The Financial Health of Defined Benefit Pension Plans
An Analysis of Certain Trade Unions Pension Plans: 2012 Update[1]

By:

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Current retirement prospects for workers in US

The primary focus of this report is the current and future prospects for defined benefit multiemployer pension (MDBP) plans in the US. The motivation for this report is to educate, inform and empower retirees involved generally in any type of retirement plan and specifically in MDBPs. More than at any other time in US history, people should be actively involved in the planning and preparation of their retirement plans.

It should be noted that challenges for retirees in the US are not limited to participants in multiemployer pensions. The US Census reports that the average retirement account for persons in the US is $50,000. Moreover, the median retirement fund is $2,000 and more than 43 percent of Americans have less than $10,000 saved for retirement.[2] Nearly 1 in 4 Americans will rely on Social Security as their primary source of retirement. One major cause of retirement woes is the 20 percent decline of the S&P from 2000 to 2010. This decade long slide in the stock market has done little to brighten the retirement prospects for working Americans.

On May 27, 2010, the GAO released a study entitled, "Long Standing Challenges Remain for Multiemployer Pension Plans.[3] The report discusses in detail how multiemployer defined benefit pension (MDBP) plans face significant ongoing funding and demographic challenges. These challenges will lead to more plan failures and will increase the financial burden on the Pension Benefit Guarantee Corporation (PBGC).

Multiemployer pension plans have a number of structural problems when compared with single employer pension plans. Such challenges include a continuing decline in the number of multiemployer pension plans and an aging participant base. A decline in collective bargaining in the United States has also left fewer opportunities for plans to attract new employers and workers. Consequently, the proportion of active participants paying into the fund has also been falling.

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[2] C. Sutton, CNN Money, March 2010.
[3] Statement of Charles A. Jeszeck, Acting Director Education, Workforce, and Income Security Issues as part of Testimony Before the Committee on Health, Education, Labor and Pensions, U. S. Senate.

The problems with MDBP plans are indicative of the overall structural economic breakdown of defined benefit plans in the US. Many companies have concluded that defined benefit pension plans are too rich and to costly to maintain after the economic crisis of 2008. [4] Watson Wyatt documents the overall movement away from DB plans as part of their 2009 survey. They reported for the first time that Fortune 100 companies began offering new employees only one type of retirement plan: a 401(k) or similar “defined contribution” plan. Moreover, due to the financial strain on the PBGC uncertainty is growing with respect to the viability of failed single and multiemployer pension plans.

In 1974 Congress attempted address the growing troubles brewing with employer provided pensions. They passed The Employee Retirement Income Security Act of 1974 (ERISA). Congress thought they could regulate employee pensions and ensure their availability for retirees. Ironically, a good case can be made that these same rules are playing a major role in the decline and possibly ultimate collapse of these same pension plans.

The first part of this report briefly discusses the unintended effects of ERISA. The second section looks at the current financial condition of the PBGC. Thirdly, a number of MDBP industry surveys are presented for the years 2008 thru 2011 to help assess recent performance of MDBP plans. In 2006 I examined Form 5500 data for a sample plans based largely in Missouri to gather anecdotal empirical evidence on the performance of MDB pensions. This study is updated and expanded in the fourth section of this report with data for 2007, 2008 and 2009. The following section reviews recent Congressional proposals to rescue certain MDP plans. This report concludes with a look at a couple of investment strategies for retirees and companies to consider in light of these challenging conditions.

2. Current financial state of PBGC

More than 10 million current workers and retirees rely on multiemployer plans. For decades, multiemployer plans were in reasonably good health, even in the face of industry

[4] S. Block, “Traditional Company Pensions are going away fast,” USA Today, May 22, 2009.

decline. Unfortunately, for many multiemployer plans, that is no longer the case. Many are substantially underfunded; for some, the traditional remedies of increased funding or reduced future benefit accruals will not keep the plans afloat.

At the time of my earlier report (McGowan 2008), PBGC assets supporting the multiemployer program had a value of $1.2 billion and accrued liabilities of $2.1 billion in the multiemployer insurance as of September 30, 2007. At that time the net deficit was $900 million. These liabilities represent the present value of future financial assistance for plans that PBGC has identified as "probables" for purposes of PBGC's financial statements. A probable" plan is one that is currently receiving, or is projected to require, financial assistance. Thus, a "probable" plan is usually a terminated or insolvent multiemployer plan. Unfortunately, the downward spiral for MDBPs has accelerated since that time. By September 2010, the PBGC deficit related to MDBPs rose to $1.4 billion. By the end of September 2011, the MDBP related deficit at PBGC doubled to $2.8 billion. Similarly, the total PBCG deficit rose from $23 billion at the end of fiscal 2010 to $26 billion by the end of the 2011 fiscal year.

