

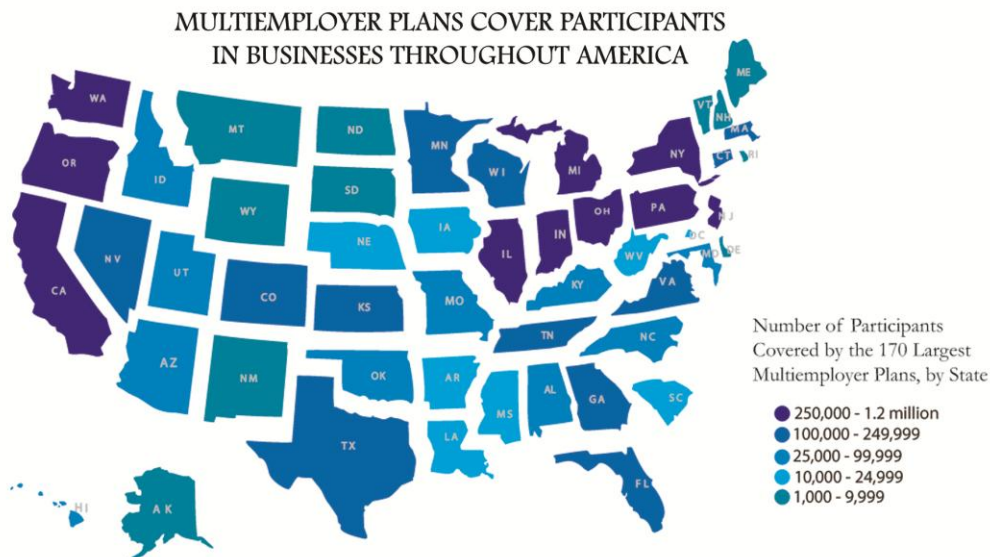
Testimony of
Hon. Joshua Gotbaum, PBGC Director
before the
Health, Employment, Labor and Pensions Subcommittee
House Committee on Education and the Workforce
December 19, 2012

Thank you for holding this hearing on multiemployer plans and on PBGC's efforts to support them.¹

Multiemployer plans are an important part of retirement security. They affect hundreds of thousands of businesses and more than ten million participants and their families. Unlike some other retirement or savings plans, multiemployer defined benefit plans offer lifetime retirement income.

Multiemployer plans offer employers, especially small businesses, the opportunity to provide retirement benefits to their workers. They are an affordable way for businesses to provide a defined benefit pension without the administrative expenses and burdens of sponsoring a separate company retirement plan.

There are about 1,340 ongoing multiemployer plans.² They are not all alike. They cover a



¹ As the Committee knows, PBGC and the Board agencies are working to complete reports on both multiemployer plans and on PBGC's multiemployer program. As we explained in a letter to the Committee on this topic, we have not yet completed the reports in part to be able to present more current information than would otherwise have been available, in part to incorporate recent legislative changes, and for other reasons. We expect to complete the reports very soon. We regret the delay.

² There are also about 110 terminated plans. These continue to pay benefits until assets are depleted, at which point PBGC funds benefits and administrative costs.

variety of industries, including construction, retail food, transportation, manufacturing, and services (*e.g.*, hotel and restaurant industry). They vary in size from small local plans covering a few hundred participants to large regional or national plans covering hundreds of thousands.

Together these plans held nearly \$400 billion in assets at the end of 2010, making them an important factor in the U.S. economy and Americans' retirement security.³ Like single-employer plans, multiemployer plans were strongly affected by recent declines in the economy and the investment markets. Virtually all of these plans suffered massive asset losses, causing underfunding to soar and compelling increased contributions at a time of economic contraction.

After all the events of the past decade, the financial health of these plans varies widely. The majority are recovering, in part by relying on the tools and authorities provided to plans under the Pension Protection Act of 2006 (PPA) and subsequent legislation, as the economy and the financial markets improve. Some plans, however, lack the necessary economic base and will not, absent changes, be able to avoid eventual insolvency.

As a result, PBGC's multiemployer insurance program will need a fresh look. Although the timing is uncertain, currently PBGC is at risk of having neither sufficient tools to help multiemployer plans deal with their problems nor the funds to continue to pay benefits beyond the next decade under the multiemployer insurance program.

