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Before the Subcommittee on Health, Employment, Labor and Pensions

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Thank you, Chairwoman Wilson, Ranking Member Walberg, and all of the members of the subcommittee. I appreciate this opportunity to appear before you to discuss the challenges facing the multiemployer pension system.

The Crisis

The title of this hearing, "The Cost of Inaction: Why Congress Must Address the Multiemployer Pension Crisis," is apt. American workers who participate in multiemployer pensions are threatened by a mounting crisis, one that will almost certainly require federal legislation to avert. The crisis arises from multiemployer pension plan sponsors' funding contributions being far inadequate to finance the benefits they have promised, and is manifested in the projected insolvency of the nation's multiemployer pension insurance program operated by the Pension Benefit Guaranty Corporation (PBGC). The PBGC insurance program's projected insolvency threatens millions of American workers with the near-total loss of their pension benefits. To allow the PBGC insurance system to become insolvent would represent a terrible public policy failure, not only because workers need and were promised these benefits by their employers and their labor representatives, but because they were led to believe that many of these benefits were secure and insured.

Multiemployer pensions are private sector defined-benefit pension plans. Like wages and health benefits, they represent compensation provided by private employers to workers for their labor. These pensions are typically sponsored together by multiple employers in a common industry or geographic area as part of a collective bargaining agreement with a labor union. A board of trustees, on which management and labor are equally represented, bears responsibility for operating the plan and for ensuring that its benefit structure aligns with its funding.

Multiemployer pension benefits are insured by PBGC, a federally-chartered corporation, which provides insurance coverage financed by premiums assessed on pension sponsors. This insurance system reflects a longstanding bipartisan consensus with respect to protecting private sector pension

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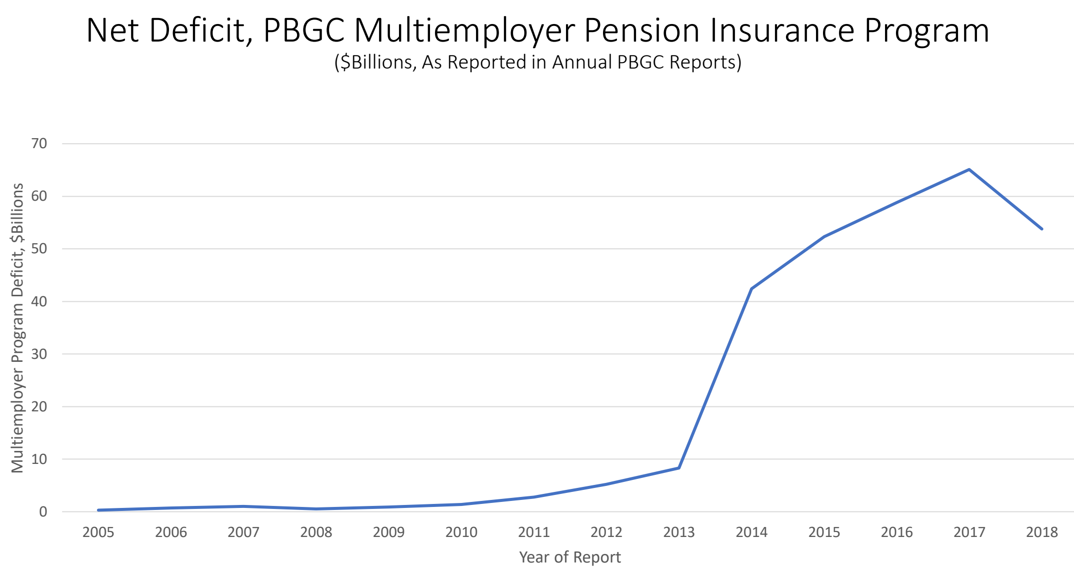
benefits. PBGC insurance exists to protect workers against the possibility that their employers may ultimately prove unable to deliver on their pension promises, whether because they have gone out of business or for any other reason. Significantly, the insurance is financed by sponsors' premium contributions, because it is deemed inappropriate for other Americans who lack access to these employer-provided pension benefits to be made responsible for financing or insuring them. Beyond these basic descriptors, multiemployer pension insurance differs in significant ways from that covering single-employer pensions, which I will further discuss later in this testimony.

