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PRIVATE PENSIONS

Multiemployer Pensions Face Key Challenges to Their Long-Term Prospects

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Education, Workforce, and Income Security Issues

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Highlights

Highlights of GAO-04-542T, a report to House Subcommittee on Employer-Employee Relations, Committee on Education and the Workforce, House of Representatives

Why GAO Did This Study

Multiemployer defined benefit pension plans, which are created by collective bargaining agreements covering more than one employer and generally operated under the joint trusteeship of labor and management, provide coverage to over 9.7 million of the 44 million participants insured by the Pension Benefit Guaranty Corporation (PBGC). The recent termination of several large single-employer plans—plans sponsored by individual firms—has led to millions of dollars in benefit losses for thousands of workers and left PBGC, their public insurer, an $11.2 billion deficit as of September 30, 2003. The serious difficulties experienced by these single-employer plans have prompted questions about the health of multiemployer plans.

This testimony provides information on differences between single employer and multiemployer pension plans, recent trends in the funding of multiemployer pension plans and worker participation in those plans, and factors that may pose challenges to the future prospects of multiemployer plans. GAO will soon release a separate report on multiemployer pension issues.

www.gao.gov/cgi-bin/getrpt?GAO-04-542T.

To view the full product, including the scope and methodology, click on the link above. For more information, contact Barbara Bovbjerg at (202)512-7215 or bovgjergb@gao.gov.

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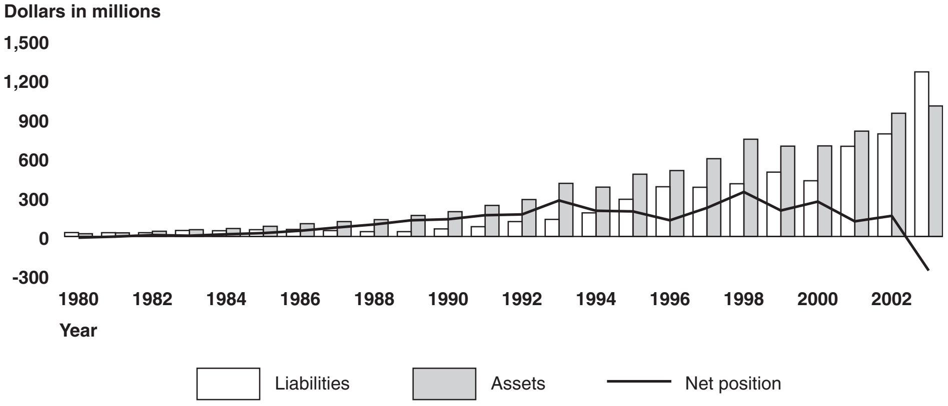
What GAO Found

The framework governing multiemployer plans generally places greater financial risk on employers and participants and less on PBGC than does PBGC's single-employer program. For example, in the event of employer bankruptcy, the remaining employers in the multiemployer plan assume additional funding responsibility. Further, PBGC's guaranteed participant benefit is much lower for multiemployer participants, and PBGC does not provide financial assistance until the multiemployer plan is insolvent.

Following two decades of relative financial stability, many multiemployer plans appear to have suffered recent funding losses, while long-term declines in participation and plan formation continue. At the close of the 1990s, the majority of multiemployer plans reported assets exceeding 90 percent of total liabilities. Since then, stock market declines, coupled with low interest rates and poor economic conditions, have reduced assets and increased liabilities for many plans. In its 2003 annual report, PBGC estimated that underfunded multiemployer plans now face an aggregate unfunded liability of $100 billion, up from $21 billion in 2000. PBGC also reported an accumulated net deficit of $261 million for its multiemployer program in 2003, the first since 1981. Meanwhile, since 1980, there has been a steady decline in the number of plans, from over 2,200 plans to fewer than 1,700, and a 1.4 million decline in the number of active workers in plans.

The long-term prospects of the multiemployer system face a number of challenges. Some are inherent in the multiemployer design and regulatory framework, such as the greater perceived financial risk and reduced flexibility for employers, compared with other plan types. The long-term decline of collective bargaining also results in fewer participants and employers available to expand or create new plans. Other factors that pose challenges include the growing trend among employers to choose defined contribution plans; the increasing life expectancy of workers, which raises the cost of defined benefit plans; and continuing increases in employer health insurance costs, which compete with pensions for employer funding.

PBGC Multiemployer Program Assets, Liabilities, and Net Position, 1980 – 2003



Source: GAO analysis of PBGC data

Mr. Chairman and Members of the Committee:

I am pleased to be here today to discuss the health of the multiemployer pension system and the challenges it faces. Multiemployer plans are plans created by collective bargaining agreements covering more than one employer. They are generally operated under the joint trusteeship of labor and management and constitute an important segment of the nation's private employer pension system. These defined benefit (DB)[1] pension plans cover over 9.7 million participants, representing about 22 percent of all workers and retirees insured by Pension Benefit Guaranty Corporation (PBGC).[2]

The recent collapse and termination of several large single-employer plans—where individual employers are responsible for funding and administering the plan—have resulted in millions of dollars in benefit losses for thousands of workers and left PBGC, their public insurer, an $11.2 billion deficit as of September 30, 2003.[3] The serious difficulties

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[1] Defined benefit (DB) plans promise a benefit that is generally based on years of service and employee's salary for single-employer plans or a flat dollar amount for multiemployer plans. In a single-employer DB plan the employer is generally responsible for funding the benefit, investing and managing plan assets, and bearing the investment risk. For a multiemployer plan the employer generally makes contributions based on the collective bargaining agreement and plan trustees are responsible for investment decisions. In contrast, under a defined contribution plan, benefits are based on the contributions to and investment returns on individual accounts, and the employee bears the investment risk. An example of a defined contribution plan is a 401 (k) plan, which operates as a salary reduction arrangement under section 401(k) of the Internal Revenue Code. The United States employer-sponsored pension system has historically been an important component of total retirement income, providing roughly 18 percent of aggregate retirement income in 2000. However, the percentage of the workforce with pension coverage has been near 50 percent since the1970s.

