NCCMP Response to Follow-up Questions

House Committee on Education and Labor
Subcommittee on Health, Employment, Labor, and Pensions

From the March 7, 2019
Hearing on
"The Cost of Inaction:
Why Congress Must Address the Multiemployer Pension Crisis"

March 29, 2019

1. **Have the changes to single employer plan funding rules, including the use of corporate bond rates to discount liabilities, under the Pension Protection Act of 2006 resulted in greater retirement security for participants of single employer plans?**

   No. The changes to single employer funding rules under the Pension Protection Act of 2006 (PPA '06) have not resulted in greater retirement security for participants. In fact, while the funded level of the few single-employer plans remaining today is strong, the number of plans and the amount of retirement security they afford their participants has fallen precipitously. The laws, regulations, Pension Benefit Guaranty Corporation (PBGC) premiums, and funding requirements established for single employer plans by the PPA'06 as well as the numerous changes that Financial Accounting Standards Board (FASB) has made to pension accounting standards since the mid-1980's have had a significant negative impact on the economic viability of single-employer defined benefit pension plans for employers. The PBGC data shows that since the passage of the Employee Retirement Income Security Act of 1974 (ERISA), 87% of single employer defined benefit plans no longer exist, either through standard terminations or distressed trusteed terminations. Additionally, 8,285 plans have accrual or participation freezes, leaving 14,048 open insured single-employer plans. The laws, regulations and rules governing single-employer defined benefit plans have clearly incented employers to terminate their defined benefit plans, discouraged employers from offering a defined benefit pension, and has led to weakening of the retirement security for working Americans.

2. **Are the funding and measurement rules adequate for multiemployer plans?**

   Yes. For the vast majority of multiemployer plans today that are healthy and are succeeding in their mission to provide secure and reliable lifetime income to their participants, the current funding and measurement rules for multiemployer plans are adequate. Currently 90% of multiemployer plans are not in critical and declining status. 65% of plans are currently in the Green Zone, and 28% of plans are currently funded at more than 100%[1]. As this crisis is addressed, it is vitally important that care is taken to preserve and protect the majority of plans that are currently in solid financial health. Multiemployer plans play a vital role in providing modest but essential lifetime retirement income to approximately 10.4 million American workers. These pension benefits, in combination with personal savings and Social Security, allow these working-class Americans to retire with dignity.

   If multiemployer funding rules are to be modified, it would be appropriate to add additional tools that would allow multiemployer plan Trustees to further proactively manage their plans to address any funding challenges that should arise. Multiemployer plans have always managed plan funding through a combination of negotiating additional contributions and adjusting future accruals. The PPA'06 introduced new tools for plans that were in critical status. Since PPA'06, Trustees have used those tools, in combination with negotiating yet further increases in contributions, to respond to the market crash in 2008 and the Great Recession that followed.

   According to Segal Consulting's fall "2018 Study of Multiemployer Plans in the Red Zone," multiemployer plans in critical status have increased their contributions by more than 75% in the last 10 years[2]. Trustees have also used the additional tools granted by PPA'06 as part of rehabilitation plans to improve plan funding. According to the same data study, adjustable benefits for non-retired participants of most critical status plans were reduced by 10%-14%. Adjustable benefits of critical and declining status plans were reduced by 15%-20%. When Trustees have had tools available to them, they have used them. Additional tools earlier in the process will allow Trustees to manage plans even more proactively.

3. **Some have suggested that the expected rate of return for investments by multiemployer plans is unrealistic. Is this true? What is the historical performance of a balanced portfolio of equities and fixed income?**

   No, it is not true that the expected rate of return for investments is unrealistic. Actuaries are guided by Actuarial Standards that relate to consideration of investment return expectations for each component of a plan's asset allocation, looking to long-term forecasts of investment professionals, as well as past experience.

   For multiemployer pension plans, the actuarial valuation interest rate assumption usually represents the expected annualized investment return based on the plan's asset allocation. For purposes of determining funding requirements for an ongoing, healthy plan, actuaries generally