The immediate crisis is a $54 billion deficit in the PBGC's multiemployer insurance program and the resulting projection of its insolvency in FY2025. If the insurance program goes bankrupt, workers in insolvent plans will not receive even their ostensibly insured levels of benefits, and payments will be limited to those that can be financed from PBGC's incoming premium revenues. Some estimates are that in such dire circumstances, affected workers' losses could reach 90%.[2]

Figure 1: PBGC's Multiemployer Insurance Program Deficit



Solving this problem requires a full and accurate understanding of its causes, and a commitment to addressing the phenomena that have brought it about.

[2] Gotbaum, Joshua, "What Congress Can Do to Help People in Multiemployer Pension Plans." Testimony before the Senate Finance Committee, March 1, 2016.

Causes of the Crisis

Put simply, the main reasons that multiemployer pension insurance faces a solvency crisis are that US multiemployer pensions are badly underfunded, and also that the premiums that sponsors pay to PBGC are inadequate to insure against this underfunding. The most recent available data indicates that multiemployer pensions are less than 50% funded relative to their current liabilities, and also that there is more than $600 billion of underfunding in multiemployer pensions nationwide. This underfunding means that while the $54 billion deficit facing PBGC is an enormous projected cost in its own right, a failure to reform multiemployer pension funding and insurance threatens potential costs (to workers, PBGC and, under some proposals, taxpayers) of an order of magnitude larger.

Figure 2: Multiemployer Pension Underfunding

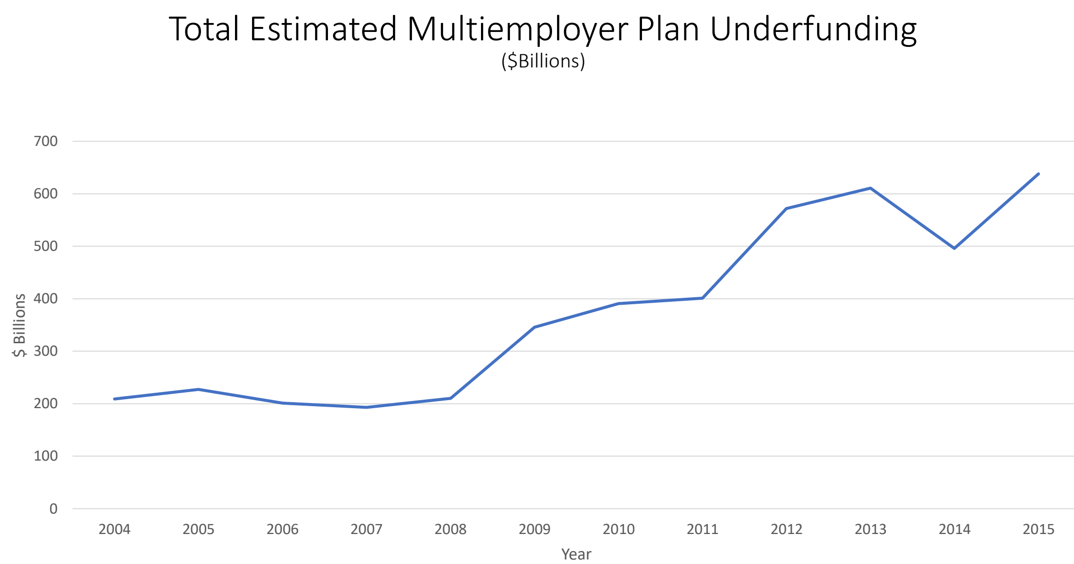
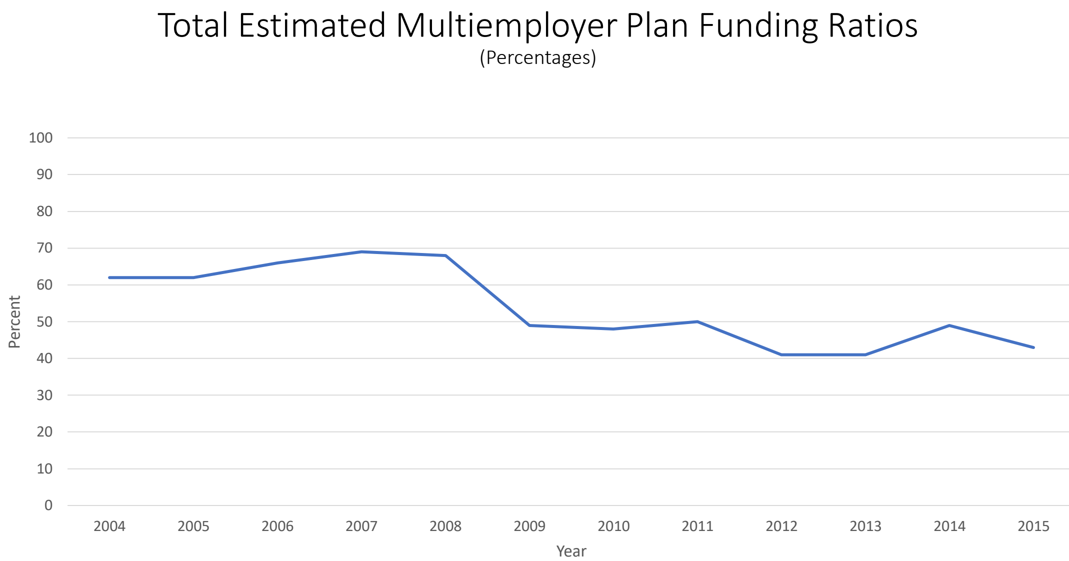


