and aggressively increase the negotiated contribution rates.

As shown in Chart 21, there was a significant increase in contribution rates between 2007 and 2009. Among plans reporting this information, the average contribution rates for 2007, 2008, and 2009 were $3.88 per hour, $4.18 per hour, and $4.80 per hour respectively. This dramatic increase in contribution rates demonstrates the commitment that the sponsors of these plans have to the goal of adequately funding their benefit promises.

***Chart 21** illustrates the distribution of hourly contribution rates as of 2007, 2008, and 2009. This chart clearly shows the parties' commitment to responsibly funding their pension obligations.*



Among the plans that responded to the survey, the percentage of total compensation that pension contributions represents varies greatly. For some plans the pension contribution is a minor component of compensation, while for others the contributions to the pension plan represents over 30% of the total compensation package. The average plan in the survey reported a total compensation package of approximately $40 per hour, with the $4.80 average pension contribution rate in 2009 representing roughly 12% of this amount.

Highlights

The survey data that the NCCMP has collected and presented in this report summarizes the recent experience of multiemployer plans and the average position of these plans as of 2009. The data supports the following conclusions:

- At the beginning of 2008, the average plan responding to the survey had assets that covered 90% of the liabilities. Under the Pension Protection Act of 2006, over 75% of plans were exempt from the requirements of Endangered or Critical status. Only one year later, dramatic declines in plan assets resulted in only 20% of plans falling outside of Endangered or Critical status.

- The asset allocations and assumed rates of return for multiemployer pension plans are both reasonable and conservative when compared to pension plans in other sectors. The recent declines in their funded positions are not due to reckless financial management or irresponsible benefit levels as some have charged, but rather they are the direct result of the global financial crisis that occurred in 2008 which devastated all sectors of our country's financial infrastructure, including defined benefit pension system.

- The average contribution rate for plans responding to the survey increased from $3.88 per hour to $4.80 per hour between 2007 and 2009. These increases represent a continuing response to the financial market declines of 2000 – 2002, and the beginning of the response to the 2008 market crash. The increases provide evidence of the serious commitment that the unions and employers have to ensuring their pension promises are adequately funded.

- The benefits offered by multiemployer pension plans are not excessively generous. The median monthly benefit paid by plans responding to the survey was approximately $872 per month, with a median of $1,376 paid to newly retired participants.

- The maximum monthly benefit amount guaranteed by the PBGC for a multiemployer plan participant with 30 years of service is $1,072 per month. Despite the modest benefits that these plans pay their participants, the majority of participants retiring today would experience a painful reduction in their benefits in the event the PBGC becomes responsible for financing their benefit payments.

Conclusions

The multiemployer system of providing workers with secure, reliable defined benefit pensions has successfully enabled millions of American workers over several generations to retire with dignity and remain a part of the middle class they labored so hard to build over their entire working careers. While the double-barreled blow to the economy generally (and the investment markets specifically), presents challenges unprecedented in the history of this system, it is far from the time to begin writing its epitaph.

Current funding rules, which were crafted more in response to a desire to reduce the PBGC's risk exposure than out of concern over worker retirement security, have pushed the pendulum far to the right. While the near-term full funding of benefit obligations is an admirable objective to which we all aspire, rigidly applying these strict standards to employers struggling to survive an economic cataclysm will only be counterproductive. This approach will result in plans that are less well funded as contributing employers are forced out of business.

This study has demonstrated that multiemployer defined benefit plans are subject to the same market volatility as any other part of the nation's financial infrastructure. Rather than accept a deterministic view that would condemn these and other defined benefit plans to obsolescence, we should view the present situation as instructional, and formulate public policy accordingly. We must realize that market volatility is part of the equation and that, in addition to structuring investment portfolios to weather normal, short-term volatility, multiemployer defined benefit pension plans are going concerns for which investment horizons and the recognition of extraordinary gains and losses must be appropriately structured. The regulatory framework must not just enable the plans to endure, but must also respect the delicate balance between adequate pension funding and the economic viability of the contributing employers.

The evolution of pension funding rules has been slow; at times, too slow to address problems that are evident to nearly anyone familiar with the system. A case in point is the deleterious effect of applying the maximum deductible rules to multiemployer plans and the reticence of Congress to address the problem. Unfortunately, not every situation carries with it the luxury of years of consideration before action becomes necessary. The need to address immediate funding relief and, for some industries, more direct intervention, is no less critical for the sponsors of defined benefit plans (whether multiemployer or single-employer) than it was for the investment community, banks, insurers, or other significant components of our nation's financial infrastructure.