3. MDBP Surveys for 2008 thru 2011: Are They on the Road to Financial Recovery?

A number of studies have been performed to assess the recent performance of MDBP plans. These results for these studies are shown chronologically in the next section.

Financial Crisis of 2008

The National Coordinating Committee for Multiemployer Plans (NCCMP) is an advocacy organization of multiemployer pension funds. Each year they perform a survey on the financial health of MDBP plans. This annual survey includes a major percentage of multiemployer pension plans. For the beginning of 2008 plan years the NCCPMP reported that over 75% of plans included in the survey were in the 'green zone', indicating a strong financial position. During 2008 the financial crisis caused the ***average*** reported funded status to decline to 77% from 90% at the beginning of the year. Moreover, by the end of the year only 20% of MDBP respondents indicated their plans were still in the green zone. Similarly, 42% of plans in the survey identified themselves as critical status or 'red zone' plans.

The plummeting financial status of defined benefit pension plans in 2008 was articulated in my earlier study (McGowan, 2008). That study analyzed certain 2006 MDBP data and projected 2008 based on the plunging indexes of the stock market. At the time, a number of local trade unions were vigorously assaulting the study as flawed and inaccurate. However, a number of other studies described the same financial difficulties for 2008 multiemployer pension plans. For example, Watson Wyatt Worldwide observed that the top 100 multiemployer pensions were just 79 percent funded.[5] Moody's Investors service also published a study in 2009 citing growing concern about multiemployer pension funding shortfalls.[6] The Hudson Institute also examined multiemployer pension data contained in Form 5500s. In their study[7], Furchtgott-Roth and Brown concluded that the risks of multiemployer pension plans exceeded those of private pension plans.

One major cause of this shift in MDBP plans can be traced to the investment results for 2008 where the median asset return was -22.1%. Moreover, the NCCMP report stated that the true impact of the crisis was even more dramatic than these figures indicated.[8] The PPA funded percentage measure relies on the *actuarial value of pension plan assets* and typically recognizes investment gains and losses gradually over time. On a *market value of assets* basis, the average funded percentage was much worse. The average funded market value percentage declined from 89% to 65%.

In addition to investment results, the financial impact on a plan is also a function of employment levels. When a plan becomes underfunded, it is important that there be a large population of active members with strong employment levels to create a contribution base capable of offsetting the shortfall. Unfortunately, an equally historic level of unemployment

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[5] Leveson, I, <u>Economic Security a Guide for an Age of Insecurity</u>, iUniverse p. 18, April 29, 2011.
[6] See, Moody's: Growing Multiemployer Pension Funding Shortfall is an Increasing Credit Concern," Sept. 10, 2009.
[7] See, Furtchgott-Roth D., and A. Brown, "Comparing Union-Sponsored and Private Pension Plans: How Safe are Workers Retirements?" Hudson Institute, September 2009.
[8] Defrehn, R.G. and J. Shapiro, 2010 Update to MCCMP Survey of Funded Status of Multiemployer Defined Benefit Plans, p. 1.

followed the historic market collapse of 2008. This unemployment level has also severely limited the ability of many plans to recover.

Returns improve in 2009: high unemployment continues

There was a high response rate for the 2009 NCCMP survey. Total plan participants numbered 6.3 million and represented 60 percent of the multiemployer plan population. Plans included in the NCCMP survey reported a median 2009 asset return of 16.6%. This figure however was not nearly enough to offset the devastating returns of the prior year. The International Foundation of Employee Benefit Plans (IFEBP) reported similar results in 2009 their survey of MDBP plans. As of August, nearly three-quarters of MDBP plans were less than 80 percent funded. The 2009 IFEBP survey had a much smaller sample size (213 plans).[9] Nevertheless, the results were proportionate and consistent with other surveys for that time period. The number of plans in the endangered or critical status had tripled from 2008.