Figure 3: Multiemployer Plan Funding Ratios



The multiemployer pension funding crisis is sometimes attributed to factors such as episodic financial market shocks, including the bursting of the dot-com stock bubble in 2000 and the Great Recession of 2007-09. Also frequently cited are adverse demographics and the intensified competitive environment in which many pension sponsors operate, resulting in a declining ratio of active workers to those already retired and collecting benefits. Though these phenomena are indeed stressors for multiemployer plans, prudent pension management would anticipate them and, in any case, they do not account for the weakness of the multiemployer pension system relative to the single-employer insurance system which, though facing those same stress factors, is in a much stronger financial position (see Figures 4 and 5).

Figure 4: Percentage of Active Workers in Multiemployer vs. Single-employer Plans

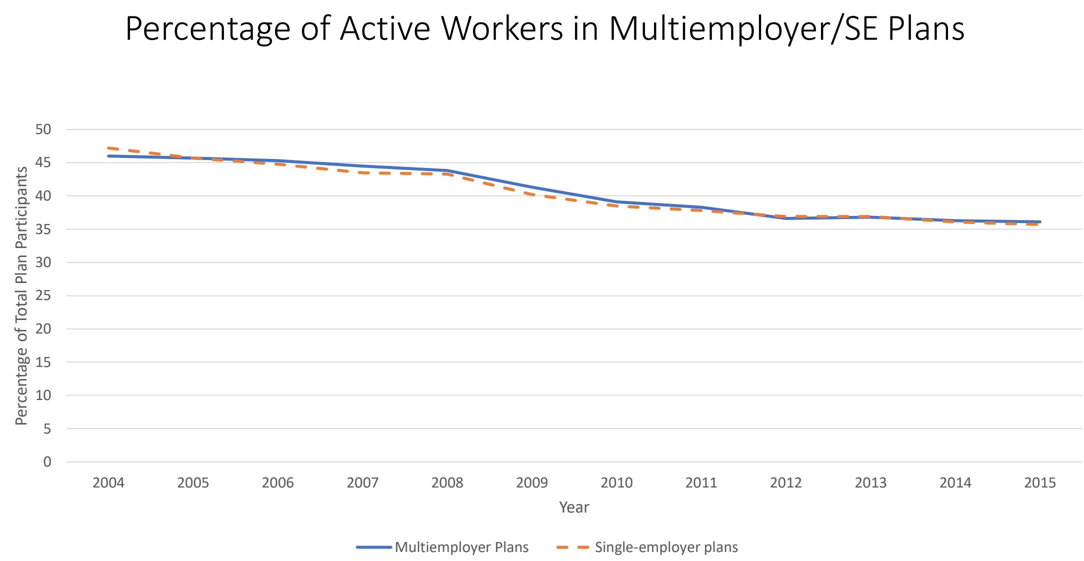
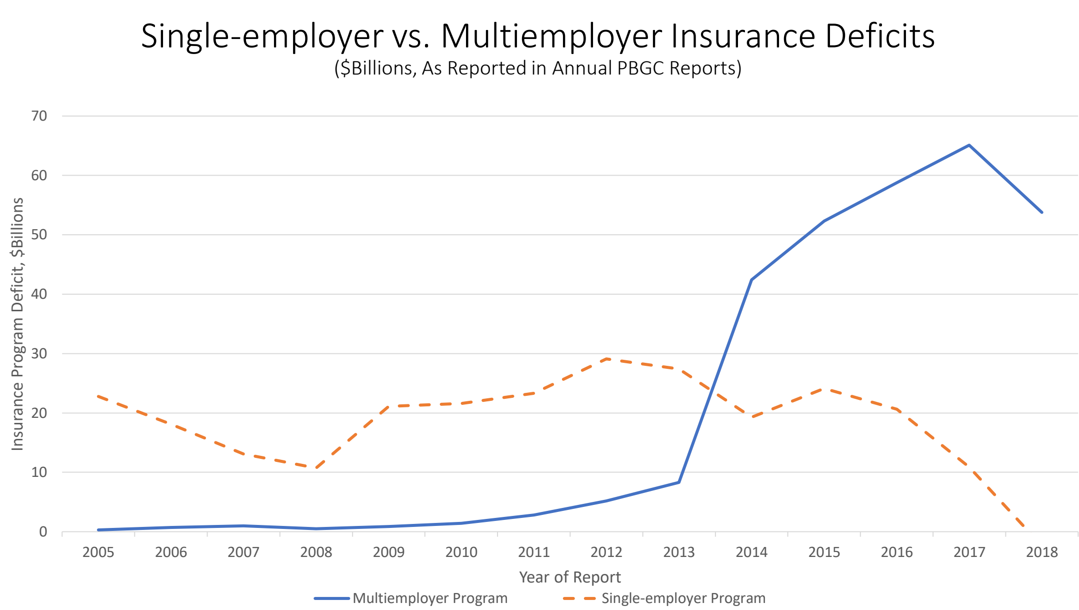