As we turn our attention to working with lawmakers and other policy makers as they take corrective action to address the current weaknesses of the statutory and regulatory framework within which these plans operate, we must continually evaluate and capitalize on opportunities to strengthen the existing system. We must also facilitate the evolution of retirement plans to ensure that plan participants can continue to enjoy the security of lifetime benefits, while enhancing the competitiveness of those employers who recognize the value of such plans to their employees and to the society in which they live.

Reference

[1] 2009 PBGC Management Report.

[2] 2008 PBGC Data Book. To place these numbers in context, by the summer of 2009 the PBGC reported having assumed responsibility for 3,850 terminated, underfunded single-employer plans covering 1.6 million participants at a cumulative cost of $34.9 billion.

[3] 2009 PBGC Management Report.

[4] It is important to note that, unlike the single-employer guaranty program which acts as the insurer of first resort when a sponsoring employer fails, the multiemployer program functions as the insurer of last resort. This means that the PBGC never assumes liability for providing financial assistance to troubled plans until all of the contributing employers have ceased making contributions or paying withdrawal liability, and the collective pool of assets is depleted to the point of insolvency (e.g. when the plan no longer has sufficient assets to pay its benefit obligations).

[5] See Internal Revenue Code Section 404 for a complete description of the maximum deductible contribution rules.

[6] According to the NCCMP survey, approximately 95% of plans' assumed rate of return fell within that range, with more than half at 7.5%

[7] Even with such increases, the NCCMP survey found that the majority of multiemployer plans pay average monthly benefits that range between $500 and $1,500, providing modest income replacement by anyone's standards for workers who have been paid good middle-class wages throughout their careers.

[8] This would have required amendments to the collective bargaining agreements, a power that is reserved to the bargaining parties.

[9] It has been estimated that as many as 70% or more of all multiemployer pension plans encountered this problem during the 1990s.

[10] IRC section 413(b)(7), added by ERISA.

[11] This policy was finally reversed by Private Ruling 200346026 (8/13/2003), once the damage became clear as the plans were hit by the market reverses of 2001-02.

[12] The amounts guaranteed are determined by a formula that guarantees 100% of the first $11 of the plan's benefit accrual and 75% of the next $33 multiplied by the participant's years of credited services with a maximum annual benefit of $12,870 payable to participants that retire with 30 or more years of service. Those with fewer years of service receive lower guaranteed benefit amounts.

[13] The Multiemployer Pension Plans Coalition, which is coordinated by the NCCMP, came together in response to the first "once in a lifetime" bear market early in this decade, to harness the efforts of all multiemployer plan stakeholders toward the common goal of achieving benefit security for the active and retired American workers who rely on multiemployer defined benefit pension plans for their retirement income. Collectively, these stakeholders worked tirelessly to devise, evaluate and refine proposals from all corners of the multiemployer community for funding reform. Their efforts culminated in a proposal for fundamental reform of the funding-related rules contained in ERISA, rules that had never been "stress-tested" under the kind of negative investment markets which prevailed from 2000 through 2002. Much of that proposal was incorporated into the multiemployer provisions of the Pension Protection Act of 2006 ("PPA"). This group recognized that benefit security rests on rules that demand responsible funding, discipline in promising benefits and an underlying notion that even the best benefit plan is irrelevant if the businesses that support it are unable to remain competitive because of excessive, unanticipated or unpredictable costs. The Coalition was reconstituted following the second "once in a lifetime" market event in 2008 when it became clear that the provisions of the PPA were not sufficiently flexible to address the magnitude of the global catastrophic market contractions that affected every part of the financial services infrastructure of the United States.

[14] By extension, plans that are neither Yellow or Red Zone plans are referred to as "Green Zone" plans.

[15] Prior to 2009 this index was named the Lehman Aggregate Bond Index.

[16] For years prior to 2005 the Segal database contained the present value of vested benefits, which we used to estimate the present value of the accrued benefits for those years.

Acknowledgements

The NCCMP wishes to thank the many people who made this survey possible. We would especially like to recognize the trustees of the various plans who generously agreed to share detailed information from their plans with us so that the community could benefit from the findings of this survey. In addition, this survey would not have been possible without the diligent efforts of both the administrative staff and outside professionals of the participating plans. These individuals performed the difficult task of gathering data from a wide variety of sources, and worked with the NCCMP staff to ensure the accuracy of the information provided.

The statistics presented in this report are also available by specific industries and professional trades. Please contact the NCCMP if you would like to receive a supplemental report containing more detailed industry or trade information.

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