In the past, multiemployer plans, the Congress, administrations of both parties, and others have worked together to preserve multiemployer plans, so they continue providing retirement security to more than 10 million participants and their families. We understand that multiemployer plan trustees, employers, unions, and others have been discussing potential solutions and expect to make proposals to the Congress and the Administration sometime next year. PBGC looks forward to assisting in that process.

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Why Multiemployer Plans Matter

Multiemployer defined benefit plans offer a broad range of advantages:

- They provide lifetime participant and spousal annuities.
- They provide portability for employees who change employers frequently within an industry, such as in the construction trades.
- They ease employers' administrative burdens: joint boards of trustees administer these collectively bargained plans, retaining professional investment advisors and benefit managers, and minimizing employers' fiduciary obligations. The employer need only remit contributions to the plan in agreed-upon amounts.
- They reduce administrative and investment costs through economies of scale.

³ Based on Form 5500 filings.

Outside the multiemployer sector, many employers over the past several decades have turned to defined contribution plans (such as 401(k) plans) to avoid the long-term liabilities, potential contribution volatility, and compliance complexities of defined benefit plans – and some have opted to offer no plan at all. This has also been occurring in the multiemployer sector. Unfortunately, the result is often that employees do not save enough for a secure retirement. Furthermore, defined contribution plans often lack lifetime income options, so many retirees are at risk of outliving their savings.

For all these reasons, at a time of inadequate retirement savings and declining retirement security, it is important to explore ways to preserve the multiemployer model.

The Last Decade was Tough for All Pension Plans

Until the 2000's, both single-employer and multiemployer defined benefit plans were generally adequately funded (plan assets were relatively high relative to liabilities). Strong investment returns provided asset growth with an affordable level of contribution effort by employers. Many plans also relied on excess investment returns to support benefit increases. However, the turmoil in the financial markets, both at the beginning and the end of the last decade, caused both single-employer and multiemployer plans to suffer dramatic losses. (Both kinds of plans had similar investment mixes.)

The effect on multiemployer plans of a \$50 billion loss in asset values following the 2001-2002 downturn and a \$100 billion loss following the 2008 downturn was devastating. Underfunding, which had totaled less than \$50 billion until 2000, increased eight-fold during the next decade, using PBGC measurements.

Equally distressing to plans was the economic recession that followed the 2008 crash, which hurt the industries in which these plans operate. Contributions to multiemployer plans are generally based on hours worked: as active employees were laid off and work hours were reduced, plan contributions plummeted. At the same time, the significant underfunding in these plans put pressure on employers to increase contributions: Minimum required contributions, as calculated by plan actuaries, rose precipitously and there were fears that hourly contribution rates for some plans would have to triple or quadruple to avoid a funding deficiency or, beginning in 2008, to conform to benchmarks required by funding improvement plans or rehabilitation plans under PPA.

Congressional Support for Multiemployer Plans

Congress has acted repeatedly to help reduce the strains on multiemployer plans and provide contribution flexibility: in 2004, certain plans were permitted to defer the charges related to one-time investment losses; in 2008, plans could elect to delay implementation of PPA requirements for one year; and in 2010, funding relief allowed many plans to lessen the impact of 2008 investment losses on their funded status and contribution requirements. Plans relied extensively on this relief as they tried to regain their footing.

PPA Tools Have Helped

Most important, Congress in the Pension Protection Act of 2006 recognized that different plans would require different combinations of authorities concerning benefits and contributions.

PPA required annual plan certifications based on standardized funding and liquidity measures for determining the financial health of plans. Plans in serious financial distress are identified as in “critical” (“red”) status, and plans experiencing some financial difficulty are identified as in “endangered” (“yellow”) status or “seriously endangered” (“orange”) status.⁴ Plans not experiencing financial difficulty are categorized as non-distressed (“green”) status.

After the turbulence of 2008, PPA steered many plans to a more structured path towards improved funded status. Over the past few years, hundreds of plans in endangered or critical status were required to adopt funding improvement plans or rehabilitation plans to increase contributions and reduce costs. Between 2008 and 2010, average annual employer contributions to these plans increased from \$4,300 per active participant to \$5,000.

In 2009 and 2010 combined, over 350 plans reported reducing future benefit accruals as a way to limit costs and liabilities. In addition, for participants who had not yet retired, PPA permitted plans in critical status to reduce certain past benefits such as early retirement subsidies that were adopted when plans appeared to have had a surplus. In 2009 and 2010, more than 250 plans reported making such past benefit reductions; those that provided information reported erasing nearly \$3 billion in past benefit liabilities.