[2] Since its enactment in 1974, multiemployer defined benefit pensions have been regulated by the Employee Retirement Income Security Act (ERISA), which Congress passed to protect the interests of participants and beneficiaries covered by private sector employee benefit plans. Title IV of ERISA created PBGC as a United States Government corporation to insure the pensions of participants and beneficiaries in private sector-defined benefit plans.

[3] Because of its accumulated deficit, the significant risk that other large underfunded plans might terminate and other structural factors, we designated PBGC's single-employer pension insurance program as a high-risk program and added it to the list of agencies and major programs that we believe need urgent attention. See U.S. General Accounting Office, *Pension Benefit Guaranty Corporation Single-Employer Program: Long-Term Vulnerabilities Warrant Program's Assignment to GAO High Risk Designation*, GAO-03-1050SP, (Washington, D.C.: July 23, 2003). Congress is currently considering legislation that would provide funding relief to certain multiemployer pension funds.

experienced by these single-employer plans have prompted questions about the health of the nation's multiemployer defined benefit plans.

The financial strength of the multiemployer system has crucial consequences, not only for the both the employers and the millions of workers and retirees participating in multiemployer pension plans, but for the elements and structure of current national pension policy. We will soon release a report addressing multiemployer issues that we undertook at the joint request of the Committee on Education and Workforce and this subcommittee. In seeking to clarify some of these issues today, my testimony will focus on (1) how multiemployer defined benefit plans differ from single-employer defined benefit plans, (2) recent and current trends in funding and worker participation in these plans; and (3) potential challenges to their long-term prospects.

To determine the trends in the funded status of multiemployer defined benefit plans, we analyzed Form 5500 disclosure statements and PBGC data. The Form 5500, which plans must file with the Department of Labor, is the only comprehensive source of financial and other plan information on private pension plans collected on a regular basis.[4] Form 5500 provides important pension information, such as the number of plan participants and data on the financial condition of plans. However, the most complete Form 5500 data is from 2001, making it difficult to accurately discern recent trends. Although some data obtained from PBGC may be more recent, much of it is based on the Form 5500. This lack of comprehensive data makes it difficult to depict recent developments, particularly with regard to plan funding. To identify the major challenges to the future prospects of multiemployer plans, we reviewed pension literature and interviewed representatives in government, industry, and labor involved with such plans. We conducted our work from April 2003 through January 2004 in accordance with generally accepted government auditing standards.

In summary, after two decades of financial stability, many multiemployer plans appear to have suffered recent and significant funding losses; meanwhile, long-term declines continue in terms of new plan formation and worker participation. At the close of the 1990s, the majority of

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[4] U.S. General Accounting Office, *Pension and Welfare Benefit Administration: Opportunities Exist for Improving Management of the Enforcement Program*, GAO-02-232 (Washington, D.C.: Mar. 3, 2002).

multiemployer plans had reported assets exceeding 90 percent of total liabilities, with average funding rising to 105 percent in 2000. However, subsequent stock market declines, coupled with low interest rates and poor economic conditions, have likely reduced the assets and increased liabilities for many multiemployer plans. Comprehensive funding data are not available to depict recent developments, but significant signs of funding weakness exist. In its 2003 annual report, PBGC estimated that underfunded multiemployer plans now face an aggregate unfunded liability of $100 billion, up from $21 billion in 2000. While most multiemployer plans continue to provide benefits to retirees at unreduced levels, the agency has increased its forecast of the number of plans that will likely need financial assistance from 56 plans in 2001 to 62 in 2003. PBGC also reported that its multiemployer program had an accumulated net deficit of $261 million at the end of 2003, the program's first deficit since 1981. Meanwhile, multiemployer plans have continued their steady long-term decline in numbers and worker participation. The number of plans has dropped by a quarter since 1980 to fewer than 1,700, and only 5 new plans have been formed since 1992. The number of workers covered by multiemployer plans has also fallen by 1.4 million since 1980, with the percentage of the private sector labor force covered by multiemployer plans declining from 7.7 percent in 1980 to 4.1 percent in 2001.

A number of factors pose challenges to the multiemployer plan system over the long term. Some are inherent to multiemployer plan design and regulatory framework, which employers may perceive as financially riskier and less flexible than other types of pension plans. For example, compared with those sponsoring single-employer plans, an employer participating in a multiemployer plan cannot as easily adjust plan contributions in response to the firm's own financial circumstances. This is because contribution rates are often fixed for periods of time by the provisions of the collective bargaining agreement. Also, multiemployer sponsors may face the risk of additional costs if one or more sponsors are unable to fund their share of the plan's vested benefits. The long-term decline of collective bargaining is another factor adversely affecting multiemployer plan growth, in that fewer employers and workers are available to provide opportunities for new plans to be created or existing ones to expand. As of 2003, union membership, a proxy for collective bargaining coverage, accounted for less than 9 percent of the private sector labor force and has been steadily declining since 1953. Finally, experts have identified other factors challenging the future prospects for defined benefit plans generally, including multiemployer plans. These factors include the growing trend among employers to choose defined contribution (DC) plans; the increasing life expectancy of American workers, which will increase plan costs; and continuing increases in health insurance costs, which will affect overall compensation costs, including pensions, for employers.

Multiemployer Plans Differ from Single-Employer Plans

It would be useful at this point to describe several differences between multiemployer and single-employer plans. Multiemployer plans are established pursuant to collectively bargained agreements negotiated between labor unions representing employees and two or more employers and are generally jointly administered by trustees from both labor and management.[5] Single-employer plans are administered by one employer and may or may not be collectively bargained. Multiemployer plans typically cover groups of workers in such industries as construction, retail food sales, and trucking, with construction representing 38 percent of all participants. In contrast, 47 percent of single-employer plan participants are in manufacturing. Multiemployer plans provide participants limited benefit portability in that they allow workers the continued accrual of defined benefit pension rights when they change jobs, if their new employer is also a sponsor of the same plan. This arrangement can be particularly advantageous in industries like construction, where job change within a single occupation is frequent over the course of a career. Single-employer plans are established and maintained by only one employer and do not normally offer benefit portability. Multiemployer plans also differ from so called multiple-employer plans that are not generally established through collective bargaining agreements and where many plans maintain separate accounts for each employer.[6] The Teachers

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[5] The National Labor Relations Act (NLRA) provides the basic framework governing private sector labor-management relations. NLRA provides employees the right to form unions and bargain collectively and requires employers to recognize employee unions that demonstrate support from a majority of employees and to bargain in good faith. NLRA also specifies the structure, rights, and responsibilities for union and employer trustees of multiemployer pension plans. Since its enactment in 1935, collective bargaining has been the primary means by which workers can negotiate, through unions, the terms of their pension plan. The Taft Hartley Act amended NLRA to establish terms for negotiating such employee benefits and placed certain restrictions on the operation of any plan resulting from those negotiations. For example, employer contributions cannot be made to a union or its representative but must be made to a trust that is jointly and equally administered by union and employer representatives. Taft Hartley also established a formal set of conditions under which these plans must be operated and provided a legal framework for their management. See 29 U.S.C. 186(c)(5).

