NATIONAL COORDINATING COMMITTEE FOR MULTIEMPLOYER PLANS

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The United States House of Representatives
Committee on Education and the Workforce
Subcommittee on Health, Employment, Labor and Pensions

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Discussion Draft to Modernize the Multiemployer Pensions

Testimony of:

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Chairman Roe, Ranking Member Polis and Members of the Committee, it is an honor to appear before you today on this important topic. I am Randy DeFrehn, Executive Director of the National Coordinating Committee for Multiemployer Plans, an advocacy organization chartered under Section 501(c)(4) of the Internal Revenue Code, created following the enactment of ERISA to represent the interests of multiemployer benefit plans, their participants and their sponsors.

Multiemployer plans are the product of collective bargaining agreements between one or more labor unions and more than one contributing employer which require contributions to a trust to be held and administered for the sole and exclusive benefit of plan participants. While commonly associated with the construction and trucking industries, they are found across the economy including in the agriculture, aerospace, bakery and confectionery, building service, clothing, entertainment, food production, distribution and sales, health care, hospitality, longshore, maritime, mining, manufacturing, retail, textile, and transportation industries.

I would like to thank the Committee for the opportunity to appear here before you once again on the topic of multiemployer retirement security. It is also an honor to say thank you, on behalf of the more than 10 million participants in multiemployer defined benefit plans, for the continued leadership shown by this Committee and Sub-committee in examining their retirement security needs and spearheading truly comprehensive reform designed to enable our plans to confront the realities of today's markets and providing a roadmap that will perpetuate the system which has worked so well for nearly 70 years.

The discussion draft before you today addresses the third and final segment of the recommendations of the Retirement Security Review Commission (or Commission), a broad based consortium of stakeholders representing more than 40 stakeholder groups including labor unions, employer associations, large plans, large individual employers and advocacy organizations from industries across the multiemployer community. For a period of eighteen months this group met to review the strengths and weaknesses of the multiemployer defined benefit pension system and formulate recommendations designed to weather its current challenges and to facilitate its success in the future. By passing the Multiemployer Pension Reform Act of 2014, you have already addressed the recommendations to make technical corrections to the Pension Protection Act to preserve the financial health of the more than two-thirds of plans which have already, or will soon regain their financial stability following the back-to-back recessions since 2000; and those recommendations designed to preserve plans otherwise headed for insolvency and preserve benefits of participants in such plans above levels they would have otherwise ultimately received under prior law.

Today's focus on the recent Discussion Draft addresses the remaining category of recommendations from the Commission concerning innovative new benefit structures designed to address the shortcomings of both the current defined benefit or defined contribution plans.

Background

For over seventy years, multiemployer defined benefit pension plans have provided tens of millions of American men and women and their families with regular, though modest retirement income which, along with Social Security and personal savings, have allowed them to retire in dignity. Since the PBGC multiemployer guaranty fund was initiated in 1980, the number of plans has declined from slightly over 2,200, consistent with the decline in defined benefit plans in corporate America. Contrary to that trend, however, the number of covered participants has increased from 8 million to over 10 million, largely due to the mergers of many smaller funds into larger ones and because of the more favorable vesting rules enacted over the years. According to the PBGC, approximately 1,350 multiemployer defined benefit plans currently cover approximately 10.4 million active, retired and terminated vested workers. Defined benefit plans continue to be the primary retirement plans for multiemployer participants, with defined contribution plans being used as supplemental income plans.

Over that period, multiemployer plans have gone through a number of evolutionary changes. They began as true "union plans," but were subsequently replaced in favor of equal labor-management plans with the passage of the Taft-Hartley Act. These pay-as-you-go plans further evolved when ERISA was passed to incorporate formal vesting and pre-funding requirements. Many employers believed that since only the contribution rates are negotiated, these plans were defined contribution until the late 1970's when the Supreme Court ruled in Connolly v. PBGC that they are defined benefit plans.