Figure 5: Comparison of PBGC Multiemployer and Single-Employer Insurance Program Deficits



As Figure 5 shows, the PBGC single-employer pension insurance program has stabilized at the same time that its multiemployer pension program has drifted into a worsening crisis. A key reason for this is that the 2006 Pension Protection Act bolstered the funding and premium requirements for single-employer pension plans, but it did not apply similar reforms to the multiemployer pension system. The aforementioned financial market shocks hit the single-employer system every bit as hard as the multiemployer system; the difference is that the single-employer system was able to weather these storms and to stabilize its funding position during subsequent financial market recovery years, whereas multiemployer pension funding continued to deteriorate.

The salient features distinguishing the multiemployer pension system from its single-employer counterpart, and which have led to systemic underfunding in multiemployer pensions, are primarily two:

1) Relative to single-employer pensions, the multiemployer pension system suffers from a lax regime of funding rules, fostering inaccurate valuations of pension liabilities and assets, inadequate contribution requirements for continuing and withdrawing sponsors alike, and inadequate and poorly-designed premium assessments.
2) The multiemployer pension system is beset by additional unfunded liabilities arising from benefits obligated to the so-called "orphan worker" population – that is, workers whose employers have withdrawn from pension plan sponsorship.

No solution to the multiemployer pension crisis is likely to hold unless it successfully addresses both of these factors.

The multiemployer pension system's comparatively weak system of insurance premium assessments, valuation measures and funding requirements were built upon the assumption that multiemployer plan benefits had an added layer of protection because these plans spread "the risk of fully funding plan benefits among numerous employers."[3] This foundational assumption, that such greater security would render a robust framework of federal funding requirements and insurance protections less necessary, has proved incorrect. Even though the insurance protection offered by PBGC's multiemployer plan insurance is far weaker than it is for single-employer plans (for example, insuring only $12,870 in benefits for a 30-year worker in a multiemployer plan as opposed to $67,300 for a 65-year-old worker in a single-employer plan), multiemployer plan underfunding has grown so vast that it threatens to deplete even its less-generous insurance backstop. This implicit assumption underlying historical federal law, that multiemployer plans can be left free to promise benefits far exceeding what they can fund, must be corrected before the consequences of that policy choice overwhelm the nation's multiemployer pension insurance system.

[3] PBGC, Multiemployer Pension Plans: Report to Congress Required by the Pension Protection Act of 2006, 25–26.

Under current federal law, unlike single-employer plans, multiemployer plans are allowed to greatly understate their liabilities by using inflated discount rates to translate them into present-value terms. While some sources tactfully say that there are diverse views on how to correctly discount pension liabilities, a more accurate way to describe the situation is that there is a firm consensus among economists on how to do it, and that most multiemployer plans' actuarial practices (as well as federal funding rules) simply disregard this consensus. Far from there being controversy on this point, economists broadly agree that payment obligations should be discounted according to their risk of nonpayment. Ergo, a payment that is fully guaranteed and risk-free should be discounted at a Treasury bond rate, whereas pension obligations generally should be discounted at rates not exceeding those reflected in a yield curve of corporate bond rates. These principles, however, are widely violated; multiemployer pension sponsors routinely discount their obligations at rates of 7% or more, causing plan funding percentages that average less than 50% in reality to be misreported as being nearly 80%. The problem is a simple one: if pension liabilities aren't properly recognized, they won't be funded, precisely what has happened throughout the multiemployer pension system.