[6] Multiemployer plans as used throughout this testimony refer to defined benefit pension plans. Note that there are other, sometimes separate, multiemployer agreements that cover programs such as health and other welfare benefits and defined contribution pension plans.

Insurance Annuity Association and College Retirement Equities fund (TIAA-CREF) is an example of a large multiple-employer plan organized around the education and research professions. TIAA-CREF offers a defined benefit contribution plan, in which contributions are accumulated over a career and paid out at retirement, often as an annuity.

Below are some features that illustrate some key differences between single-employer and multiemployer plans:

- *Contributions*· In general, the same ERISA funding rules apply to both single- and multiemployer defined benefit pension plans. While ERISA and IRC minimum funding standards permit plan sponsors some flexibility in the timing of pension contributions, individual employers in multiemployer plans cannot as easily adjust their plan contributions. For multiemployer plans, contribution levels are usually negotiated through the collective bargaining process and are fixed for the term of the collective bargaining agreement, typically 2 to 3 years. Employer contributions to many multiemployer plans are typically made on a set dollar amount per hour of covered work, and thus to the number of active plan participants. With other things being equal, the reduced employment of active participants will result in lower contributions and reduced plan funding.[7]

- *Withdrawal liability*· Congress enacted the Multiemployer Pension Plan Amendments Act (MPPAA) of 1980 to protect the pensions of participants in multiemployer plans by establishing a separate PBGC multiemployer plan insurance program and by requiring any employer wanting to withdraw from a multiemployer plan to be liable for its share of the plan's unfunded liability.[8] The law contains a formula for determining the amount an employer withdrawing from a multiemployer plan is required to contribute, known as "withdrawal liability." This amount is based upon a proportional share of the plans' unfunded vested benefits.[9] Furthermore, if a participating employer becomes bankrupt, MPPAA requires that the

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[7] Benefit levels are generally also fixed by the contract or by the plan trustee, based on the agreed level of contributions.

[8] Congress is currently considering a proposal that would revise the current requirements concerning withdrawal liability, shifting some of those liabilities to PBGC.

[9] Vested benefits are benefits that are no longer subject to risk of forfeiture. Unfunded vested benefits are the excess, if any, of the present value of a plan's vested benefits over the value of plan assets, determined in accordance with ERISA, including claims of the plan for unpaid initial withdrawal liability and redetermination liability.

remaining employers in the plan assume the additional funding responsibility for the benefits of the bankrupt employer's plan participants. For single-employer plans, the sponsoring employer is liable only for the unfunded portion of its own plan or its current liability in a bankruptcy (distress termination).

- *Different premiums and benefit guarantee levels·* PBGC operates two distinct insurance programs, one for multiemployer plans and one for single-employer plans, which have separate insurance funds, different benefit guarantee rules, and different insurance coverage rules. The two insurance programs and PBGC's operations are financed through premiums paid annually by plan sponsors, investment returns on PBGC assets, assets acquired from terminated single employer plans, and recoveries from employers responsible for underfunded terminated single employer plans. Premium revenue totaled about $973 million in 2003, of which $948 million was paid into the single-employer program and $25 million paid to the multiemployer program. Single-employer plans pay PBGC an annual flat-rate premium of $19 per participant per year for pension insurance coverage. Plans that are underfunded generally also have to pay PBGC an additional annual variable rate premium of $9 per $1,000 of underfunding for the additional exposure they create for the insurance program. In contrast, the only premium for multiemployer plans is a flat $2.60 per participant per year. PBGC guarantees benefits for multiemployer pensioners at a much lower dollar amount than for single-employer pensioners: about $13,000 for 30 years of service for the former compared with about $44,000 annually per retiree at age 65 for the latter.[10]

- *Financial assistance and the insurable event·* PBGC's "insurable event" for its multiemployer program is plan insolvency. A multiemployer plan is insolvent when its available resources are not sufficient to pay the level of benefits at PBGC's multiemployer guaranteed level for 1 year. In contrast, the insurable event for the single-employer program is generally the termination of the plan. In addition, unlike its role in the single-employer program where PBGC trustees weak plans and pays benefits directly to participants, PBGC does not take over the administration of

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[10] Under the single-employer program, the maximum guarantee in 2004 is $44,386.32 annually ($3,698.86 monthly) for a single life annuity beginning at age 65. The maximum is adjusted downward for retirees younger than age 65. Under the multiemployer program, PBGC guarantees the first $11 of monthly accrual and 75 percent of the next $33 of monthly accrual, for a maximum monthly accrual of $35.75 per month times the years of credited service. For a participant with 30 years of service under the plan, the maximum annual PBGC guaranteed benefit would be $12,870. Workers with less than 30 years service would receive a lower maximum guaranteed benefit.

multiemployer plans but instead, provides financial assistance in the form of loans when plans become insolvent. A multiemployer plan need not be terminated to qualify for PBGC loans, but it must be insolvent and is allowed to reduce or suspend payment of that portion of the benefit that exceeds the PBGC guarantee level. If the plan recovers from insolvency, it must begin repaying the loan on reasonable terms in accordance with regulations. Such financial assistance is infrequent; for example, PBGC has made loans totaling $167 million to 33 multiemployer plans since 1980[11] compared with 296 trusteed terminations of single-employer plans and PBGC benefit payments of over $4 billion in 2002-2003 alone.[12]

The net effect of these different features is that there is a different distribution of financial risk among, employers, participants and PBGC under the multiemployer program, compared with PBGC's single-employer program. Multiemployer member employers and participants bear far more financial risk, and PBGC, and implicitly the taxpayer, bear far less risk, under the multiemployer program. In addition, PBGC officials explained that the features of the multiemployer regulatory framework have also led to a lower frequency of financial assistance. They note that greater financial risks faced by employers and the lower guaranteed benefits assured participants create incentives for employers, participants, and their collective bargaining representatives to avoid insolvency and to collaborate in trying to find solutions to a plan's financial difficulties.