While ERISA provided for the creation of the PBGC to provide a safety net for plans in industries that fail, the multiemployer plan guaranty fund was not implemented until the passage of the Multiemployer Pension Plans Amendment Act of 1980. A second aspect of that legislation was the creation of withdrawal liability – in essence, an exit fee – to be paid by employers who withdraw from plans with unfunded vested benefits. While theoretically a sound idea, industry specific limitations on when this fee is imposed, the 20 year cap on the amount ultimately imposed, amounts excused by bankruptcy courts and departures of small employers that are judgment-proof have resulted in recovery of less than 10% of assessed liabilities and have made withdrawal liability more of a hindrance than a help to the long-term financial health of plans by creating a barrier to entry by new employers that might otherwise join the system and an incentive to existing employers to depart.

When this fee was first imposed, it was forecast by some to be the end of multiemployer plans; however, a combination of conservative benefit payments, an expanding economy and robust investment markets soon made unfunded liabilities a thing of the past for the vast majority of plans. Instead, the focus of attention for most plan sponsors shifted to Treasury's maximum deductible limits which limited the current deductibility of contributions to over funded plans. The remedy to this problem for the vast majority of plans was to increase benefit payments sufficient to raise the cost high enough to preserve the current deductibility of contributions. It is estimated that over seventy percent of plans faced this problem in the late 1980's and 19990's. While effective for addressing the immediate problem these actions also increased recurring plan liabilities prior to the inevitable market corrections and re-emergence of unfunded liabilities that followed soon after the turn of the century.

To compound the problem, additional financial disclosures required by the Financial Accounting Standards Board (regardless of the potential for incurring such liability) imposed after the 2008 recession has resulted in the downgrading of the credit rating of at least one publically traded firm and has had an adverse effect on the ability of other contributing firms to access credit markets. These new rules have made a bad situation worse by making it nearly impossible to bring new contributing employers into the contribution base in many industries. Without the influx of new employers, plans will be destined to deal with a continually contracting base of contributing employers – a prospect that has dire implications for the long-term viability of even the best funded such plans.

For the majority of industries and employers, multiemployer defined benefit plans have recovered or are on a path to recovery from the devastating losses of the past decade and will continue to be the norm. For others, the MPRA has provided a life line for plans and their participants that choose to utilize the new tools that have become available.

For still other employers, however, these recent past developments have left them feeling that the current structure continues to present an unacceptable risk of recurrence, causing them to seek other forms of pension coverage for their employees. For these employers, the only alternative currently available is a defined contribution plan based on an individual account – primarily, the 401(k). As a primary form of retirement security vs. a wealth accumulation process, however, for average workers defined contribution plans present certain recognized inefficiencies which may result in lower benefit payments during the decumulation phase, many of which are vexing even to those who specialize in retirement policy matters, including assuming the responsibility for making correct investment choices, paying the lowest possible fees and in estimating (our own) life expectancy.

To the Commission this resulted in yet another challenge: how to find an alternative plan design for the future that would reduce or eliminate the risks of unfunded liabilities for those employers, yet addresses the shortcomings of the current defined contribution system so that workers can continue to receive a regular monthly retirement income and maximize the utility of employer contributions without requiring each participant to take on responsibilities of actuary and investment manager for which they are ill equipped. The result of their analysis was a recommendation to encourage the development and approval of an American version of innovative, "shared risk" plan designs which have become more prevalent in other parts of the Western world. The Commission offered two different models - the variable defined benefit and the composite (or target plan as it was described in the Commission's report) as illustrative rather than finite solutions for the future. Having determined that no statutory changes were required for the variable defined benefit model which has already been adopted and, in at least one situation received a tax qualification letter from Treasury, the current proposal is focused on the composite model.