The funding flexibility that multiemployer plans were given under PPA was particularly valuable to cushion the effects of financial market and economic disruptions. To accelerate plan funding, PPA shortens the amortization periods for all types of unfunded liabilities to 15 years. However, PPA also allows plans to extend their amortization periods by up to 5 years, without government approval, if they would otherwise face a funding deficiency in the future and they are on a path to funding improvement. By 2010, 178 multiemployer plans were operating under automatic amortization extensions, compared to only six plans using extensions in 2005 when IRS approval was required. In addition, PPA generally exempted plans from the excise tax assessed against employers for funding deficiencies, thus freeing up employer resources for the plan’s rehabilitation program. For the 2010 plan year, 90 plans reported funding deficiencies totaling \$1.9 billion for which an excise tax will not be owed.

PRA 2010 Funding Relief Also Helped

In 2009, nearly 70% of all plans (covering 70% of all participants) were in moderate or serious financial distress under PPA standards – endangered (yellow), seriously endangered (orange), or critical (red) status. By 2011, these numbers had dropped significantly: yellow, orange or red status plans represented only 40% of all plans and currently cover about 50% of all participants. This improvement in funded status is due in part to positive investment returns in 2009 and 2010 and the steps plans took to improve their status.

⁴ Critical status is triggered when a plan is less than 65% funded (on the plan’s actuarial basis) and projects a funding deficiency within 5 years or projects insolvency within 7 years, or the plan has similar funding or insolvency characteristics; endangered status is triggered when a plan is less than 80% funded (on the plan’s actuarial basis) or projects a funding deficiency within 7 years (including amortization extensions); seriously endangered status is triggered when a plan exhibits both endangered status triggers.

But it is also due to the funding relief in the Pension Relief Act of 2010 (PRA 2010). This relief allowed certain plans to amortize net investment losses incurred during the 2008 crisis over a 29-year period – rather than the shorter 15-year period that would otherwise apply – significantly reducing annual amortization charges and minimum required contributions. It also allowed plans to increase the actuarial value of their assets for funding purposes by recognizing 2008 investment losses over 10 years rather than the regular smoothing period of five years.

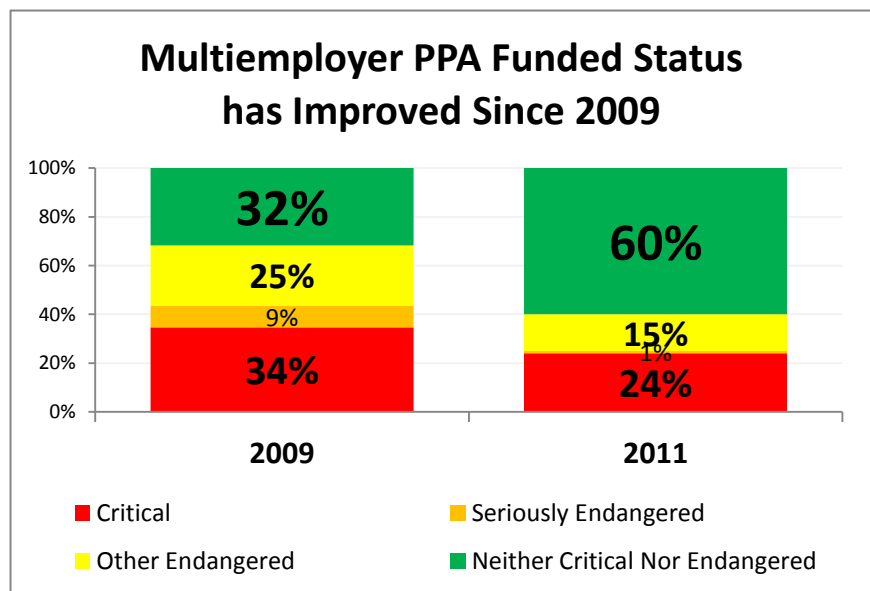
Plans relied extensively on PRA 2010 relief – more than 700 plans elected the relief. Form 5500 filings indicate that a decrease in amortization charges and an increase in amortization credits boosted these plans’ aggregate credit balances by \$2 billion over the amounts reported in the 2009 plan year.

The special funding rules had an additional importance: increasing the actuarial value of assets had the effect of inflating a plan’s funded percentage, and larger credit balances delayed the date of a future funding deficiency, both of which positively impacted plans’ funded statuses under PPA. About 400 plans that elected the relief were in non-distressed (green) status in 2010.