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[11] Of the 33 plans that have received financial assistance (loans) to pay insured benefits, 24 received assistance in 2003, 4 merged with other healthier plans and 1 purchased an annuity from a private sector insurance company and terminated, transferring benefit obligations to the insurance company. Only 1 plan has repaid any of its financial assistance and that plan repaid only the principal amount of its financial assistance.

[12] The number of trusteed terminated plans is based on the fiscal year that PBGC trusteed the plans, rather than the fiscal year of the plan termination.

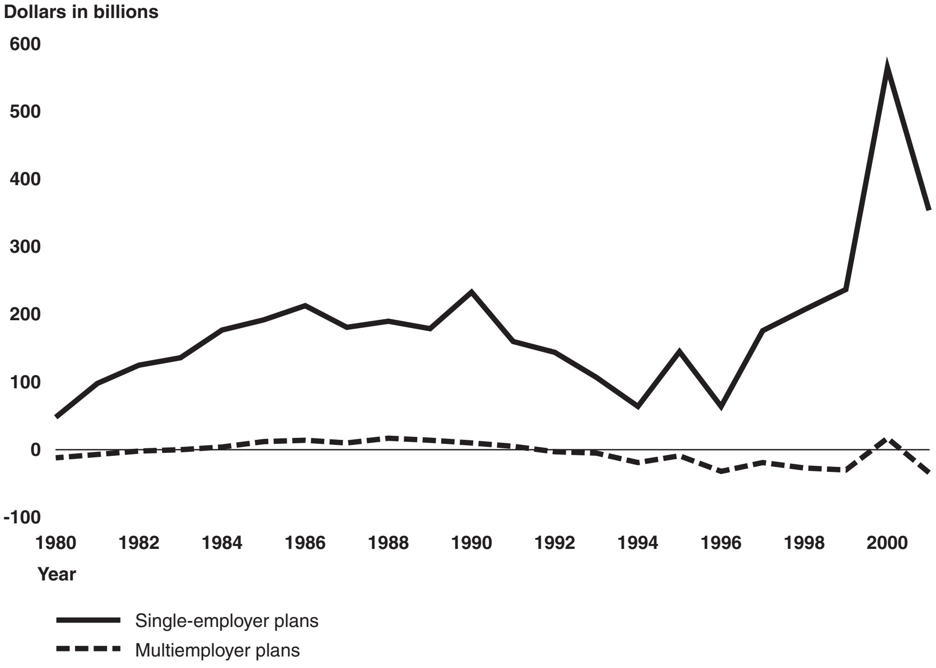
The Financial Stability of Multiemployer Plans Has Likely Weakened Recently, while Long-Term Declines in the Number of Plans and Participants Continue

While multiemployer plan funding has exhibited considerable stability over the past two decades, available data suggest that many plans have recently experienced significant funding declines. Since 1980, aggregate multiemployer plan funding has been stable, with the majority of plans funded above 90 percent of total liabilities and average funding at 105 percent in 2000. Recently, however, it appears that a combination of stock market declines coupled with low interest rates and poor economic conditions has reduced the assets and increased the liabilities of many multiemployer plans. In PBGC's 2003 annual report, the agency estimated that total underfunding of underfunded multiemployer plans reached $100 billion by year-end, from $21 billion in 2000, and that its multiemployer program had recorded a year-end 2003 net deficit of $261 million, the first deficit in more than 20 years. While most multiemployer plans continue to provide benefits at unreduced levels, the agency has also increased its forecast of the number of plans that will likely need financial assistance, from 56 plans in 2001 to 62 plans in 2003. Private survey data are consistent with this trend, with one survey by an actuarial consulting firm showing the percentage of fully funded client plans declining from 83 percent in 2001 to 67 percent in 2002. In addition, long-standing declines in the number of plans and worker participation continue. The number of insured multiemployer plans has dropped by a quarter since 1980 to fewer than 1,700 plans in 2003, according to the latest data available. Although in 2001, multiemployer plans in the aggregate covered 4.7 million active participants, representing about a fifth of all active defined benefit plan participants, this number has dropped by 1.4 million since 1980.

Multiemployer Plan Funding Remained Stable during the 1980s and 1990s

Aggregate funding for multiemployer pension plans remained stable during the 1980s and 1990s. By 2000, the majority of multiemployer plans reported assets exceeding 90 percent of total liabilities, with the average plan funded at 105 percent of liabilities. As shown in figure 1, the aggregate net funding of multiemployer plans grew from a deficit of about $12 billion in 1980 to a surplus of nearly $17 billion in 2000. From 1980 to 2000, multiemployer plan assets grew at an annual average rate of 11.7 percent, to about $330 billion, exceeding the average 10.5 percent annual percentage growth rate of single-employer plan assets. During the same time period, liabilities for multiemployer and single-employer pensions grew at an average annual rate of about 10.2 percent and 9.9 percent respectively.

Figure 1: Aggregate Net Funding Position of PBGC-Insured DB Pension Plans, 1980-2001



Source: GAO analysis of PBGC data.