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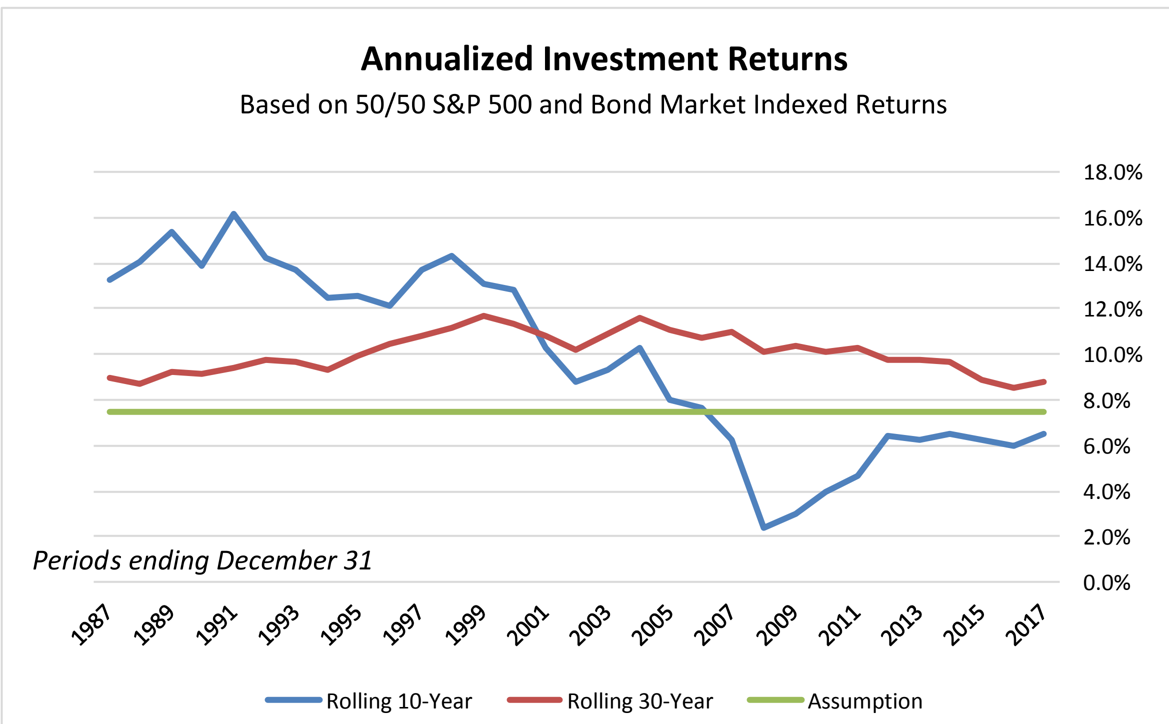
[1] https://www.segalco.com/annual-survey-of-plans-zone-status/#Multiemployer

[2] https://www.segalco.com/publications-videos/data/2018-segals-study-of-multiemployer-plans-in-the-red-zone/#Multiemployer

use a long-term horizon in developing this assumption; for example, the assumption represents the forward-looking expected return on plan assets over the lifetime of the plan, taking into account the timing of when benefits are expected to be paid.

Typically, this means that actuaries consider the expected rate of return over next 20 or 30 years, as investment professionals are unable to supply capital market expectations over longer timeframes. Based on publicly-available data from the U.S. Department of Labor's Form 5500, in approximately 75% of multiemployer plans, the actuary's used an investment return assumption between 7.0% and 7.5%.[3]

As the chart below demonstrates, the actual investment returns over rolling 30-year periods have consistently exceeded the high-end benchmark investment return assumption of 7.5%. For simplicity, these returns are based on a 50/50 blend of S&P 500 and bond market indices. When focused on a shorter-term, rolling 10-year periods, actual returns have exceeded a 7.5% benchmark except in the years following 2008. The 10-year return for the period from 1/1/2008 through 12/31/2017 was 6.5%. However, as noted earlier, actuaries for ongoing, healthy plans look to longer investment horizons when developing the actuarial rate of return assumption. If these projections change or the asset allocation changes, the discount rate used will also change.



[3] Form 5500 data for plan years ending in 2016.

4. **What is the argument to use the Treasury rate to discount the liabilities of multiemployer pensions?**

   The purpose of discounting in finance is to value an asset or liability based on the level of risk involved in that asset or liability. For example, if a beneficiary is expected to receive a stream of risk-free payments from the U.S. Government, which could be in the form of cash received from redeemed Treasury securities or Social Security payments, then the appropriate discount rate would be the relevant Treasury rate for a given maturity.

   However, as we know, multiemployer pensions are not risk-free obligations of the PBGC, the U.S. Government, or of plan sponsors, and therefore there is no fact-based rationale or credible investment theory to use the Treasury rate to discount these liabilities.

   Those who have advocated for the Treasury rate often cite the financial economist Jeremy Gold for their position. However, in his article "Fair Value of Liabilities: The Financial Economics Perspective"[4], Gold says that

   > "there are at least three theoretically correct methods for estimating the value of a series of (potentially risky) future cash flows. (1) Discount the true *probability-weighted future cash flows* using discount rates that are the *sum of a risk-free rate* ***and*** *a risk premium*. (2) *Modify the probabilities of the risky future cash flows to account for risk* and discount at risk-free rates. (3) *Modify the risky cash flows to account for risk* and discount at risk-free rates." [Emphasis added]

   In order to translate the practical meaning of Gold's position, one must understand the actual payment risk involved in multiemployer pensions. Here, we must examine the current risk of non-payment inherent in multiemployer pension plans and to their participants under current law.