Notices from many of these plans explained that the relief provided a buffer against future adverse experience and made it easier to avoid endangered or critical status in future years.

Given the lack of timely information available on multiemployer plans, it is not possible to fully quantify the effects of funding relief on plans’ PPA funded statuses. Nonetheless, it seems clear that many plans enhanced their certified status as a result of the relief.

Many plans certified as in endangered (yellow) and seriously endangered (orange) status for the 2010 plan year were re-certified to non-distressed (green) status as a result of the application of PRA 2010 relief. About 170 critical (red) status plans (45% of red plans in 2010) used PRA 2010 relief, stating that the plan was expected to either immediately move into endangered (yellow) or non-distressed (green) status or to emerge from critical status sooner as a result of the relief.



For some plans, the deferral of recognition of obligations permitted by PRA 2010 may make funding of those obligations ultimately more difficult. The ratio of active (employed) participants to inactive participants in multiemployer plans as a whole has been steadily declining: 60% of participants were active participants in 1990, but only 40% of participants are active today. Plans reported about 1.3 million non-sponsored (“orphan”) participants (whose employers have withdrawn) in 2010, whose underfunded benefits become the responsibility of

employers other than their own. A smaller pool of participating employers and active employees reduces the funding available to meet plan obligations.

Multiemployer Plans Now in Varied Financial Situations

For Most Plans Challenges Seem Manageable, but Future Flexibility Can Help

Our research suggests that the majority of multiemployer plans, though currently substantially underfunded, will be able to recover over time as the economy improves, financial markets stabilize, and small and large businesses ramp up hiring and hours worked. This assumes that these plans will generally maintain a base of contributing employers able to sustain their liabilities and benefit disbursements, and will avoid investment losses that significantly erode their asset base. A diverse industrial base, broad geographical coverage, and careful management help position plans for the future.

Generally, plans are using the tools and authorities provided under PPA to reduce costs, limit liabilities, and increase contributions steadily over time. They are using their new flexibility under PPA to respond to market fluctuations and to reduce excessive stress on employers and participants.

Trustees and others associated with these plans have begun suggesting additional flexibility to address pressing issues, such as the need to attract new employers, to transition to new benefit formulas that reduce costs and minimize risks, and to adjust their liabilities to ensure sustainability.

Severely Distressed Plans Will Need More Help

While a majority of plans appear primed for gradual recovery, a minority of plans will not be able to recover using the tools and authorities under PPA. Many critical status plans (and some seriously endangered status plans) are severely distressed and will need still further provisions to remain viable.

At the beginning of the 2008 plan year, only 12% of all plans were in critical (red) or seriously endangered status (orange). That number spiked to 44% of all plans at the beginning of the 2009 plan year. In 2010, nearly one-third of all plans, covering more than four million participants, continued to be in critical (red) or seriously endangered (orange) status. While the percentage of critical (red) and seriously endangered (orange) plans dropped slightly in 2011 to 26% (336 plans) of all plans, that percentage is likely understated due to the effect of PRA 2010 funding relief. A substratum of critical and seriously endangered status plans is beyond the point of recovery without significant changes in the rules that govern their operations.

These plans' underlying fundamentals reveal why they are so distressed. They often operate in declining industries – such as furniture manufacturing, textiles, or typesetting, or in intensely competitive markets, from which large numbers of employers have gone out of business. Their participant populations are mature, with a large proportion of retirees and significant unfunded retiree liabilities. As a result, contributions coming into these plans on behalf of current workers are small compared to the outflow of benefit payments. Investment returns during the 2000s were unable to make up the difference, as those returns suffered due to the drop in the overall

asset base. In the worst-case scenarios, these plans' negative cash flows each year further erode their asset base and the plans are faced with eventual insolvency.

The severely distressed subset of plans includes several hundred plans. Some of these plans have already terminated and are expecting to receive financial assistance from PBGC. Others are ongoing plans that operate under PPA funding improvement or rehabilitation plans. The rehabilitation plans of critical status plans often signal that they have exhausted all "reasonable measures" for contribution increases and reductions in adjustable benefits and do not expect to emerge from critical status; they are merely striving to delay insolvency.

In the case of some of these ongoing plans, further contribution increases may be needed: our research shows that critical status plans averaged lower contributions per active participant in 2010 than plans in other funded statuses – about \$4,000 per participant as compared with about \$5,500 per participant. On the other hand, we also know that some employers contribute substantially more and participate in numerous multiemployer plans – large employers in one critical status plan contributed \$18,000 per active participant in 2011.