A number of factors appear to have contributed to the funding stability of multiemployer plans, including:

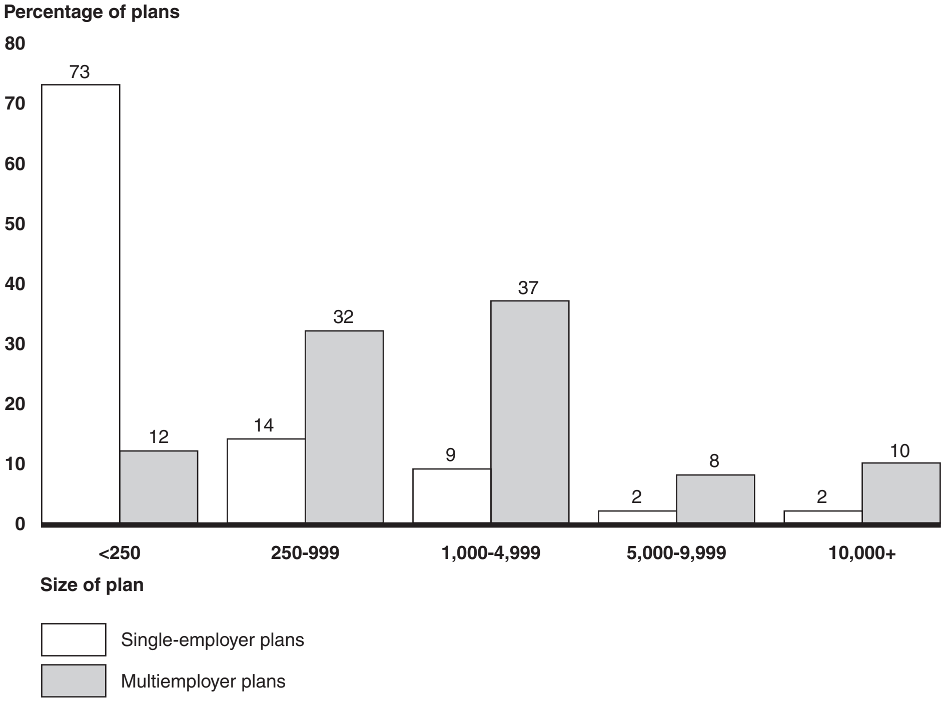
Investment strategy · Historically, multiemployer plans appear to have invested more conservatively than their single-employer counterparts. Although comprehensive data are not available, some pension experts have suggested that defined benefit plans in the aggregate are more than 60 percent invested in equities, which are associated with greater risk and volatility than many fixed-income securities. Experts have stated that, in contrast, equity holdings generally constitute 55 percent or less of the assets of most multiemployer plans.

Contribution rates · Unlike funds for single-employer plans, multiemployer plan funds receive steady contributions from employers because those amounts generally have been set through multiyear collective bargaining contracts. Participating employers, therefore, have less flexibility to vary their contributions in response to changes in firm performance, economic conditions, and other factors. This regular contribution income is in addition to any investment return and helps multiemployer plans offset any declines in investment returns.

Risk pooling · The pooling of risk inherent in multiemployer pension plans may also have buffered them against financial shocks and recessions, since the gains and losses of the plans are less immediately affected by the economic performance of individual employer plan sponsors. Multiemployer pension plans typically continue to operate long after any individual employer goes out of business because the remaining employers in the plan are jointly liable for funding the benefits of all vested participants.

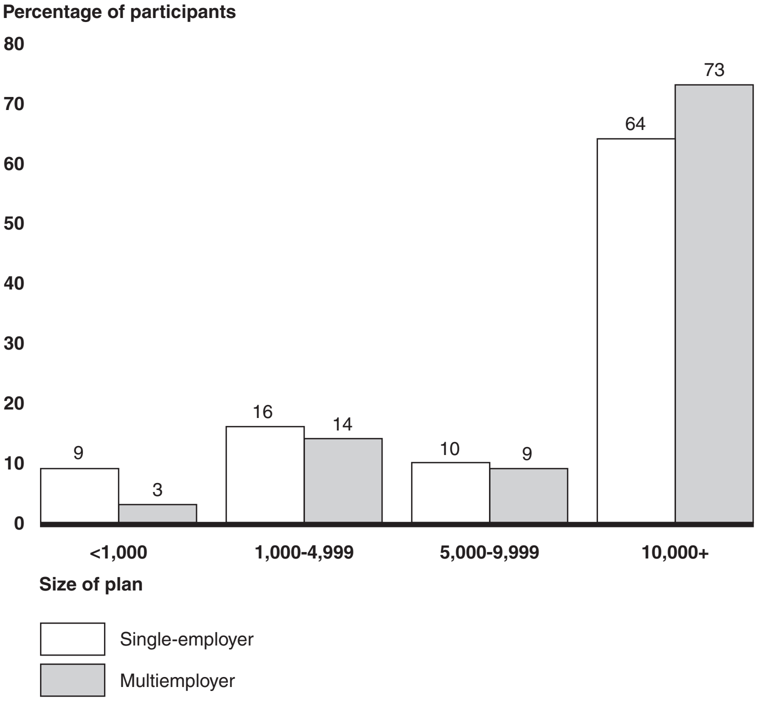
Greater average plan size · The stability of multiemployer plans may also partly reflect their size. Large plans (1,000 or more participants) constitute a greater proportion of multiemployer plans than of single-employer plans. (See figs. 2 and 3.) While 55 percent of multiemployer plans are large, only 13 percent of single-employer plans are large and 73 percent of single-employer plans have had fewer than 250 participants, as shown in figure 2. However, distribution of participants by plan size for multiemployer and single-employer plans is more comparable, with over 90 percent of both multiemployer and single-employer participants in large plans, as shown in figure 3.

Figure 2: Distribution of PBGC-Insured DB Pension Plans by Number of Plan Participants, 2003



Source: GAO analysis of PBGC data.

Figure 3: Distribution of Participants of PBGC-Insured DB Pension Plans by Plan Size, 2003



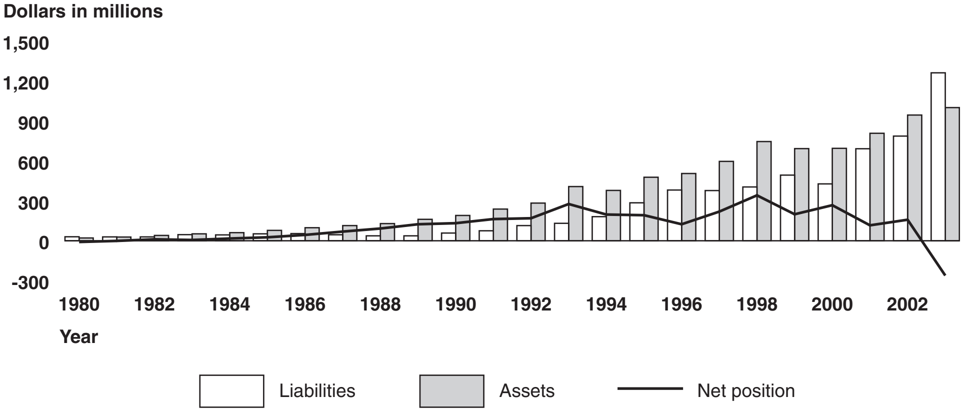
Source: GAO analysis of PBGC data.