   For those plans heading toward insolvency, the Multiemployer Pension Reform Act of 2014 ("MPRA") provided plans with the statutory authority to seek approval from the U.S. Department of Treasury to suspend accrued benefits, if this is the only course of action that would enable the plan to restore solvency. Based on a review of MPRA applications, the average benefit reduction was 36%.

   However, if the Trustees of plans heading toward insolvency are either statutorily barred from seeking a MPRA benefit suspension, or do not do so, when the plan goes insolvent, it receives financial assistance from PBGC in an amount up to the PBGC maximum guarantee benefit amount as applied to each participant and beneficiary. Participants' and beneficiaries' contractual benefits are reduced to conform to the PBGC maximum guarantee amount, which in the multiemployer program will result in an average reduction of 53% from their contractual

[4] North American Actuarial Journal, Volume 6, Number 1, *"Fair Value of Liabilities: The Financial Economics Perspective"*, David F. Babbel, Jeremy Gold, and Craig B. Merrill, accessed March 21, 2019 at http://citeseerx.ist.psu.edu/viewdoc/download;jsessionid=B3B383BE1B8AD51D94271C0B5FC4D1CB?doi=10.1.1.321.1461&rep=rep1&type=pdf.

benefit, until the PBGC itself becomes insolvent. At PBGC insolvency, the average reduction will be between 94% and 98% of contractual benefits payable.

Therefore, under current law the benefit reductions coming to participants in plans heading toward insolvency range from 36% to 98%, which suggests that the payment risk in multiemployer plans is actually very high, and should not be discounted at the Treasury rate, unless the cash flows of the plan's liabilities are adjusted for risk or a risk premium is added to the risk-free rate that is reflective of the risk in the cash flows. In any environment where there is the potential for at least a 36% loss of benefit, the discount rate that is reflective of this benefit reduction suggests a very high discount rate, which only gets higher at a 53% benefit reduction, and even higher at a 98% benefit reduction. The riskiness of these cash flows is not reflective of Treasury rates or high-grade corporate bond rates, and therefore these are not appropriate to use to discount multiemployer pension liabilities.

5. **Please explain how federal laws, regulations, and policies have impacted the financial condition of multiemployer plans today and whether these impacted single employer plans differently.**

The current crisis is predominantly the product of the unintended consequences of 44 years of federal laws, regulations, rules, policies, the unwillingness of the previous Administration's Treasury Department to implement the Multiemployer Pension Reform Act of 2014 (MPRA) in a statutorily faithful manner, and the most severe market crash since the Great Depression which led to the Great Recession.

The specific federal laws that impacted multiemployer plans include the limitation on the ability of Trustees of severely troubled plans to proactively manage benefits over time to preserve plan solvency presented by the anti-cutback rule under ERISA, the withdrawal liability established as part of the Multiemployer Pension Plan Amendments Act of 1980, the deregulation of the trucking industry through the Motor Carrier Act of 1980, and the excise tax on contributions of fully funded plans as part of the Tax Reform Act of 1986. Technological advances, global offshoring and trade policy are also crucial factors that led to the decimation of formerly vibrant domestic industries. Further, it is also important to consider that since 2008, the monetary policy of the Federal Reserve has crushed both short-term and long-term Treasury rates, which serve as the basis for the pricing of other fixed income investments that are common in pension portfolios. These lower-than-market rates have caused long-term pension liabilities to be overstated and have also reduced investment earnings on plan assets.

The excise tax on contributions of fully funded plans resulted in significantly different outcomes for multiemployer plans and single employer defined benefit plans, which in turn explains much of the current crisis in multiemployer plans as well as the criticism that single employer plans received prior to the PPA '06.

Specifically, when single employer plans became well-funded, particularly due to market gains, the employers often took contribution holidays which in many instances included multiple years. However, in the late 1980's and the 1990's well-funded multiemployer plans did NOT have the luxury of taking contribution holidays. This is because multiemployer plans are collectively bargained, and those bargained contributions are required to be made under federal law. This meant that unlike single employer plans, the principal tool that multiemployer pension Trustees had to ensure that the contributing employers would not be subject to an excise tax was to increase benefits to participants and therefore increase plan liabilities. The "anti-cutback" rule then prevented these increased benefits from being reduced, even in low or negative return years.