Because benefits generally cannot be reduced after they are earned, there is also a natural limit to how much underfunding can be made up through reductions in benefits. Plans may reduce future benefit accruals for active workers and, under PPA, critical status plans may reduce certain previously earned benefits (known as "adjustable benefits") – such as early retirement benefits, early retirement subsidies, subsidized optional forms of benefit, and disability and death benefits (other than normal spousal death benefits) – for active workers and terminated vested participants (participants no longer earning benefits under the plan but not yet retired). However, where a majority – or close to a majority – in a plan are already retired participants whose benefits cannot be reduced, some employers and active workers will be reluctant to consent to contribution increases if the bulk of the money goes to retirees, while active workers' earnings and benefits deteriorate.

If the bargaining parties cease to view the employer's contribution to a plan as valuable, they will negotiate for the employer's withdrawal from the plan. Such actions can ultimately lead to a mass withdrawal of all employers from the plan and the plan's ultimate insolvency. A mass withdrawal termination can result in withdrawal liability assessments that can be particularly onerous at today's high plan underfunding levels.

Preserving severely distressed plans is important, not just to the employers and participants in those particular plans, but also to the health of other multiemployer plans. Many contributing employers, chiefly large employers, participate in numerous multiemployer plans, and the termination of one plan that produces withdrawal liability assessments for these employers could undermine the ability or willingness of those employers to contribute to other multiemployer plans. This, in turn, could result in multiple employer withdrawals and mass withdrawal terminations for other plans, damaging hundreds or thousands of businesses and hurting tens of thousands of workers along the way.

PBGC's Multiemployer Insurance Program

PBGC helps to secure the retirement benefits of more than ten million workers and retirees in multiemployer plans by working with plans to retain and attract participating employers and by

paying financial assistance to cover benefits earned by workers up to the maximum allowed by law when plans are no longer able.

Multiemployer Financial Assistance

PBGC's multiemployer program is very different from its larger and better-known single-employer insurance program. Unlike the single-employer program, when multiemployer plans are in distress, PBGC generally can take no action until the plans have entirely run out of money and are insolvent. Also unlike the single-employer program, when PBGC becomes responsible for a multiemployer plan, the agency does not take over the plan. Instead, the plan administrator remains in place while PBGC funds the administrative and benefit costs.

PBGC multiemployer benefit levels are also very different. The maximum guarantee for a multiemployer participant with 30 years of service is \$12,870 per year; it is not indexed for inflation. In contrast, the maximum guarantee set by law for single-employer participants at age 65 is \$55,840 for the 2012 calendar year; the maximum guarantee is indexed for inflation for future plan terminations.

PBGC's Other Multiemployer Activities

In addition to providing financial assistance to insolvent plans, PBGC has oversight authority for certain activities of multiemployer plans that are important to their financial well-being.

Plans must notify PBGC when they propose to merge. PBGC evaluates a merger to determine whether the merged plan poses a risk of loss to PBGC or plan participants. Generally, this involves a confirmation that the plan's finances will not be weakened and the plan will have sufficient assets to pay benefits for a period of time. In some instances, mergers can reduce a plan's administration costs, improve future investment returns, and help expand the plan's ratio of active to inactive participants. PBGC can and does provide technical assistance, on request, to plans evaluating a merger option.

In a few rare cases, PBGC has facilitated a merger of an insolvent (or near-insolvent) plan by providing financial assistance to the merged plan rather than to the insolvent plan. However, PBGC does not have the legal authority to provide financial assistance to facilitate a merger in the absence of insolvency, nor the financial resources to step in in such circumstances.

Plans may also apply to PBGC for an order of partition, which permits a plan to transfer benefits of non-sponsored participants, whose sponsors no longer participate in the plan, to a partitioned portion of the plan that receives financial assistance from PBGC. The requirements necessary for a partition are strict, in part because retirees and participants in the partitioned plan incur an immediate reduction in their benefits to PBGC's guarantee levels. A partition requires a finding by PBGC that the plan has had a substantial reduction in contributions due to employer bankruptcies and is likely to become insolvent. PBGC has partitioned two plans; the second occurred in 2010 when PBGC partitioned a trucking plan. PBGC does not have the finances needed to undertake expanded partitioning activities, even though doing so would relieve employers of burdensome unfunded liabilities.