Data Suggest the Funded Status of Multiemployer Plans Has Declined Since 2000

Although data limitations preclude any comprehensive assessment, available evidence suggests that since 2000, many multiemployer plans have experienced significant reductions in their funded status. PBGC estimated in its 2003 annual report that aggregate deficit of underfunded multiemployer plans had reached $100 billion by year-end, up from a $21 billion deficit at the start of 2000. In addition, PBGC reported a net accumulated deficit for its own multiemployer program of $261 million for fiscal year 2003, the first deficit since 1981 and its largest ever. (See fig. 4.) While most multiemployer plans continue to provide benefits at unreduced levels, PBGC has also reported that the deficit was primarily caused by new and substantial “probable losses,” increasing the number of plans it classifies as likely requiring financial assistance in the near future from 58 plans with expected liabilities of $775 million in 2002 to 62 plans with expected liabilities of $1.25 billion in 2003.

Private survey data and anecdotal evidence are consistent with this assessment of multiemployer funding losses. One survey by an actuarial consulting firm showed that the percentage of its multiemployer client plans that were fully funded declined from 83 percent in 2001 to 67 percent in 2002.[13] Other, more anecdotal evidence suggests increased difficulties for multiemployer plans. For example, discussions with plan administrators have indicated that there has been an increase in the number of plans with financial difficulties in recent years, with some plans reducing or temporarily freezing the future accruals of participants. In addition, IRS officials recently reported an increase in the number of multiemployer plans (less than 1 percent of all multiemployer plans) requesting tax-specific waivers that would provide plans relief from current funding shortfall requirements.

Figure 4: PBGC Multiemployer Program, 1980-2003



Source: GAO analysis of PBGC data.

As with single-employer plans, falling interest rates coincident with stock market declines and generally weak economic conditions have contributed to the funding difficulties of multiemployer plans. The decline in interest rates in recent years has increased the present value of pension plan liabilities for DB plans in general, because the cost of providing future promised benefits increases when computed using a lower interest rate. At the same time, declining stock markets decreased the value of any equities held in multiemployer plan portfolios to meet those obligations. Finally,

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[13] Segal Benefits, Compensation and HR Consulting, SEGAL Survey, *Effects of "The Perfect Storm" Begin to Emerge: Erosion of the Funded Position of Multiemployer Pension Plans*, Spring 2003.

because multiemployer plan contributions are usually based on the number of hours worked by active participants, any reduction in their participant employment will reduce employer contributions to the plan.

Multiemployer Plans Experiencing Long-Term Declines in Plan Formation and Worker Participation

Despite their relative financial stability, the multiemployer system has experienced a steady decline in the number of plans and in the number of active participants over the past 2 decades. In 1980, there were 2,244 plans, and by 2003 the number had fallen to 1,623, a decline of about 27 percent. While a portion of the decline in the number of plans can be explained by consolidations through mergers, few new plans have been formed - only 5, in fact, since 1992. Meanwhile, the number of active multiemployer plan participants has declined in both relative and absolute terms. By 2001, only about 4.1 percent of the private sector workforce was composed of active participants in multiemployer pension plans, down from 7.7 percent in 1980 (see fig. 5), with the total number of active participants decreasing from about 6.1 million to about 4.7 million. [14]

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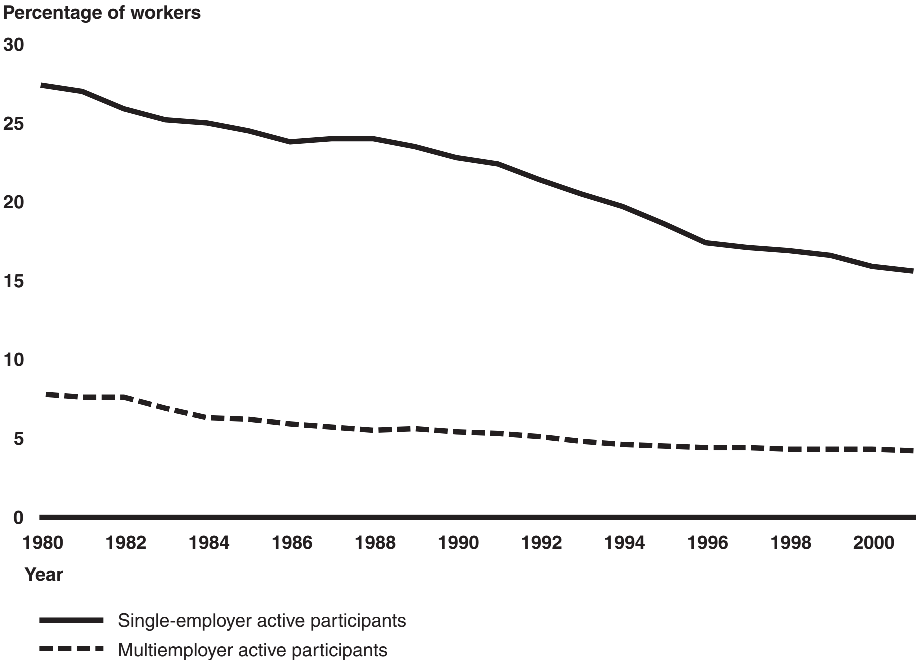
[14] A similar decline was observed for active participants of single-employer plans, with the total falling from 27.3 percent of the private sector labor force in 1980 to 15.5 by 2001.

Figure 5: PBGC-Insured Active Participants as a Percentage of Private Sector Wage and Salary Workers, 1980-2001



Source: GAO analysis of PBGC data.

Finally, as the number of active participants has declined, the number of retirees increased – from about 1.4 million to 2.8 million, and this increase had led to a decline in the ratio of active (working) participants to retirees in multiemployer plans. By 2001, there were about 1.7 active participants for every retiree, compared with 4.3 in 1980. (See fig. 6.) While the trend is also evident among single-employer plans, the decline in the ratio of active workers to retirees affects multiemployer funding more directly because employer contributions are tied to active employment. The higher benefit payouts required for greater numbers of retirees, living longer, and the reduced employer contributions resulting from fewer active workers combines to put pressure on the funding of multiemployer plans.

