NATIONAL COORDINATING COMMITTEE FOR MULTIEMPLOYER PLANS

815 16TH STREET, N.W., WASHINGTON, DC 20006 • PHONE 202-737-5315 • FAX 202-737-1308

United States Senate

Committee on Health, Education, Labor and Pensions

Building a Secure Future for Multiemployer Pension Plans

May 27, 2010

Testimony of

Randy G. DeFrehn, Executive Director

National Coordinating Committee for Multiemployer Plans

INTRODUCTION

Chairman Harkin, Ranking Member Enzi and other distinguished members of the Committee, my name is Randy DeFrehn. I am the Executive Director of the National Coordinating Committee for Multiemployer Plans (the "NCCMP")[1]. The NCCMP is a non-partisan, non-profit advocacy corporation created under Section 501(c)(4) of the Internal Revenue Code in 1974, and is the only organization created for the exclusive purpose of representing the interests of multiemployer plans, their participants and sponsoring organizations. It is an honor to be invited here once again to speak with you about issues of critical importance to the more than ten millions of working Americans who depend upon multiemployer defined benefit plans for their retirement income security. I am testifying today on behalf of the NCCMP and the Multiemployer Pension Plans Coalition ("Coalition")[2], a broad group comprised of employers, employer associations, labor unions, multiemployer pension funds, trade and advocacy groups from across the country, representing the full spectrum of the multiemployer community.

I will focus my remarks this morning on putting the effects of the 2008 market contractions into perspective and on the proposal by the Coalition to address targeted relief for plans adversely affected by those markets.

---

[1] The NCCMP is the premier advocacy organization for multiemployer plans, representing their interests and explaining their issues to policy makers in Washington since enactment of ERISA in1974. Its members include more than 200 affiliates which directly sponsor over 700 pension, health and welfare and training trust funds, as well as employers and labor unions whose workers and members participate in multiemployer plans.

[2] The Multiemployer Pension Plans Coalition, which is coordinated by the NCCMP, came together in response to the first "once in a lifetime" bear market early in this decade, to harness the efforts of all multiemployer-plan stakeholders toward the common goal of achieving benefit security for the active and retired American workers who rely on multiemployer defined benefit pension plans for their retirement income. Collectively, these stakeholders worked tirelessly to devise, evaluate and refine proposals from all corners of the multiemployer community for funding reform. Their efforts culminated in a proposal for fundamental reform of the funding rules contained in ERISA; rules that had never been "stress-tested" under the kind of negative investment markets which prevailed from 2000 through 2002; and rules that were largely adopted in the multiemployer provisions Pension Protection Act of 2006 ("PPA"). This group recognized that benefit security rests on rules that demand responsible funding, discipline in promising benefits and an underlying notion that even the best benefit plan is irrelevant if the businesses that support it are unable to remain competitive because of excessive, unanticipated or unpredictable costs. The Coalition was reconstituted following the second "once in a lifetime" market event in 2008 when it became clear that the provisions of the PPA were not sufficiently flexible to address the magnitude of the global catastrophic market contractions that affected every part of the financial services infrastructure of the United States.

BACKGROUND

Multiemployer plans have provided retirement security to tens of millions of American workers for more than 60 years. They currently account for nearly one of every four participants covered by a defined benefit plan. This system has survived and thrived as a result of a joint commitment by labor and management (reinforced by the statutory and regulatory structure) to responsibly balance the needs of all of the stakeholders. Through the collective bargaining process, tens of thousands of small businesses have negotiated with employee representatives to provide good, middle class wages and excellent pension and health benefits while enabling employers to remain competitive. Multiemployer plans enable employees in mobile industries to receive reliable benefits through a system that enables portability of service among employers that contribute to the same plan and, through reciprocity agreements, to virtually all plans in many trades while providing employers with the benefits of economies of scale in the pooling of assets, administrative costs and liabilities. They are prevalent in virtually every area of the economy where employment patterns require frequent movement within an industry, including: construction; trucking; retail; communications; hospitality; aerospace; health care; longshore; maritime; entertainment; food production, sales and distribution; mining; manufacturing; textiles; and building services.