During 2009, participants and sponsors of multiemployer pensions responded by increasing contributions and reducing benefit accrual levels. Similarly, many plans in the IFEBP survey indicated that they were taking advantage of the temporary freeze option available to MDBP plans in 2009.

Returns stable in 2010: unemployment shows little improvement

Participants in the 2010 NCCMP survey declined to 3.6 million or approximately 35 percent of multiemployer plans. For a second straight year, respondents reported strong investment returns in 2010. Consequently, these plans reported an increase in average fund status to over 82% from 77%.

The 2010 strengthening for pensions was not confined to multiemployer plans. Milliman is among the world's largest independent actuarial and consulting firms in the world. Their annual study covers 100 U.S. public companies with the largest defined benefit pension plan

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[9] See Wojcik, J., "73 percent of multiemployer pension plans underfunded: Study," Business Insurance, Sept. 29, 2009.

assets for which an annual report (Form 10-K) is released by March 3 of the following year. Their study also reflected an overall improvement in funding status due to increased fund contributions. However, the improvement was somewhat curtailed by ongoing low interest rates.

More specifically, the record cash contributions for these plans and investment gains (12.8% actual returns for 2010 fiscal year vs. 8.0% expected returns) were offset by the 7.7% increase in liabilities generated by the decrease in discount rates (5.43% for 2010, down from 5.82% in 2009 and 6.36% in 2008) used to measure pension plan liabilities. The lower discount rate coupled with record cash contributions culminated in a small improvement in the funding ratio for these plans in 2010. The average increased to 83.9% from 81.7%.

Reasons for improved plan status in 2010 and 2009

As noted in the NCCMP report, the number of plans in the green zone (more than 80 percent funded under PPA 2006 rules) more than doubled from 20 to 48% by the end of 2010. Similarly, the number of plans in the red zone (critical status) declined from 42 to 32%. The report traced this improvement to three factors. First, there were strong investment returns. Second, the plans and sponsoring employers implemented a combination of contribution increases and benefit cuts to shore up their financial status. Thirdly, the funding relief provisions of the Preservation of Access to Care for Medicare Beneficiaries and Pension Relief Act of 2010 helped improve multiemployer funding status.

Pension expense continues to rise for 2010

Record levels of pension expense were recorded in 2010. A $30.0 billion charge was recorded for firms in the 2010 Milliman Pension Funding Study. There were 11 companies with pension income (e.g., negative expense) in 2010, down from 16 in 2008. Pension expense is projected to increase for 2011 as companies using asset smoothing are still reflecting the impact of losses in 2008.

Accounting changes adopted by some companies

A number of companies elected to recognize substantially all of their accumulated losses for 2010. This accounting change resulted in a significant charge to the year-end balance sheets for Honeywell, Verizon and AT&T. The elimination of this charge in 2010 will lead to a reduction of future years' pension expense through the elimination of the annual charge to earnings for those losses. Milliman estimates that similar charge to earnings for the remaining 100 companies would have resulted in a $342 billion charge to their cumulative balance sheets and a reduction in their 2011 pension expense of about $19.9 billion.

Proposed change to International Accounting Standards

There is also a serious debate raging regarding whether International Accounting Standards should be converged with or adopted in place of U.S. GAAP. A proposed change to International Accounting Standards would eliminate the pension expense credit for Expected Return on Assets (8.0% for the Milliman 100 companies in 2010). Under this change, companies would have a pension expense equal to the discount rate on the excess of liabilities over assets (or a similar credit if the plan were more than 100% funded). If that change had been adopted for U.S. GAAP accounting in 2010, the pension expense for the Milliman 100 companies (and the charge to corporate earnings) would have increased by about $30.0 billion. Such changes would have a commensurate effect on multiemployer pension plans. Therefore pension expenses would be pushed higher.

Defined Benefit Plans in 2011

A review of defined benefit plan performance in 2011 in Canada shows that things also took a turn for the worse. Towers Watson has kept a tracking index to represent defined benefit pension plans across the country for more than a decade. In 2011, the index declined from 86 at the start of the year to 72 by the end. The index was at 100 in December 2000 and after a brief rise in 2001, has been on a steady decline ever since.[10]

Expected plan contributions expected for 2012

CFO Magazine reports that big pension contributions are expected in 2012. According to a new report from Credit Suisse and accounting analyst David Zion, Companies in the S&P 500 will likely have to contribute $90 billion to fund pension plan gaps in 2012, up from $52 billion in 2011.