Even with these impediments, multiemployer plans have made changes where they could to ensure plan solvency, which has principally been to the detriment of the active workforce through the lowering of future accruals or changes to ancillary benefits authorized under the PPA '06. After the 2008 financial crisis and the resulting Great Recession, the multiemployer community actively sought new tools to fix those plans experiencing financial distress without federal assistance, which resulted in the passage of MPRA. MPRA could have effectively managed the solvency problems facing plans if Treasury had faithfully implemented the law in 2016. MPRA was designed to be, and still could be, a very powerful tool for plan Trustees to restore plan solvency. MPRA also protects participants in critical and declining status plans from the far larger benefit reductions they will see when their plans go insolvent and become subject to the PBGC guarantee, and the even larger benefit reductions they will see when the PBGC itself becomes insolvent.

Further, MPRA provided the U.S. Government with the best dial to ensure that plans do not come to the PBGC in the first place, because every approved MPRA application removes that plan from the list of plans that comprise the PBGC's deficit, thereby improving the finances of the PBGC's multiemployer program. Unfortunately, in May 2016, the Treasury Department did not approve the MPRA application of the largest and most systemically important plan, the Central States Pension Fund, among others, which now means that a new tool is needed to address those plans where MPRA is no longer an option.

The bottom line is that the current state of financially distressed multiemployer pension plans can be directly traced back to the actions and inactions of the U.S. Government.

6. Is it common for pension funds, mutual funds, IRA's, 401K's, private equity funds, insurance companies, and other investment funds to invest in equities and other "risky" assets as part of diversified portfolios?

Yes, these types of investors are typically invested in a diverse portfolio of securities depending on their time horizon and risk appetite. According to the Federal Reserve Board of Governors[5] and as shown in the table below, with the sole exception of the defined benefit pension plan provided to certain employees of the U.S. Government, households, public and private defined benefit pensions, as well as public and private defined contribution plans invest in a wide variety of assets, but particularly equities.

[5] Board of Governors of the Federal Reserve System, Federal Reserve Statistical Release, "*Z.1 Financial Accounts of the United States: Flow of Funds, Balance Sheets, and Integrated Macroeconomic Accounts*", Fourth Quarter 2019, Released March 7, 2019.

Figure 1. Federal Reserve Z.1 Data (Q4 2018)							
($ Trillions)	**Households & Non-Profit Organizations (Excluding Retirement Assets)**	**Private Defined Benefit Pension Plans**	**Private Defined Contribution Pension Plans**	**Federal Government Employee Defined Benefit Plans**	**Federal Government Employee Defined Contribution Plan[6]**	**State & Local Government Employee Defined Benefit Plans**	**State & Local Government Employee Defined Contribution Plans**
Investable Assets	$59.40	$2.85	$5.99	$1.80	$0.57	$3.81	$0.48
Unfunded Liability of Plan Sponsor		$0.55	$0.00	$1.65	$0.00	$4.72	$0.00
Asset Allocation							
Cash & Cash Equivalents	21.67%	2.18%	2.41%	0.07%	0.00%	1.92%	0.79%
Bonds	10.69%	32.43%	6.96%	99.15%	49.18%	26.63%	0.00%
Equities	62.30%	50.42%	74.62%	0.77%	50.82%	66.31%	47.17%
Other Assets	5.33%	14.98%	16.01%	0.00%	0.00%	5.14%	52.04%
	100.00%	100.00%	100.00%	99.99%	100.00%	100.00%	100.00%

Separately, the table below summarizes the data from the Investment Company Institute's 2018 Investment Company Fact Book, which shows that asset diversification for insurance company provided variable annuities, defined contribution plans, and IRA's is both the norm and heavily weighted toward equities.

Figure 2. Investment Company Institute, 2018 Data Book			
($ Trillions)	**Variable Annuity Funds**	**Mutual Funds: Defined Contribution Assets**	**Mutual Funds: IRA Assets**
Investable Assets	$1.83	$4.54	$4.29
Asset Allocation			
Cash & Cash Equivalents	1.8%	2.7%	5.6%
Bonds	25.7%	23.9%	27.3%
Equities	72.6%	73.4%	67.1%
Other Assets	0.0%	0.0%	0.0%
	100.0%	100.0%	100.0%

What is also interesting is that of the $3 trillion in annuity assets in the market, more than $1.8 trillion are in variable annuities which had 72.6% of their 2017 assets invested in equities.

Given the very long-time horizons of most pension funds and the historical investment performance of pension funds and the markets generally, it would be inconsistent with well-developed investment theories and practices in the United States, the intent of many of the securities laws enforced by the U.S. Securities and Exchange Commission, as well as the fiduciary duty of Trustees under ERISA to limit long-duration retirement investments to annuities.

[6] Thrift Savings Plan

In fact, even the U.S. Government's Defined Contribution plan for federal employees, the Thrift Savings Plan, is invested at 51% equities, 49% fixed income, and zero percent annuities.