PROBLEM STATEMENT

Since the passage of ERISA in 1974, the multiemployer pension plan system has had a history of secure funding and conservative management to systematically accumulate funds needed to meet long-term pension benefit obligations when they became due. This statutory framework was enhanced in 1980 with the passage of the Multiemployer Pension Plan Amendments Act (MPPAA) which imposed a framework within which departing employers would be assessed for their proportionate share of any unfunded vested benefits[3]. Additionally, the fiduciary rules imposed a measured discipline on plan trustees to responsibly manage the plans' assets and plan design. This system was badly damaged by the recent collapse of the financial markets. It is important to understand the factors that influenced that damage in order to craft an appropriate resolution.

As the system evolved, plan trustees prudently adhered to guidance by the Department of Labor to place their assets in broadly diversified investment portfolios. They retained professional advisors who guided them to allocate plan assets in investment classes that were thought to be uncorrelated to minimize risk. While a minority of advisors began to suggest movement to "immunized" and "risk-free" portfolios, most advisors and plan fiduciaries rejected that advice as failing to adequately recognize the equity premium which was historically realized by long-term "patient" investors. Fueled by a favorable economy and strong investment markets of the1980's and 1990's, plans were able to eliminate the majority of unfunded liabilities. Accepting, for the moment, that this represented the prevailing advice among the investment consultant community, the system would have remained vulnerable to the volatility of the markets. Unfortunately, when "the bear" arrived at the door, few asset classes were left

[3] MPPAA imposed the concept of "withdrawal liability" that required sponsoring employers who depart from plans pay their proportionate share (if any) of the plan's unfunded vested benefit obligations. These assessments were deemed necessary to prevent such obligations from being unfairly shifted either to the remaining employers thereby providing a double competitive advantage to the departing employers (first, by no longer having any obligation to make contributions to the plan, and second, by imposing those costs on the remaining employers) or to the taxpayer.

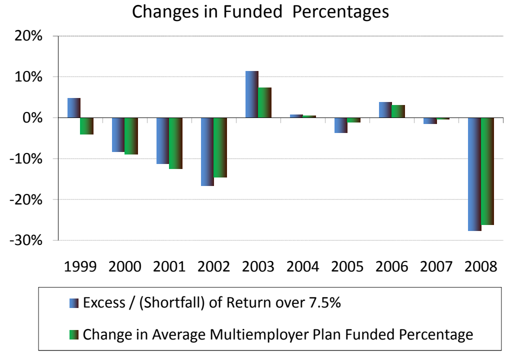
unscathed, as investors around the world experienced and continue to suffer from, the profound and lingering effects of its two most recent visits. Had the system been permitted to operate within the narrow context of ERISA's funding goals, however, it might still have avoided or at least moderated the effects of market volatility.

Unfortunately, plans are also exposed to a variety of other, perhaps more insidious, risks from an unexpected source - other government policies with only a tangential relationship to pension funding. These included restrictions placed on the tax favored treatment of excess contributions to fully funded pension plans, which prevented plan sponsors from accumulating reserves that would protect plans from adverse markets; the deregulation of the trucking industry; the Clean Air Act; and, some may submit, the weakened enforcement of labor laws that depressed the historical pattern of replacement of organized firms in industries such as construction, resulting in a contracting contribution base. Each of these policies has had the unintended consequence of eroding the funding of some or all multiemployer defined benefit plans.

By the end of 2007, the average funded level of multiemployer plans at the beginning of that year had returned to 90%,[4] rebounding from the earlier collapse of the tech bubble from 2000 to 2002 and the ensuing crisis of confidence. By the end of 2008, however, multiemployer plans suffered the same kinds of losses that plagued the rest of the nation's financial infrastructure with median investment returns reported at -22.91%. This situation was compounded in 2008 by the implementation of the new, more aggressive funding rules of the Pension Protection Act.

Therefore, it is entirely understandable, if not predictable, that the market contraction would have reduced the funding levels of pension plans as it has the fortunes of all investors. In fact, a similar correlation can be seen between funding levels and historical rates of returns on invested assets. (See Chart 1).