PBGC's Multiemployer Program Financial Status is Strained

Another difference from PBGC's single-employer program is that multiemployer premiums are much lower, too. Historically, the program had very low premium rates: multiemployer plans paid an annual flat-rate premium of \$2.60 per participant per year until 2006, when Congress increased the rate to \$8 per participant, indexed for inflation. Plans have paid \$9 per participant per year since 2008, and multiemployer premiums to the insurance program totaled \$92 million for FY 2012. Under the Moving Ahead for Progress in the 21st Century Act (MAP-21), multiemployer premiums will increase to \$12 per participant in 2013 (indexed), generating about \$120 million for the program. For single-employer plans, the per-participant flat rate premium under MAP-21 for plan years beginning in 2013 is \$42 (indexed) and these plans also pay a variable rate premium on their underfunding. For multiemployer plans, even with the MAP-21 increases, absent further changes, PBGC premiums will be insufficient to support the guarantee at some point in the future.

Because PBGC does not trustee multiemployer plans, the multiemployer insurance program's assets consist only of premium income and investment income on the premiums. The multiemployer program has few assets: as of September 30, 2012, the program had total assets of \$1.8 billion.

As of the end of FY 2012, the multiemployer insurance program has \$7.0 billion in booked liabilities. This represents the present value of all future financial assistance payments owed to participants in 148 plans that are recorded as liabilities on our FY 2012 financial statements; these are plans currently receiving financial assistance, terminated plans not yet receiving financial assistance, and ongoing plans that are expected to receive financial assistance. Thus, our current deficit – the difference between the program's \$7.0 billion in liabilities and \$1.8 billion in assets – is \$5.2 billion. We expect both our liabilities and our deficit to increase as more distressed plans terminate or approach insolvency in future years.

PBGC pays financial assistance in the form of life annuities and administrative expenses. In 2012, PBGC paid \$95 million in financial assistance to 49 insolvent plans that had run out of assets to pay benefits when due. Another 61 plans are terminated plans to which PBGC expects to begin paying financial assistance in the future. Based solely on our current inventory of booked plans as of September 30, 2012, the amount of financial assistance PBGC will pay each year is projected to rise rapidly – with payments exceeding \$500 million in 2022. This does not take into account financial assistance payments to any plans that would be first recognized as liabilities of the program in FY 2013 or future years.

Over the next decade or so, even before any new obligations are added, there is a substantial risk that, without significant change to the multiemployer system, the multiemployer program will become insolvent and not be able to pay financial assistance. If new claims are recognized and additional payments required, insolvency could occur within a shorter timeframe, particularly if a large plan became insolvent. However, the risk of program insolvency, while serious, is not immediate and its timing is uncertain. Timing is dependent on many factors, including investment returns and the actions of trustees, employers, and unions dealing with individual ongoing plans.

Next Steps

For several years, multiemployer plans, participating employers, unions, actuaries, plan professionals and others have been discussing various changes to the multiemployer system that would preserve plans by providing them greater flexibility to address various challenges. Several are now planning to present proposals to both the Congress and the Administration in the coming months.

The financial condition of multiemployer plans varies widely. Some plans will propose flexibility in benefit structures, or in contributions or withdrawal obligations. Severely distressed plans, on the other hand, will probably require broader changes.

Historically, when necessary to preserve plans, Congress has worked in a bipartisan way with the executive agencies, plans, businesses, unions, and others. It was such a collaboration that resulted in the Pension Protection Act of 2006. Some of the provisions of that Act will sunset in 2014, which creates both the need and the opportunity to consider what changes are appropriate for the future. PBGC looks forward to working with Congress and the multiemployer community as this important dialogue evolves.

PBGC's multiemployer program should also be reviewed as part of that discussion. The basic contours of the program have not been modified in more than 30 years. Some of the tools and authorities the statute provides that might be useful in certain circumstances are not useable in practice because of the agency's lack of financial resources. Both the program and PBGC's finances should be analyzed as part of and in the context of the broader changes for multiemployer plans generally.

PBGC takes the support and preservation of multiemployer pension plans very seriously. Since I have been Director, I have doubled the size of multiemployer staff, am planning to add further resources and make further changes to strengthen PBGC's capabilities.

PBGC staff has expertise and analytic ability in the area of multiemployer plans, as well as a dedication to multiemployer plans. We look forward to providing assistance in the deliberations, and to continuing to serve the millions that look to multiemployer plans for a secure retirement.

Appendix: PBGC FY 2012 Annual Report