Figure 6: Number of Active Participants per Retiree, 1980-2001

Source: GAO analysis of PBGC data.

A Number of Factors Challenge the Long-Term Prospects of the Multiemployer Defined Benefit System

A number of factors pose challenges to the long-term prospects of the multiemployer pension plan system. Some of these factors are specific to the features and nature of multiemployer plans, including a regulatory framework that some employers may perceive as financially riskier and less flexible than those covering other types of pension plans. For example, compared with a single-employer plan, an employer covered by a multiemployer plan cannot easily adjust annual plan contributions in response to the firm’s own financial circumstances. This is because contribution rates are often fixed for periods of time by the provisions of the collective bargaining agreement. Collective bargaining itself, a necessary aspect of the multiemployer plan model and another factor affecting plans’ prospects, has also been in long-term decline, suggesting fewer future opportunities for new plans to be created or existing ones to expand. As of 2003, union membership, a proxy for collective bargaining coverage, accounted for less than 9 percent of the private sector labor force and has been steadily declining since 1953. Experts have identified other challenges to the future prospects of defined benefit plans generally, including multiemployer plans. These include the growing trend among employers to choose defined contribution plans over DB plans, including multiemployer plans; the continued growing life expectancy of American workers, resulting in participants spending more years in retirement, thus increasing pension benefit costs; and increases in employer-provided health insurance costs, which are increasing employers' compensation costs generally, including pensions.

Certain Features of the Current Regulatory Framework and the Decline of Collective Bargaining May Discourage Future Plan Growth

Some factors raise questions about the long-term viability of multiemployer plans are specific to certain features of multiemployer plans themselves, including features of the regulatory framework that some employers may well perceive as less flexible and financially riskier than the features of other types of pension plans. For example, an employer covered by a multiemployer pension plan typically does not have the funding flexibility of a comparable employer sponsoring a single-employer plan. In many instances, the employer covered by the multiemployer plan cannot as easily adjust annual plan contributions in response to the firm's own financial circumstances. Employers that value such flexibility might be less inclined to participate in a multiemployer plan. Employers in multiemployer plans may also face greater financial risks than those in other forms of pension plans. For example, an employer sponsor of a multiemployer plan that wishes to withdraw from the plan is liable for its share of pension plan benefits not covered by plan assets upon withdrawal from the plan, rather than when the plan terminates, as with a single-employer plan. Employers in plans with unfunded vested benefits face an immediate withdrawal liability that can be costly. In addition, employers in fully funded plans also face the potential of costly withdrawal liability if the plan becomes underfunded in the future through the actions of other sponsors participating in the multiemployer plan. Thus, an employer's pension liabilities become a function not only of the employer's own performance but also the financial health of other plan sponsors in the multiemployer plan. These additional sources of potential liability can be difficult to predict, increasing employers' level of uncertainty and risk. Some employers may hesitate to accept such risks if they can sponsor other plans that do not have them, such as 401(k)-type defined contribution plans.

The future growth of multiemployer plans is also predicated on the future of collective bargaining. Collective bargaining is an inherent feature of the multiemployer plan model. Collective bargaining, however, has been declining in the United States since the early 1950s. Currently, union membership, a proxy for collective bargaining coverage, accounts for less than 9 percent of the private sector labor force. In 1980, union membership accounted for about 19 percent of the entire national workforce and about 27 percent of the civilian workforce in 1953.

Multiemployer Plans Are Limited by the Same Factors Affecting All Defined Benefit Plans

Pension experts have suggested a variety of challenges faced by today's defined benefit pension plans, including multiemployer plans.[15] These include the continued general shift away from DB plans to defined contribution (DC) plans, and the increased longevity of the U.S. population, which translates into a lengthier and more costly retirement. In addition, the continued escalation of employer health insurance costs has placed pressure on the compensation costs of employers, including pensions.

Employers have tended to move away from DB plans and toward DC plans since the mid-1980s. The total number of PBGC-insured defined benefit plans, including single employer plans, declined from 97,683 in 1980 to 31,135 in 2002. (See fig. 7.) The number of DC plans sponsored by private employers nearly doubled from 340,805 in 1980 to 673,626 in 1998.[16] Along with this continuing trend toward sponsoring DC plans, there has also been a shift in the mix of plans that private sector workers participate in. Labor reports that the percentage of private sector workers who participated in a primary DB plan has decreased from 38 percent in 1980 to 21 percent by 1998, while the percentage of such workers who participated in a primary DC plan has increased from 8 percent to 27 percent during this same period. Moreover, these same data show that by 1998, the majority of active participants (workers participating in their employer's plan) were in DC plans, whereas nearly 20 years earlier the majority of participants had been in DB plans.[17] Experts have suggested a variety of explanations for this shift, including the greater risk borne by employers with DB plans, greater administrative costs and more onerous regulatory requirements, and that employees more easily understand and favor DC plans. These experts have also noted considerable employee demand for plans that state benefits in the form of an account balance and

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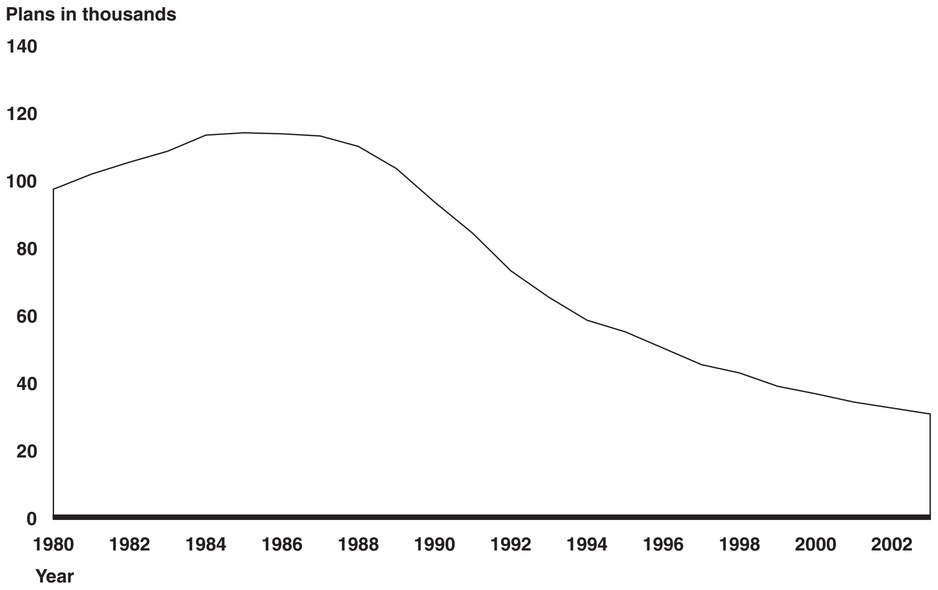
[15] "Strengthening Pension Security: Examining the Health and Future of Defined Benefit Pension Plans" Hearing before the Subcommittee on Employer-Employee Relations of the House Committee on Education and Workforce, (Washington D.C.: June 4, 2003).