Inaccurate discounting is a particular problem with multiemployer pensions because of the ways they are designed. A typical multiemployer plan is built around a sponsor contribution rate negotiated between participating employers and labor representatives. It is then incumbent on the plan's trustees, with the assistance of the plan's actuaries, to translate those contributions into a set of benefit promises they can safely fund. Thus, if the plan's trustees employ inflated discount rates, this decision not only results in plan underfunding but also directly inflates the benefits promised to workers. Whenever trustees employ inflated rates to increase a plan's promised benefits in this manner, it becomes especially inappropriate for the sponsors to then be allowed to transfer these benefit payment obligations to others, such as federal taxpayers or the PBGC.

Multiemployer pension plans are also governed by federal funding rules that are far more lax than those governing single-employer plans. Multiemployer plans are given much longer time frames to address their underfunding, and critically underfunded plans are exempted from otherwise applicable statutory penalties for inadequate contributions. Average insurance premiums paid by multiemployer plans are less than one-sixth of what they are for single-employer plans, despite the large multiemployer insurance program deficit. Underfunded multiemployer plans are also not subject to variable rate premiums as underfunded single-employer plans are, which means that PBGC cannot charge sponsors of underfunded plans for the additional risks they pose to the insurance system and that they implicitly pose to other participating employers and their workers.

In 2018, PBGC collected $295 million in flat-rate premiums from multiemployer plan sponsors, as opposed to $1.8 billion in single-employer flat rate premiums and $3.7 billion in single-employer variable rate premiums. This occurred in the context of a $54 billion projected deficit in the multiemployer program, as compared with a $2 billion projected surplus in the single-employer program. In a nutshell, multiemployer premiums are inadequate and fail to properly recognize the risks of plan underfunding.

Another phenomenon adversely affecting multiemployer pension funding in a distinctive way is that of orphan liabilities—that is, obligations of plans to pay benefits to former workers of employers that have since withdrawn from sponsorship. An employer withdrawing from sponsoring a multiemployer pension plan is theoretically obligated to make a withdrawal liability payment equal to that employer's share of unfunded vested benefits, but various limitations and exceptions often cause actual withdrawal payments to fall well short of this amount. It is therefore often much less expensive for a sponsor to withdraw from a plan than to continue contributing to it, which has a predictable adverse impact on multiemployer plan funding. Research finds that the most underfunded multiemployer plans have a substantially greater share of "orphan workers" than better-funded plans, on average. One study found that orphan workers in critically underfunded "red zone" plans constituted 27% of their participants, compared with only 10% in comparatively healthy "green zone" plans.[4]

To effectively address the multiemployer pension solvency crisis, reforms must correct both sets of problems: on the one hand, the flawed valuation, premium and funding rules governing multiemployer pensions, and on the other, inadequate withdrawal liability requirements and the orphan worker benefit liabilities that have arisen from them.

Principles for Reform

The members of this committee, and Congress generally, face an unenviable task in addressing the multiemployer pension solvency crisis. Putting it bluntly, at this advanced stage of the crisis there are no easy answers. Any solution that successfully addresses the problem will certainly make one constituency or another extremely unhappy, and likely make most stakeholders unhappy. Crafting a solution that can pass both houses of Congress will require considerable creative thinking, flexibility, bipartisanship, and a willingness to consider a wide variety of measures, including ones that generate substantial political challenges. The following section of my testimony offers suggested principles for reform without intending to minimize the complexities facing lawmakers.

Resolving the multiemployer pension crisis requires maneuvering past a Scylla and a Charybdis, two potentially fatal dangers on opposite sides. On the one side, when correcting the system's flawed valuation, premium, withdrawal and funding rules, one must avoid applying so much pressure on plan sponsors that terminations of pension plans are triggered that otherwise need not occur. But on the other side lies an even more dangerous potential mistake; procrastinating by propping up plans without arresting their continued movement along an unsustainable course, allowing their underfunding to mushroom further, and rendering their eventual collapses even more expensive. This latter course would be a continuation and escalation of policy failures to date.