4. A sample of Missouri based MDBP plans: an expansion and update

My original 2008 study was also presented at a Senate Hearing on May 27, 2010. [11] The Senate Hearing was entitled: "Building a Secure Future for Multiemployer Pensions." The purpose of this hearing was to address the structural problems of multiemployer pensions.[12]

The key findings of my 2008 report are:

- The assumption of failing pensions by PBGC had led to an overall deficit of $955 million
- By September 2007, the PBGC insured about 1,500 multiemployer (sometimes called union plans) plans and promised benefits to about to roughly 10 million participants
- Multiemployer pensions problems were forcing fund managers to cut benefits
- The other avenue to improve multiemployer fund status was to increase contributions
- Central States required a withdrawal liability payment of $6 billion from UPS
- Both employers and employees were encouraged to carefully consider the financial condition of multiemployer pension plans whether they were current or prospective participants

Measuring the funding status of multiemployer plans

The Pension Protection Act of 2006 places the task of computing the funded status of MDBP plans in the hands of the actuary. Various actuarial assumptions and methods are used to determine cost, liabilities, interest rates, and other funding factors. While these assumptions must be reasonable, they tend to make the actuarial value of the assets significantly higher than market value. For example, the actuarial value of the assets recognizes investment gains and losses gradually over time.

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10 CBC News.CA, "Defined benefit pension plans had bleak 2011," Jan. 4, 2012.
11 See summary at http://www.help.senate.gov/imo/media/doc/McGowan.pdf
12 See http://www.help.senate.gov/imo/media/doc/McGowan.pdf.

The PPA 2006 directs actuaries to place MDBP plans in one of three separate zones: green for healthy (80% funded), yellow for endangered (65% funded) and red for critical (under 65% funded). Plans are in the green or healthy zone if they are more than 80 percent funded. Yellow zone or endangered plans are funded at least 65 but less than 80 percent. Plans are also in the yellow zone if they have had a funding deficiency in the past 7 years. When a plan hits both conditions they are considered "seriously endangered." According to Eli Greenblum, an actuary and senior VP of the Segal Co., "Yellow zone plans cannot cut protected or adjustable benefits, there is no official shelter from funding-deficiency penalties, and there are no employer surcharges."[13] If a plan goes into the red zone or funding level below 65 percent, the trustees must adopt a rehabilitation plan. Pension trustees may reduce certain benefits under the rehabilitation plan.

People covered by a traditional defined-benefit pension plan should receive a funding notice every year, which gives workers an idea of how well the plan is doing. However, people frequently do not have access to the funding notice. In these cases,[14] people can get a rough idea of how well their plan is doing by looking at Form 5500. Moreover, participants in private pension plans have the legal right to request the most recent Form 5500 from their plan administrator. Participants can also find a less recent copy of the Form 5500 on a web site called FreeERISA.com.

Certain multiemployer pension administrators take such strong exception to the notion that people are able to get a rough idea of the financial solvency of their multiemployer pensions by looking at data on IRS form 5500. Then Pension Rights Center stands behind this notion and presents it clearly on their website.[15] The Pension Rights Center encourages people to determine the funded status of their pension by dividing the current value of plan assets by the "RPA 94" current liability. The RPA 94 (Retirement Protection Act of 1994) current liability is based on the

[13] See comments by Eli Greenblum at March 21, 2007 at BNA sponsored pension conference.
[14] See:http://www.pensionrights.org/publications/fact-sheet/how-well-funded-your-pension-plan.
[15] http://www.pensionrights.org/publications/fact-sheet/how-well-funded-your-pension-plan.

present value of benefits accrued to date. This liability is discounted using a statutory interest rate assumption range that is tied to average long-term bond yields.[16] Numerous studies have used this funding ratio as provided on Form 5500 as a proxy for the financial solvency of multiemployer or union pension plans.[17]

Sample of MDBPs in Missouri

This study expands on the sample of Missouri based multiemployer pensions next. As can be seen from a casual review of the actuarial data presented here from Form 5500s is that these plans are not doing well.