The composite plan is neither a defined benefit, nor a defined contribution plan under the current statutory structures, as the variable nature of the benefit is neither definitely determinable, nor is it based on an individual account, rather it is intended to bring together the best features of each. When the bargaining parties voluntarily determine such a structure is preferable for a specific population, it would be made available to jointly managed, multiemployer plans as a successor plan to their current defined benefit plan. The model includes very clear conditions for the parties to pay off the liabilities of the "legacy" defined benefit plan as the first priority for contributions. The discussion draft, which is several generations from the original proposal included when MPRA was first introduced, has benefited from the opportunity to more closely examine and stress test various proposals contained in this legislation. It has also been strengthened by a thorough review of concerns expressed by others; some of whom had participated in the proposal's original draft, and by some expressed by the Administration. As the overall objective was to create innovative plan designs, the input by these others has been welcome and beneficial to the overall end product. Such suggestions include proposals to limit plans that can elect to become composite plans by placing a statutory prohibition on critical status plans or those which can elect critical status. It also strengthens the funding of the legacy plans by requiring that contributions to fund future accruals be subject to a higher funding standard than are required for the current defined benefit plans. The discussion draft now requires contributions at the greater of the plans' required funding levels under the Pension Protection Act, or the Transition Minimum Contribution. It also strengthens legacy plan funding by reducing the amortization period for existing liabilities over 25 years rather than 30. At that level, plans which are permitted to adopt composite components will still be able to offer benefit accruals at levels sufficient to retain the support of active workers; many of whom are paying multiples of the contribution rates paid by recent retirees for a fraction of the benefit. Other changes to improve the discussion draft include elimination of trustee discretion in determining the amount of the contribution payable to the legacy and composite plans and requiring new employers who contribute to the plan to also contribute to the legacy plan which will pay off these liabilities faster.

If the parties so desire, the benefit plan design could mirror the current plan design for the defined benefit plan. It could also continue many of the more favorable features of defined benefit plans. From the participants' perspective, this new structure will provide higher monthly benefits than would be derived from simply purchasing an annuity from his or her account balance in a defined contribution account. This can be accomplished in several ways including through the pooling of longevity risk, and by limiting other features that result in plan leakage and ultimately lower retirement income such as loans, hardship distributions, distributions before retirement and lump-sum distributions, as benefits would be required to be paid as annuities.

This new structure is clearly not a defined benefit plan, however, as benefits are variable based on the market value of assets (as currently happens with defined contribution plans). The amount one would receive would be adjusted on an annual basis determined using a fifteen year projection at the plan's assumed rate of return to mitigate the frequency and impact of market fluctuations.

Contributions to both plans would be determined by the plan's actuary. As the market risk for future service rests with the participant, however, the minimum contribution requirement to fund the cost of future accruals would be set at 120% of the actuarial projected costs to provide a buffer against market volatility. For plans that are making a complete conversion to the new model, a "fresh-start" may be elected which would allow the plan to amortize existing liabilities over a 25 year period. Stress testing of this approach shows that in almost all cases, this would be sufficient to retain the current benefit accrual rate under the defined benefit plan as the target accrual, funded at the 120% level without increasing contributions. Such a fresh-start does not excuse full funding of any of the accrued liabilities, but simply extends the period over which such liabilities would be funded.

Each year the plan would conduct an actuarial valuation to determine whether the assets were sufficient to meet that funding projection at the end of a fifteen year period. Assuming the plan continues to meet that target, no action would be necessary and, if a sufficient margin were to develop, the plan trustees could consider possible benefit improvements, provided that such improvements do not reduce the projected funding below the 120% target. If, however, the projections fall below the 120% target, the trustees would be required to take remedial action within 210 days of the date of the certification of plan funding based on a clearly defined hierarchy.

If the asset decline is modest, the parties would negotiate additional contributions, or the trustees could adjust the value of future accruals, much the same as is currently done for defined benefit plans. Because this is not a defined benefit plan, however, in the event projected plan assets fall more precipitously, action would be required to adjust benefits for all participants to return the plan to the required funding level. Benefits that could be adjusted include those that are not considered "core" benefits – normal retirement benefits payable at normal retirement age – and would include post-retirement benefit improvements, subsidized early retirement or surviving spouse benefits or other benefits that are currently adjustable for critical status plans under the PPA.

In the event of a catastrophic market event, and all other reasonable measures as described above are exhausted, all benefits, including core benefits in pay status could be adjusted in order to restore required funding.