[4] Munnell, Aubry, and Crawford, "Multiemployer Pension Plans: Current Status and Future Trends," tables 3 and 10.

Under current law, when a multiemployer plan can no longer meet its obligations, PBGC provides ongoing financial support rather than assuming the assets and obligations as it does with a terminated single-employer plan. This financial support is technically described as a "loan" but in effect it represents an ongoing subsidy, because such loans are rarely paid back. This current practice of propping up insolvent plans with loans that are never repaid will become more expensive the longer it is continued. If a plan is already in so much trouble that that there is simply no practical way to require its sponsors to properly measure its obligations, and to fully fund benefits over time without ongoing subsidy support from the federal government, then it is better that policy makers attempt to effectuate the least painful termination possible now rather than to allow the plan to dig its financial hole still deeper.

Accurate measurement of pension liabilities and assets is the essential, irreplaceable component of multiemployer pension reform. For pension liabilities, this means discounting at rates no greater than those reflected in a yield curve of high-quality corporate bond rates, simplified to roughly match the durations of benefit obligations. It's highly unlikely that any solution will hold if this is not done. Without this core reform, actual pension obligations will continue to far exceed what they are measured as being for funding purposes, resulting in funding percentages declining further and leading inexorably to mounting pressure for more expensive future federal bailouts.

It is sometimes objected that the adoption of accurate liability discounting measures will result in contribution requirements that are too onerous for multiemployer plan sponsors to bear. This is incorrect for several reasons. First, measurement accuracy and funding requirements are two different things. Contribution requirements reflect a discretionary choice; measurement accuracy does not. Lawmakers can craft any funding requirements they choose, however lenient or stringent, irrespective of how liabilities are measured. What is to be avoided is the embrace of liability and asset measurement inaccuracy for the deliberate purpose of arriving at one's desired contribution schedule. A pension plan's liabilities are what they are; this reality is not changed by a policy desire to have a less onerous funding requirement. As such, contribution requirements are rightly a matter of policy discretion and legislative negotiation. Accurate liability measurements, however, are not.

It is significant in this context that inaccurate liability and asset measurements have played a leading role in precipitating the current crisis. It is certainly reasonable to believe that the crisis has become so acute that various novel interventions by PBGC should be authorized, many of which might be considered undesirable or unpalatable if the multiemployer pension system were in stable condition. It is not reasonable, however, for pension plan sponsors to request and receive federal assistance in meeting their compensation promises to their own workers, while also being allowed to continue with the mismeasurement of pension plan liabilities that created much of the problem in the first place. As federal lawmakers consider various forms of intervention to forestall the crisis, it is essential that they put an end to flawed actuarial valuations that, if continued, must inevitably precipitate future calls for more expensive federal bailouts.

In addition to establishing accurate pension asset and liability measurements, effective multiemployer pension reforms would also include safeguards against further deterioration of underfunded plans, improved incentives for plan trustees, stronger funding requirements, and risk-based premiums. Legislators may wish to consider authorizing the PBGC to relieve plans of so-called orphan liabilities, subject to strict requirements that any relief must reduce projected claims on pension insurance. If in the worst-case scenario PBGC's solvency simply cannot be maintained even with a reformed premium revenue stream, then there should be a resolution of the unfunded obligations of insolvent multiemployer plans and of the PBGC's current multiemployer insurance program that is as orderly as possible, followed by a successor program that remains durable because it is built on a foundation of sufficient pension funding.

The worst policy choice would be to exacerbate the current problem by requiring federal taxpayers to pay tens and potentially hundreds of billions of dollars to subsidize competitive advantage for those sponsors who fail to meet their benefit promises, over competitors who have responsibly funded their retirement plans. Doing so would almost certainly cause multiemployer pension underfunding to soar, as a clear incentive would have been established for plan sponsors to forego adequate pension funding.

In sum, while there are no easy answers to the multiemployer pension crisis, lawmakers would do well to understand the causes of the crisis and to craft solutions based what that history tells us. A lasting solution must rest on a foundation of accurate measurements, strong funding rules, and reformed premium assessments. Creative solutions should be considered, including PBGC interventions to partition plans to relieve them of their orphan liabilities, if and only if offsetting plan amendments and measurement reforms eliminate the remaining plan's projected claims on the PBGC and reduce the insurance program's total exposure. The goal of these and other reforms should be a viable private sector defined-benefit pension system; viable because sponsors only promise benefits that they can fund, and because they fully fund all benefits that they promise.