[16] 1998 is the most recent year for which the Department of Labor has issued its *Private Pension Plan Bulletin: Abstract of Form 5500 Annual Reports*.

[17] U.S. General Accounting Office, *Private Pensions: Participants Need Information on Risks They Face in Managing Pension Assets at and during Retirement*, GAO-03-810 (Washington, D.C.: July 2003).

emphasize portability of benefits, such as is offered by 401(k)-type defined contribution pension plans.

Figure 7: Number of PBGC-Insured DB Pension Plans, 1986-2003



Source: GAO analysis of PBGC data.

The increased life expectancy of workers also has important implications for defined benefit plan funding, including multiemployer plans. The average life expectancy of males at birth has increased from 66.6 in 1960 to 74.3 in 2000, with females at birth experiencing a rise of 6.6 years from 73.1 to 79.7 over the same period. As general life expectancy has increased in the United States, there has also been an increase in the number of years spent in retirement. PBGC has noted that improvements in life expectancy have extended the average amount of time spent by workers in retirement from 11.5 years in 1950 to 18 years for the average male worker as of 2002. This increased duration of retirement has required employers with defined benefit plans to increase their contributions to match this increase in benefit liabilities. This problem is exacerbated for those multiemployer plans with a shrinking pool of active workers because plan contributions are generally paid on a per work-hour basis, contributing to the funding strain we discussed earlier.

Increasing health insurance costs are another factor affecting the long-term prospects of pensions, including multiemployer pensions. Recent increases in employer-provided health insurance costs are accounting for a rising share of total compensation, increasing pressure on employers' ability to maintain wages and other benefits, including pensions. Bureau of Labor Statistics data show that the cost of employer-provided health insurance has risen steadily in recent years, growing from 5.4 percent of total compensation in 1999 to 6.5 percent as of the third quarter of 2003. A private survey of employers found that employer-sponsored health insurance costs rose about 14 percent between the spring of 2002 and the spring of 2003, the third consecutive year of double-digit acceleration and the highest premium increase since 1990.[18] Plan administrators and employer and union representatives that we talked with identified the rising costs of employer-provided health insurance as a key problem facing plans, as employers are increasingly forced to choose between maintaining current levels of pension and medical benefits.

Conclusions

Although available evidence suggests that multiemployer plans are not experiencing anywhere near the magnitude of the problems that have recently afflicted the single-employer plans, there is cause for concern. The declines in interest rates and equities markets, and weak economic conditions in the early 2000s, have increased the financial stress on both individual multiemployer plans and the multiemployer framework generally. Most significant is PBGC's estimate of $100 billion in unfunded multiemployer plan liabilities that are being borne collectively by employers and plan participants.

At this time, PBGC and, potentially, the taxpayer do not face the same level of exposure from this liability with multiemployer plans that they do with single-employer plans. This is because, as PBGC officials have noted, the current regulatory framework governing multiemployer plans redistributes financial risk toward employers and workers and away from the government. Employers face withdrawal and other liabilities that can be significant. In addition, should a multiemployer plan become insolvent, workers face the prospect of receiving far lower guaranteed benefits than workers receive under PBGC's single-employer program guaranteed limits. Together, not only do these features limit the exposure for PBGC, they create important incentives for all interested parties to resolve difficult financial situations that could otherwise result in plan insolvency.

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[18] *Employer Health Benefits 2003 Annual Survey*, The Kaiser Family Foundation and Health Research and Education Trust.

Because the multiemployer plans' structure balances risk in a manner that fosters constructive collaboration among interested parties, proposals to address multiemployer plans' funding stress should be carefully designed and considered for their long-term consequences. For example, proposals to shift plan liabilities to PBGC by making it easier for employers to exit multiemployer plans could help a few employers or participants but erode the existing incentives that encourage interested parties to independently face up to their financial challenges. In particular, placing additional liabilities on PBGC could ultimately have serious consequences for the taxpayer, given that with only about $25 million in annual income, a trust fund of less than $1 billion, and a current deficit of $261 million, PBGC's multiemployer program has very limited resources to handle a major plan insolvency that could run into billions of dollars.

The current congressional efforts to provide funding relief are at least in part in response to the difficult conditions experienced by many plans in recent years. However, these efforts are also occurring in the context of the broader long-term decline in private sector defined benefit plans, including multiemployer plans, and the attendant rise of defined contribution plans, with their emphasis on greater individual responsibility for providing for a secure retirement. Such a transition could lead to greater individual control and reward for prudent investment and planning. However, if managed poorly, it could lead to adverse distributional effects for some workers and retirees, including a greater risk of a poverty-level income in retirement. Under this transition view, the more fundamental issues concern how to minimize the potentially serious, negative effects of the transition while balancing risks and costs for employers, workers, and retirees, and for the public as a whole. These important policy concerns make Congress's current focus on pension reform both timely and appropriate.

This concludes my prepared statement. I am happy to answer any questions that the subcommittee may have.

GAO Contact and Staff Acknowledgments

For further questions on this testimony, please contact me at (202) 512-7215. Individuals making key contributions to this testimony include Joseph Applebaum, Tim Fairbanks, Charles Jeszeck, Gene Kuehneman, Raun Lazier, and Roger J. Thomas.

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