As it is not a defined benefit plan, service earned after adoption would not be subject to PBGC guaranty, nor would employers be subject to withdrawal liability. Both of these features would remain in place, however, for remaining obligations under the legacy plan. While some have suggested that a portion of the benefit be guaranteed as a means of extending the payment of PBGC premiums on employees with no prior service in the legacy plan, that suggestion was not included in this draft as the intent of the composite plan is not to replicate the current defined benefit system – a point which has been made several times in this document. However, the suggestion raises a concern that has been touched upon by the Committee in the past and is referenced in the Questions and Answers published in conjunction with the release of the Discussion Draft.

That concern is over the current deficit of the PBGC. While the magnitude of this deficit has grown exponentially over the past few years, the assets available to meet the Agency's obligations have remained relatively constant. Although the proposals put forth by the Administration to eliminate the deficit may provide a solution to the mathematical problem, the structure put forth – of including a variable component and assessing an exit fee on employers leaving the system –demonstrates an astonishing lack of understanding of the collective bargaining process upon which multiemployer plans are found and the delicate balance of the needs of the stakeholders. Implementation of this proposal will produce the opposite result, by driving employers from the system and weakening the funding of plans thereby putting the Agency at greater risk and threatening the future of even the well-funded plans. Shortly after the Administration made it's proposal, the NCCMP reconvened the Retirement Security Review Commission for the limited purpose of examining the PBGC's precarious situation and looking at alternatives to the current safety net structure upon which it is based. At the end of their deliberations, the Commission concluded that the magnitude of the proposed premium increase is unachievable through the current (or proposed structure) and that there is a need for a full review of the fundamental premise of the guaranty program itself, how it is structured; should the benefit be restructured as a function of the benefits being paid or of the wages in the industries covered, noting that in some of the low wage industries the proposed premiums would surpass the annual contributions being made to the plan. The analogy was made to having a mandate to purchase home owners insurance, only to learn that the annual premiums equal or surpass the value of the home being insured.

It discussed whether there are alternatives that exist that could significantly reduce the exposure of the community at large to the failure of one mega-plan or of a specific industry. Among the options discussed were industry or union based risk pools, or mandating that the PBGC be charged with the responsibility to intercede and step in to take over a fund, just as it currently does in the single employer fund, at such time as a plan which meets the criteria to apply for MPRA relief, has such relief denied by the Department of the Treasury. Such intervention would be immediate following the Treasury's denial and a finding by the fund that it is unable to craft an alternative that meets Treasury's demands for a restructured rescue plan. As in the single employer situation PBGC would immediately reduce benefits to the level sustainable by the plan assets to allow maximum payment of the fund's own obligations by its own accumulated assets before coverage under the guaranty fund would be provided.

There are other similar alternatives that could be implemented and, rather than having the Congress enact massive premium increases under an admittedly short legislative calendar, the Commission has recommended that a study be commissioned by the Congress to conduct a thorough evaluation of these and others that may be suggested, so that those who are truly dependent on the safety net can receive the help needed when all other avenues have been precluded.

Conclusion:

In the past few years much as been made of the need to improve the retirement security of workers. This body has taken bold action to preserve the long-term solvency of multiemployer plans in last year's passage of MPRA. Yet there remains one last aspect reform to be enacted.

For some, the composite plan is the next logical step in the evolution of collectively bargained multiemployer plans. For those who are no longer willing to assume the risk of ensuring the performance of the investment markets, yet are genuinely concerned that many if not most of the workers covered by multiemployer plans do not possess the income levels, sophistication or discipline to accumulate sufficient wealth in a traditional defined contribution plan to meet the lifetime income objective (a concern that is not limited to this population but shared by many in the retirement community), the composite plan provides the best of both worlds. If enacted, the structure and safeguards will provide greater long-term retirement security by creating a path for contributing employers to remain in and new employers to enter the multiemployer system without presenting existential risks, while providing the greatest possible benefit for covered participants.

I thank you for the opportunity to share these thoughts and welcome any questions you may have.

Respectfully submitted,

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