What Congress Could Do To Stop a Pension Crisis

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A looming retirement crisis is facing the U.S. taxpayer that will become an economic tsunami if Congress doesn't act. The pensions of 1.3 million workers in certain multiemployer pension plans and the federal government's Pension Benefit Guaranty Corporation (PBGC) are set to collapse. Only Congress can prevent this from cascading throughout the economy, to taxpayers and into healthy pension plans and their employers.

How things spiraled into this crisis is complicated, but important to understand. Some say it's a multiemployer problem, but it's more than that, and the U.S. taxpayer is ultimately on the hook. The broad reasons for this crisis and the consequences of failure came about not because of financial mismanagement or irresponsible actions of the management and labor trustees of these plans, but because of government actions and inaction.

The government's list of self-inflicted errors is as diverse as it is long. It ranges from ill-conceived provisions within ERISA (the Employee Retirement Income Security Act of 1974) and the tax code. Also involved is trucking deregulation, trade and other policies that decimated domestic industries, the failure to regulate financial derivatives and housing policies that led to the financial market crisis and the Great Recession, and the monetary policy of the Federal Reserve, which artificially crushed short and long term Treasury rates.

ERISA's "anti-cutback rule" prevented trustees in severely troubled plans from proactively managing benefits to ensure plan solvency. This rule never protected retirees; it simply meant that when plans go insolvent the participants will face even more severe benefit reductions.

The government's excise tax on well-funded plans impacted single and multiemployer plans differently. Only single employer plans could take contribution holidays during outperforming markets, whereas multiemployer Trustees were incentivized to increase benefits, which could not be reversed during underperforming markets.

The Multiemployer Pension Reform Act ("MPRA") provided a self-help tool to save plans from insolvency. It allowed plans to suspend benefits to protect retirees from the far larger benefit reductions that would happen if their plan became insolvent. But then, in 2016, the U.S. Treasury Department denied the largest and most systemically important plan, the Central States Pension Fund, from using this self-help.

Some have asserted that the rate used to discount pension liabilities is the central cause of the crisis. At the House Ways & Means Committee on July 10, it was proclaimed that multiemployer pensions are underfunded by $638 billion. This is nonsensical as it requires discounting liabilities at a Treasury rate, which has no credible basis in financial theory or practice.

Discounting is meant to measure the risk in a liability. A full faith and credit obligation of the U.S. Government, such as a Treasury security or Social Security, should be discounted at the relevant Treasury rate. Ironically, Social Security discounts their liabilities at almost 2.5% higher than the 30-year Treasury rate. Using the Treasury rate, the reported present value of Social Security's unfunded obligations would increase from $13.9 trillion to $23.6 trillion (75-year horizon).

But multiemployer pensions are clearly not risk-free. Under MPRA, the average benefit loss was over 34%. When a plan is insolvent and subject to the PBGC guarantee, the average benefit loss is 53%, and when the PBGC is insolvent, the benefit loss would be approximately 98%.

None of these reductions reflect the risk inherent in a Treasury or a high-grade corporate bond, and therefore are clearly inappropriate to measure multiemployer liabilities.

The frequently referenced success of the single employer system is a myth. Suggestions that the discount rate required of these plans contributed to their better funding ignores that 87% of these plans no longer exist, and of the remaining, 37% are frozen or closed to new participants. These discount rates contributed to their extinction and the massive rise of 401(k)'s, which have a terrible record of providing lifetime income.

Given the long-term investment horizon of pensions, the use of the expected rate of return for a specific asset allocation is sound both mathematically and as policy, and is supported by the historical returns track record.

Some have suggested that multiemployer plans are over-weighted in equities. The Federal Reserve's data shows that the highest equity allocations belong to 401(k)'s (75%), state/local government pensions (66%), and non-retirement household assets (62%). Private sector pensions average 50%. ERISA requires fiduciaries to invest in a diversified portfolio, which given the universe of investable assets, suggests that multiemployer Trustees are complying with ERISA.

Others have demanded that all stakeholders in the system participate in any legislative solution. Employers and active workers have participated through massive reductions in their future benefits while their contribution rates have skyrocketed.

The multiemployer system is critical to the job creating employers of America, to their union partners, to the participants in these plans, to the government, as well as to the economy.

In 2015 alone, the multiemployer system paid $158 billion in federal taxes and $82 billion in state and local taxes, supported 13.6 million American jobs, and contributed more than $1 trillion to U.S. GDP. This includes $41 billion in pension payments to retirees and $203 billion in wages to active workers.

The government is clearly a significant stakeholder through its $158 billion annual "dividend" and its multiple poverty safety net programs. The government's minimum exposure for lost tax revenue and new safety net spending is more than $170 billion (10-years) and $330 billion (30-years). In a 2012 report, then-ranking member Sen. Orrin Hatch predicated these types of impacts from reductions in municipal pensions, which would never see the 98% reductions coming to multiemployer pensions.

We all want to solve the crisis for retirees in troubled plans and strengthen the system for all stakeholders. ALL of us have a stake in saving the last credible source of retirement security for America's workers. It's up to us to work together to quickly solve this complex crisis before it becomes an economic disaster.

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