7. How do asset allocations in multiemployer pension plans compare to 401(k) allocations? How do they compare to allocations in "target date funds"?

As shown in the Federal Reserve's Z.1 data chart in question 6, private sector defined benefit pension plans, which includes multiemployer defined benefit pension plans, invest more conservatively (lower equity allocation) than private sector defined contribution plans, which includes 401(k) accounts. Specifically, defined benefit pension plans have slightly more than 50% of their assets invested in equities, whereas 401(k) accounts invest almost 75% of their assets in equities.

Target date funds, also known as lifecycle funds, diversify across asset classes (equities, fixed income, cash). The specific allocation varies by the fund provider and the years to retirement, but in general will have equity allocations upwards of 90+% at 40-years to retirement then decreasing in increments through retirement, although even at 30-years into retirement the equity asset allocation is above 20% in most funds.

8. What is the actual performance of 401K's as a provider of lifetime retirement income?

Despite the fact that 401(k) accounts been available since 1978 and have supplanted defined benefit pensions as the principal retirement income vehicle for U.S. workers, the simple fact is that they have not enabled workers to retire with enough assets and income to maintain their lifestyle. In 2016, 55 million U.S. workers were active 401(k) participants with assets of $4.76 trillion[7]. The EBRI/ICI Participant-Directed Retirement Plan Data Collection Project showed that the average account balance in 2016 was $75,358, while the median account balance was $16,836[8]. Neither amount represents enough assets to provide meaningful lifetime income.

These numbers logically confirm the substantive details of the "Report on the Economic Well-Being of U.S. Households in 2017" by the Board of Governors of the Federal Reserve. This report noted that (1) less than 40% of non-retired adults think that their retirement savings are on track[9], (2) 25% of non-retired adults have no retirement savings or pension whatsoever[10], and (3) 40% of adults would either borrow, sell something, or not be able to pay if faced with a $400 emergency expense[11].

As telling, the report indicated that among non-retirees in their 50's and 60's, 12.5% do not have any retirement savings and less than 50% think that their retirement savings are on track[12].

[7] Investment Company Institute, ICI Research Perspective, September 2018, Vol. 24, No. 6, page 2, *"401(k) Plan Asset Allocation, Account Balances, and Loan Activity in 2016"*, https://www.ici.org/pdf/per24-06.pdf.
[8] Ibid, 5.
[9] Board of Governors of the Federal Reserve System, *Report on the Economic Well-Being of U.S. Households in 2017*, May 2018, page 3, https://www.federalreserve.gov/publications/files/2017-report-economic-well-being-us-households-201805.pdf.
[10] Ibid.
[11] Ibid, 21.
[12] Ibid, 47.

Finally, 60% "of non-retirees with self-directed retirement savings accounts, such as a 401(k) or IRA, have *little or no comfort* [emphasis added] in managing their investments.[13]" This last observation supports the importance of professional management of retirement assets, which is what occurs in multiemployer defined benefit plans.

9. Would a variable rate PBGC premium be appropriate for multiemployer pension plans?

No. Variable rate PBGC premiums are not appropriate for multiemployer pension plans. Some have argued that variable premiums in the single employer system have resulted in higher funding levels in plans and a significantly improved funded position of the PBGC's single employer fund. It is certainly true that many single employer funds determine contribution levels to avoid variable premiums. However we argue, as we have elsewhere in these remarks, that much of the apparent improvement in single employer funding is due to the excise tax on well-funded plans causing different decisions in multiemployer pensions as well as the termination of the majority of single employer plans.

A variable premium would have a far different effect for multiemployer plans. Unlike single employer plans where the plan is considered part of the employer's legal entity, multiemployer plans are separate legal entities from their contributing employers. In single employer plans, employers are incentivized to make additional contributions when the plan would otherwise be subject to a variable premium. Because the plan and the employer are the same legal entity, the effect of the premium would be a loss of assets reported on the employer's financial statements. In multiemployer plans, the effect of a variable premium would be far less direct, because the plan is a separate entity from the contributing employers.

This is not to say that employers participating in multiemployer plans will not feel the impact of variable premiums, but rather that there is not the direct incentive to improve plan funding seen in single employer plans. Because multiemployer contributions are set through collective bargaining, the variable premium or some portion of the variable premium may be incorporated into the bargained contribution rates. The extent to which the cost of the new premium is added to contributions will vary by plan and will depend on the strength of the bargaining relationships. If new funds are not available, the funding will be diverted from the wages of active workers, who have already seen their accrual rates drop significantly over the past 15 years in order to pay for plan underfunding. If additional funds are not available to be allocated to fund the plan and avoid the premium, the remaining premium will be paid out of the assets of the plans that are least able to afford it.

