MULTIPLYING INVESTMENT, INSURANCE & RETIREMENT KNOWLEDGE

PROJECT M

RISK

Broken promises

A controversial solution to pension plan underfunding could reduce benefits for retirees and active workers

With little fanfare or international attention, the US Congress last year passed a sweeping pension reform bill that, for the first time, allows a select group of pension plans to voluntarily reduce benefits for active workers and retirees if those reductions are necessary to save the plan from insolvency.

THE AUTHOR

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The law – called the Multiemployer Pension Reform Act (MPRA) – is a remarkable step in the development of US pension law, but the jury is still out as to whether it will actually work as intended.

Approximately 10 million workers and retirees have been promised pension benefits by multiemployer plans. Those plans are collectively bargained pensions that usually cover an entire industry or region rather than the employees of a single company. They provide small employers

with a simple way to offer retirement benefits and allow workers to take their pensions with them when they change jobs, provided their new employers also participate.

An important feature of multiemployer pensions is that all employers are collectively responsible for the benefit obligations. If an employer withdraws from a plan, that employer is responsible for an exit fee representing its share of the underfunding. However, a variety of statutory limitations and practical challenges make it rare for multiemployer plans to collect the true value of the obligation when employers withdraw. The result is that remaining employers often pay for benefits earned by competitors' employees.

FEWER SHOULDERS TO BEAR THE BURDEN

Although many multiemployer plans have been successful for decades, declines in the financial markets between 2000 and 2008 caused the funding level of some to deteriorate dramatically. Those funding problems put a significant strain on employers.

The more underfunded a plan becomes, the higher contribution rates need to be to balance the books. That makes participating employers less and less competitive, especially given the fact that competitors often do not have pension obligations. Moreover, as employers withdraw from the plans – either voluntarily or via bankruptcy – the remaining employers are saddled with a growing share of the underfunding.

Multiemployer funding challenges are also a growing threat to the Pension Benefit Guaranty Corporation (PBGC). PBGC is a government-created insurance company that guarantees a portion of multiemployer pension benefits in the event a plan goes insolvent. The agency has never received government financing and instead relies exclusively on insurance premiums collected from pension plans. The multiemployer funding crisis is sufficiently large that the agency lacks the resources to cover the guaranteed benefits, and without changes, PBGC itself will go insolvent in the next 10-15 years, leaving workers and retirees without a safety net.

A CHOICE OF LESSER EVILS

Congress began considering reforms in 2010: Unfortunately, none of the options available were particularly appealing. Providing government funds to prop up failing multiemployer pensions or the PBGC was a non-starter for many politicians in both political parties. And it was

apparent that in many cases it would be counterproductive to require employers to contribute more, as that would result in bankruptcies and withdrawals that do not serve to protect participant benefits. In some plans, high contribution rates were even fomenting backlash from younger workers who were seeing a large portion of their salary go to pay the benefits of retirees.

With no possibility of providing the plans with increased funding, the only option left to consider was whether to allow seriously troubled multiemployer pensions to address their funding challenges by reducing promised benefits. That idea was, and continues to be, controversial, particularly where the reductions hit retirees already receiving benefits.

Some argued that allowing benefit reductions represented a dangerous and unprecedented weakening of the protections for pension plan participants. For 40 years, a central tenet of pension law in the US was that once a benefit had been promised, it should never be reduced. Others argued that, despite the benefit promises that plans have made, the reality is that the resources necessary to support the promises simply do not exist. From this perspective, MPRA is an acknowledgement of economic facts as much as it is a major policy shift.

Despite the concerns of stakeholders, leaders in Congress began to seriously consider allowing changes to promised benefits. It took nearly four years of political wrangling and heated debate, but Congress finally passed MPRA and forever changed the face of the multiemployer pension system.

A SEISMIC SHIFT

MPRA is a comprehensive piece of legislation that provides multiemployer trustees with a variety of self-help tools, but the most powerful is a provision that allows trustees of certain severely troubled multiemployer pension plans to reduce their benefit payment obligations if those reductions can save the plans from insolvency. The underlying concept is that the interests of participants may be best served by making smaller, proactive benefit reductions today, rather than accepting larger reductions when the plans exhaust their resources.

The law incorporates a number of protections. For example, benefits cannot be reduced below 110% of the PBGC guarantee, and trustees must consider every other possible option before implementing benefit reductions. MPRA also limits the reductions for vulnerable populations (older retirees and the disabled) and provides for the restoration of benefits if a plan recovers. Because the plans are collectively bargained,

benefit reductions cannot be adopted unless representatives of the labor union vote in favor of their adoption.

MPRA represents a seismic shift in US pension law, but only time will tell whether it will accomplish the goals intended. Nothing in the law is mandatory, and it is unclear how many plans will make the difficult decision to reduce promised benefits. And for some plans, the reductions permitted by MPRA will almost certainly not be enough to prevent insolvency. That said, MPRA is an important attempt by policymakers to deal with the pension funding crisis, and it provides a path toward saving some multiemployer pensions, should plan trustees choose to take it.

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