Pension Fund	Year	Current Assets	Total Liabilities	Percentage
Carpenters Pension Trust of SL	2009	$1,176,145,761	$3,143,709,605	37.4%
Carpenters Pension Trust of SL	2008	$1,611,931,135	$2,794,336,754	57.6%
Carpenters Pension Trust of SL	2007	$1,589,538,148	$2,305,084,039	68.9%
Carpenters Pension Trust of SL	2006	$1,435,159,165	$2,031,453,937	70.6%
Construction Laborers of SL	2009	$361,501,014	$815,694,842	44.3%
Construction Laborers of SL	2008	$458,876,011	$719,746,151	63.7%
Construction Laborers of SL	2007	$437,851,451	$594,131,725	73.7%
Construction Laborers of SL	2006	$391,340,770	$519,434,403	75.3%
IBEW Local No 124	2009	$ 121051761	$254,496,469	47.6%
Plumbers and Pipefitters Misc. Local Chapters		$79,631,277	$118,332,486	67.3%
Sheet Metal Workers Local 36	2008	$153,004,997	$262,235,832	58.3%
Sheet Metal Workers Local 36	2007	$140,785,417	$212,424,703	66.2%
Sheet Metal Workers Local 36	2006	$129,274,465	$201,574,482	64.1%
Roofers Local No 20	2009	$53,148,454	$93,805,474	53.8%
MO-KAN Teamsters	2010	$46,084,294	$120,499,797	38.2%
Kansas City Cement Masons	2009	$35,269,314	$93,852,982	37.5%
Painters District Council No 3	2009	$68,471,488	$249,667,631	27.4%
Operating Engineers Local 101	2010	$497,389,413	$1,113,743,496	44.6%

[16] See: http://www.actuary.org/pdf/pension/moodys_march06.pdf Letter from D.J. Segal, VP of Pension Practice Counsel to American Academy of Actuaries March 1, 2006.

[17] See: Allen, S.G., R.L. Clark, and A.A. McDermed, "Post-Retirement Increases in Pensions in the 1980s: Did Plan Finances Matter?" National Bureau of Economic Research Working Paper #4413; D., Furchtgott-Roth, "Union vs. Private Pension Plans: How Secure Are Union Members' Retirements?" Hudson Institute, Summer 2008, September 2009; Addoum, J.M., J.H. van Binsbergen, and M.W. Brandt, "Asset Allocation and Managerial Assumptions in Corporate Pension Plans," Duke Working Paper 2010; McGowan, J.R., "The Financial Health of Multiemployer Pension Plans, PBGC and the Recent Government Bailout Proposal: Create Jobs and Save Benefits Act of 2010," Report prepared for Senate Committee on Health, Education, Labor and Pensions: Building a Secure Future for Multiemployer Pension Plans, May 27, 2010, See: http://help.senate.gov/hearings/hearing/?id=6a51d13d-5056-9502-5d61-e47c92a6a05f.

Insulators Local 27	2010	$22,761,378	$66,298,542	34.0%
Iron Workers of St. Louis	2009	$347,808,001	$847,967,614	41.0%
Bricklayers Union Local No. 1	2008	$66,319,296	$95,449,574	69.4%
Carpenters District Council of Kansas City	2009	$527,566,339	$1,312,230,524	40.2%

* Serves Laborers' International Union of North America Locals #42, #53, and #110.

5. Congressional Efforts to "Rescue" Certain Underfunded MDBP Pension Plans

In May 2010, Senator Casey introduced S. 3157 under the title of Create Jobs and Save Benefits Act of 2010. The bill mirrors legislative proposals introduced in 2009 by Reps. Earl Pomeroy and Patrick Tiberi. Among other things, the bill proposes to transfer all pension liabilities of "orphan" retirees – those who had worked at the now-defunct trucking firms whose pensions are being funded by the surviving truckers to the PBGC. Senator Casey characterized the current dilemma as follows, "The current costs of multi-employer pension compliance represent a huge, hidden tax on large and small business." This characterization understates the problem. Michael H. Belzer, a professor at Wayne State University is one of the nation's foremost experts on tru8cking labor law. He was correct when he recently said, "the multi-employer concept was "dumb" and an inconceivably great failure" of public policy.

6. What is a realistic option for workers going forward?

Congress should have the courage to address the real problems with MDBPs. The solution is not to write a blank check to fund these pensions. The private sector is reflecting modern economic reality when it comes to pension plans. There will be a continued migration away from DB plans and toward 401K plans, or perhaps some combination of DB and 401(K) plans, and possibly forced contributions from both employers and employees to retirement plans.

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