10. Dr. Naughton recommends that multiemployer plans should purchase annuity contracts for their participants to provide retirement benefits. Please discuss this concept and its implications, where it has been adopted and successful, and the support that this idea has in the financial markets and among investment professionals.

Dr. Naughton position that defined benefit pension plans should be solely invested in fixed annuity contracts is an extreme outlier among financial market participants, professional

[13] Ibid, 3.

investment managers, government regulators, and virtually anyone who is even passingly familiar with investments.

Today, the entire market for annuities is $3 trillion, which includes $2.1 trillion in variable annuities, $454 billion in fixed annuities, and $409 billion in indexed annuities. The market for fixed annuities (group or individual) is not deep or liquid, and the product is burdened with very high expenses and pricing that heavily favors the insurer.

Variable and indexed annuities, which comprise nearly 85% of the annuity market, can result in the loss of money because they are investing in equities and fixed income products or indexes based on equities and fixed income. The underlying annuities themselves are considered illiquid investments.

The laws, regulations, funding rules, accounting rules, and PBGC premiums required primarily by the Omnibus Budget Reconciliation Act of 1987 and PPA '06 have had a significant negative impact on the economic viability of single-employer defined benefit pension plans for employers. They have clearly incented employers to terminate their defined benefit plans, discouraged employers from offering a defined benefit pension, and led to the weakening of retirement security for working Americans.

In fact, while the funded level of the few single-employer plans remaining today is strong, the number of plans and the amount of retirement security they afford their participants has fallen precipitously. The PBGC data shows that since the passage of ERISA, 87%[14] of single employer defined benefit plans no longer exist, either through standard terminations or distressed trusteed terminations. Additionally, 8,285 plans have accrual or participation freezes, leaving just 14,048 open insured single-employer plans.

The changes driving the termination of single employer defined benefit pension plans has opened the door to group fixed annuity transactions, although those that have taken place in the single employer market are often driven by economic, regulatory, and market factors that are unique to the company and its shareholders, which are principally focused on reducing balance sheet liabilities and income statement volatility. In short, employers have been willing to pay whatever it costs to terminate their defined benefit pension plan, but that decision has little to do with the actual economics of the underlying transaction itself.

As has been documented in the response to question 6, the professional and individual investors that manage the more than more than $80 trillion of investable assets from households, defined benefit plans, defined contribution plans, or other retirement assets, have allocated their investments to a diversified portfolio of market assets. Fixed annuities are not an asset class that most investors desire, particularly given their very low returns, high cost, illiquidity, small market size, and capacity. Further, U.S. workers already have a significant exposure to a

[14] Calculation = (140,935 standard terminations plus 4,769 trusteed terminations, plus 22,333 current plans at paying PBGC premiums)/22,333. See Pension Benefit Guaranty Corporation, Standard Terminations 1975-2016, Table S-3, https://www.pbgc.gov/sites/default/files/2016_pension_data_tables_-_release_1.pdf

significantly higher quality fixed annuity through Social Security, which is the foundational retirement asset for all U.S. workers.

Given the very long-time horizons of most pension funds and the historical investment performance of pension funds and the markets generally, it would be inconsistent with well-developed investment theories and practices in the United States, the intent of many of the securities laws enforced by the U.S. Securities and Exchange Commission, as well as the fiduciary duty of Trustees under ERISA to limit long-duration retirement investments to fixed annuities.

One aspect of the "Report on the Economic Well-Being of U.S. Households in 2017" by the Board of Governors of the Federal Reserve was financial literacy test in which only 20% of respondents got all five questions correct. One particular question asked by the Federal Reserve was "Considering a long time period (for example, 10 or 20 years), which asset described below normally gives the highest returns? [Stocks, Bonds, Savings accounts, Precious metals]."[15] According to the data of the Federal Reserve, the correct answer is stocks.

The actual asset allocation decisions of investors as supported by the Federal Reserve's Z.1 data shown in response to question 6, suggests that market participants understand the role of equities (stocks) in a diversified portfolio, and select the appropriate asset allocation for their individual circumstances and risk tolerances.

While converting multiemployer defined benefits pensions into fixed annuities is absurd, if this was required by the U.S. Government, the benefits payable under the fixed annuity contracts would need to be reduced upwards of 50% to 60% from their current contractual levels.

11. Is the market for group annuities deep and liquid? What are the principal reasons for defined benefit pensions to annuitize their obligations?

Today, the entire market for annuities is $3 trillion, which includes $2.1 trillion in variable annuities, $454 billion in fixed annuities, $409 billion in indexed annuities. The market for fixed annuities (group or individual) is not deep or liquid, and the product is burdened with very high expenses and pricing that heavily favors the insurer.

Variable and indexed annuities, which comprise nearly 85% of the annuity market, can result in the loss of money because they are investing in equities and fixed income products or indexes based on equities and fixed income. The underlying annuities themselves are considered illiquid investments.

