WHY FRESH START?

The Multiemployer Pension Plans Coalition proposes that Congress allow multiemployer pension plans to elect one of the following options in 2010:

a) Fresh-Start the plan's Funding Standard Account and amortize the costs over a period of 30 years; or

b) Isolate the asset losses associated with the 2008 stock market crash, and amortize those losses over 30 years

There have been some concerns raised about the appropriateness of Option (a), the 'fresh start' option, claiming that doing so provides relief beyond the needs which have arisen as a direct result of the 2008 market losses. However, it is important to recognize that the financial crisis which devastated the investment markets produced collateral damage to the economy that presents ongoing financial challenges for the tens of thousands of small business who sponsor multiemployer plans. The following discussion addresses the reasons why this provision provides both reasonable and prudent targeted relief.

As with many aspects of pension funding, it is easiest to understand this issue through an analogy to a homeowner's mortgage. Under the Pension Protection Act of 2006 (PPA), multiemployer plan sponsors are generally required to fund their pension plans using 15-year amortization schedules. This arrangement was like a homeowner who, having weathered a recent financial setback, believed his financial outlook for the foreseeable future would return to more normal times and, on the basis of that assumption, agreed to move from a 30 year fixed-rate mortgage to a 15 year mortgage on his home. Upon the passage of the PPA in 2006, but before its effective date in 2008, multiemployer plan sponsors, believing that the funding rules were now clear for the foreseeable future, accepted these new rules and responded by taking an aggressive approach to increasing their plans' funded position by raising contributions (to the point of stretching employers' ability to compete) and reducing benefits to the extent permitted.

However, rather than returning to more historical performance, in 2008 the global financial services industry experienced the most severe collapse since the great depression. Several very large financial services companies failed, and others survived only due to a cash infusion from an enormous taxpayer-funded bailout. Nearly all pension funds invest a substantial portion of their assets in publicly traded stocks, and the average stock portfolio declined as much as 40% during 2008. In addition to the financial crisis, 2008 also marked the implementation of the Pension Protection Act with new funding rules that placed substantial additional burdens on these same contributing employers. From the perspective of our homeowner analogy, the collapse was the equivalent of having a category 5 hurricane sweep through his town.

Using the preceding comparisons as a foundation, it is helpful to consider how Options (a) and (b) would apply to our homeowner in negotiating with his bank.

- Under Option (a) the homeowner has lost his primary job and his replacement job pays an hourly wage which is only two-thirds of his former rate. Because he can no longer pay his mortgage over the more aggressive 15 year amortization schedule, he approaches his bank to refinance under a 30 year, fixed-rate mortgage. In addition, his home has

suffered significant storm damage which he must also pay to repair, which he finances through a home equity loan. Unfortunately, the generalized damage in the community has also reduced the demand for his services, reducing his income further by cutting his normal number of hours from 40 to 35 per week. While the homeowner benefits from a longer amortization of his mortgage, no one would deny it was the storm that was the direct and proximate cause of the significant, ongoing damage to his long-term financial viability. As with our homeowner who must deal with all aspects of the immediate financial crisis, the fresh-start approach of Option (a) addresses the direct market value of investment losses as well as the continuing damage to the economy that has resulted in the ongoing problem of reduced hours of contributions. Therefore, while the relief extends beyond the market value loss to the plans' investments, it is still relief that is specifically targeted to the effects of the current financial crisis.

- Option (b) is similar, but instead of refinancing the entire amount, the homeowner is required to quantify exactly how much the hurricane damage cost him or her, and the bank agrees to finance only that amount over 30 years.

In both Options (a) and (b), the fundamental rules of the PPA (15 year amortization for everything going forward) continue to apply.

While Option (b) does provide sufficient relief for many multiemployer pension plans, many more plans face additional complex issues that would not be resolved under the scope of this provision, and could only be adequately helped by allowing them to elect Option (a). Some of the issues that these plans face are as follows:

- In addition to the recent investment losses, many multiemployer plans have experienced significant declines in their employment levels and a reduction of hours of contributions in the range of 20% to 30% have been reported due to the tight economy. These declines have created additional funding challenges to contributing employers' ability to absorb new costs and remain competitive.
- In the late 1980's and 90's the vast majority of multiemployer pension funds reached their full funding limit. U.S. tax policy prevented these plans from banking reserves generated from the up-side gains, which were necessary to compensate for the inevitable and predictable losses in subsequent years when the market performance fell short of their long-term funding assumptions. As a result, they were obligated to increase benefit levels to ensure that the employer contributions required by the bargaining agreements would be currently deductible and exempt from an excise tax. Since that time the economy has experienced two periods of financial decline, and now many plan sponsors need additional time to fund those mandatory benefit increases that were required to comply with the provisions of the tax code.

It is also worth noting that when ERISA was adopted in 1974, multiemployer plans were initially required to fund their pension obligations over 40 years. This period was reduced through a series of legislative changes, culminating with the 15-year requirement of the PPA in 2006. Nevertheless, despite increasingly demanding funding rules, it is important to note that since the passage of ERISA, only 57 multiemployer plans were forced to seek financial assistance from the PBGC, compared to over 3,500 single employer plans – a clear demonstration of the stability of this system.