As has been documented in the response to question 6, the professional and individual investors that manage the more than more than $80 trillion of investable assets from households, defined benefit plans, defined contribution plans, or other retirement assets, have allocated their

[15] Board of Governors of the Federal Reserve System, *Report on the Economic Well-Being of U.S. Households in 2017*, May 2018, page 50, https://www.federalreserve.gov/publications/files/2017-report-economic-well-being-us-households-201805.pdf.

investments to a diversified portfolio of market assets. Fixed annuities are not an asset class that most investors desire, particularly given their very low returns, high cost, illiquidity, small market size, and capacity. Further, U.S. workers already have a significant exposure to a significantly higher quality fixed annuity through Social Security, which is the foundational retirement asset for all U.S. workers.

The laws, regulations, funding rules, accounting rules, and PBGC premiums required primarily by the Omnibus Budget Reconciliation Act of 1987 and PPA '06 have had a significant negative impact on the economic viability of single-employer defined benefit pension plans for employers. They have clearly incented employers to terminate their defined benefit plans, discouraged employers from offering a defined benefit pension, and led to the weakening of retirement security for working Americans.

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12. Are the insurance companies that sell annuities risk-free?

No, insurance companies are not risk-free. While most insurance companies enjoy investment grade ratings, and certain annuities have support from state regulators, variable and indexed annuities which comprise nearly 85% of the annuity market can result in losses. Further, even the highest rated insurance companies are not immune from downgrades or adverse markets that impair or impede their ability to honor their commitments. These include the previously "AAA" rated entities of American International Group, Executive Life Insurance Company, and Mutual Benefit Life Insurance Company

[16] Calculation = (140,935 standard terminations plus 4,769 trusteed terminations, plus 22,333 current plans at paying PBGC premiums)/22,333. See Pension Benefit Guaranty Corporation, Standard Terminations 1975-2016, Table S-3, https://www.pbgc.gov/sites/default/files/2016_pension_data_tables_-_release_1.pdf

13. **How are the level of contributions to multiemployer plans determined? Is it typical for bargaining parties in contribute only the minimum required contribution?**

Contributions to multiemployer plans are set as part of the collective bargaining process between the contributing employers and the unions representing the employees. The bargaining process is informed by recommended or required contributions as set by the Board of Trustees of the pension fund. The contributions recommended or required by the Board are informed by actuarial analysis performed by the plan's actuaries.

The level of contributions required by the Board of Trustees is determined based a number of factors, including the minimum required contribution, Trustees' formal or informal funding policies, requirements of Rehabilitation or Funding improvement plans, and Trustees' desire to remain in the Green Zone or out of a lower Zone. The minimum required contribution rarely controls in this determination, and many Trustees have strong funding policies requiring contributions well above that level.

If the bargaining process results in lower contributions than are required, for example by the operation of a Rehabilitation or Funding improvement plan or the minimum required contribution, the Trustees pursue payment of the required contributions or terminate the employer triggering withdrawal liability. Alternatively, if the recommendation was a result of a funding policy, Trustees sometimes adjust the plan to be supported by the bargained contributions.

Once contributions are set during collective bargaining, and the agreement is accepted by the fund, plans vigorously pursue any contributions that are delinquent.

14. **Dr. Blahous testified that "Ergo, a payment that is fully guaranteed and risk-free should be discounted at a Treasury bond rate" and that "economists broadly agree that payment obligations should be discounted according to their risk of non-payment". What are the logical implications of his testimony for multiemployer pension liabilities?**

Dr. Blahous first statement seems to suggest that multiemployer pension payments are "fully guaranteed and risk-free" and therefore should be discounted at a Treasury bond rate. It is only by discounting multiemployer pension liabilities at a Treasury bond rate that he can say that "there is more than $600 billion of underfunding in multiemployer pensions nationwide[17]" and that the "crisis arises from multiemployer plan sponsors' funding contributions being far inadequate to finance the benefits they have promised.[18]" Dr. Blahous's error in understanding the actual legal characteristics of multiemployer defined benefit leads him to place the blame for the crisis on the discount rates used to discount the liabilities and inform employer contribution requirements.

[17] Statement of Charles P. Blahous, Before the Subcommittee on Health, Employment, Labor and Pensions of the U.S. House of Representatives Committee on Education and Labor, March 7, 2019, page 3.
[18] Ibid, 1.

Unfortunately, Dr. Blahous either wittingly or unwittingly omits the material fact that multiemployer pension payments are not fully guaranteed by the PBGC, the U.S. Government, or the plan sponsors. How do we know this?

This is evidenced by the fact that the PBGC is not a full faith and credit obligation of the U.S. Government, with the statutory terms of ERISA explicitly rejecting any such liability.[19] Also supporting this fact is that the U.S. Government disavows any obligation for the PBGC by denying plaintiffs against the PBGC access to the Judgment Fund.[20] Finally, when the PBGC's multiemployer fund is exhausted, the PBGC can only pay out what it takes in from premium income. This reduces the current PBGC guarantee to a level that is supported solely by premium income.

The very terms of the PBGC's multiemployer guarantee establishes a maximum limit of $12,870 annually (at 30-years of service). This means that when a plan goes insolvent, it will receive financial assistance from PBGC in an amount up to the PBGC maximum guarantee benefit amount as applied to each participant and beneficiary. Today, the participants' and beneficiaries' contractual benefits are reduced to conform to the PBGC maximum guarantee amount, which in the multiemployer program will result in an average benefit reduction of 53% from their contractual benefit. When the PBGC itself becomes insolvent, the average benefit reduction will be between 94% and 98% of contractual benefits payable. The simple legal fact is clear, multiemployer pension benefits are not "fully guaranteed and risk-free", nor do they look like the expected payouts of high-grade corporate bonds.

Dr. Blahous goes on to say that "economists broadly agree that payment obligations should be discounted according to their risk of non-payment." As we have established above, the risk of non-payment is actually very high in multiemployer pensions. This makes his recommendation that pension liabilities should be discounted "at rates no greater than those reflected in a yield curve of high-quality corporate bonds[21]" at odds with his belief that payment obligations should be discounted according to their risk of non-payment.

In trying to square his view of the success of the single employer system, and the recommended use of high-quality corporate bonds to discount liabilities and drive funding changes, it is actually instructive to look at the PBGC's single employer program.

For instance, the PBGC's single-employer program provides a guaranty of $67,295 at age 65, regardless of the participant's years of service. This effectively guarantee's 95.5% of the contractual benefits of a retiree in a trusteed plan and we have no reason to doubt the PBGC's ability to continue to do so. The principal reason that the effective guarantee of the single-

[19] 29 U.S.C §1302(g)(2).

[20] 31 U.S.C §1304. *See* Congressional Research Service, The Judgment Fund: History, Administration, and Common Usage, R42835, March 7, 2013, https://fas.org/sgp/crs/misc/R42835.pdf, See also The Availability of the Judgment Fund for the Payment of Judgments or Settlements in Suits Brought Against the Commodity Credit Corp. Under the Fed. Tort Claims Act, 13 Op. Off. Legal Counsel 362 (1989), https://www.justice.gov/file/24371/download.

[21] Statement of Charles P. Blahous, Before the Subcommittee on Health, Employment, Labor and Pensions of the U.S. House of Representatives Committee on Education and Labor, March 7, 2019, page 9.

employer program is not closer to 100% is the spate of the airline bankruptcies between 2001 and 2011. A 95.5% guarantee is the rough equivalent of a BBB- bond, so while there is a significant difference between the "A", "AA", and "AAA" rated corporate bonds that are used to discount single-employer liabilities, it is at least tangentially tethered to a basis considering the actual riskiness of the cash flows.

As has been discussed above as well as in the response to question 4, the risk of non-payment is dramatically different in multiemployer pension plans than in single employer pension plans, which demonstrates that Dr. Balhous's discounting regime is not only inappropriate but also inconsistent with his stated rationale.

Dr. Blahous has had opportunities to implement his theory as a Public Trustee for the Social Security Trust Fund. Social Security benefits are actually full faith and credit obligations of the U.S. Government, yet during Dr. Blahous's tenure as a Public Trustee he supported discounting the liabilities of Social Security at 5.7% or 5.6%, which was between 1.36% and 2.85% higher than the 30-year Treasury rate in each of his years of service as a Public Trustee. Obviously if Social Security had used the risk-free Treasury rate to discount its liabilities, the reported liabilities would have been trillions of dollars higher over both the 75-year and infinite horizons.

Dr. Blahous's focus on the discount rate ignores the actual reasons for this crisis, which was discussed in the response to question 5. In summary, it is the product of the unintended consequences of 44 years of federal laws, regulations, rules, and policies which impacted multiemployer plans very differently than single employer plans. Additionally, the unwillingness of the previous Administration's Treasury Department to implement MPRA in a statutorily faithful manner limited the ability of plans like the Central States Pension Fund to restore plan solvency, protect their retirees from the even higher benefit reductions that they will see when their plan is insolvent and subject to the PGBC guarantee, and protect the PBGC from insolvent plans.

Dr. Blahous's assertion that the defined contribution system is performing comparatively better than the multiemployer pension system and represents a solution to the multiemployer crisis is inconsistent with the facts discussed in our response to question 10.