Chart 1
Comparison of Historical Asset Returns and
Changes in Funded Percentages



THE RESPONSE

The response to the market contraction by the multiemployer community was, once again, a concerted, carefully conceived proposal to comprehensively and constructively address the current situation. For the vast majority of the more than 1,500 multiemployer defined benefit plans that suffered significant losses, but are expected to remain solvent for the long-run, the

[4] See "*Multiemployer Pension Plans: Main Street's Invisible Victims of the Great Recession of 2008*"; DeFrehn, Randy G. and Shapiro, Joshua; April 2010; pp 12 – 13.

objective is to provide additional time to fund these long-term obligations through measures along the lines of those contained in the tax extenders package, some of which have already been passed by the Senate.

For a very few other plans that have more serious problems, the Coalition proposed more direct intervention designed to provide a continuum of relief at appropriate levels to protect the interests of all of the stakeholders – participants, plan sponsors and the PBGC. These measures include making it easier for stronger, better funded plans to merge, or form alliances with, weaker plans in the same industry. For those few plans that are projected to become insolvent, the proposal includes two additional features: partition, which could preserve the benefits of a portion of the participants of the failing plan and reduce the ultimate exposure of the PBGC; and an increase in the amount of plan benefits guaranteed by the PBGC from $12,870 for participants with 30 or more years of service (which is $1,700 below the federal poverty level for a family of two) to an annual maximum of $20,070. It was proposed that the increase would be funded by an increase in the annual premium paid by plans. Each of these proposals are contained in S 3157, the "*Create Jobs and Save Benefits Act of 2010.*" We commend Senator Casey for his leadership in this matter and his co-sponsors for their support.

Mergers and Alliances

Mergers have been a traditional mechanism for consolidating plans within an industry, usually involving a weaker, perhaps struggling plan and a larger, stronger plan, often national in scope. Typically mergers leverage contributions and investment income to the advantage of incoming plan participants by maximizing the economies of scale. They may be self-initiating among the groups, or they may be encouraged by plan sponsors as part of a broader consolidation within an industry. In a limited number of occasions, the PBGC has facilitated mergers where the likelihood of plan failure of the weaker plan was great, by providing funding from the guaranty fund. By doing so, it reduced the exposure to the agency, while protecting the benefits of the participants and reducing the exposure of contributing employers to withdrawal liability. Unfortunately, the agency has not incorporated this approach as an option for troubled plans. Furthermore, with the implementation of the Pension Protection Act zone system, additional fiduciary concerns have complicated the voluntary merger activity at a time when mergers could be used to the advantage of all stakeholders. For these reasons, the Coalition proposal, reflected in S 3157, includes the formal codification of the PBGC's prior practice.

Partition

Partition is not a new concept. It acknowledges that even a system with the stability of a multitude of contributing employers could be at risk if the entire industry declines, making the burden of funding for liabilities associated with departed employers unsustainable for those that remain. While it has been available for decades, it has rarely been used by the PBGC and it is anticipated that its use going forward would be equally rare. Furthermore, while the instances in which it has been used in the past involved plans that are much smaller or localized than those currently at risk, the underlying principle remains the same.

"At Risk" Industries

While one of the major advantages of a multiemployer plan is its design as an ongoing entity disconnected from the fortunes of any one employer, the evolution of our economy and the law of unintended consequences have prevented that objective from being fulfilled. Just as the average household in the 1950's and 1960's took for granted the early morning delivery of milk, which is now only a distant memory for most of us, often what we assume to be a regular part of American life can take an unexpected turn. Two similar situations are at work that have contributed to the current problems in the trucking and mining industries.

In 1980 the trucking industry was deregulated. While the objective of this government policy was to expand the opportunities for open competition among trucking firms, one of the unforeseen consequences was that many of the new firms which entered the industry found that one way to undercut the industry pricing standards was to eliminate the strong benefits protections provided to their employees by the major carriers. Rather than expanding the opportunities for good paying jobs with pension and health care benefits that characterized this industry and contributed to the expansion of the nation's middle class, the number of firms who were able to continue to do so declined to the point of near extinction; leaving the responsibility for funding the accrued benefits to a continually contracting remaining few and leaving only ABF as the lone freight hauler out of a universe of approximately 70 major employers at the time of deregulation. Although this situation existed throughout the trucking industry, its effect on the myriad of plans differed as a result of numerous factors including differences in the other industries served and the strength of the economy in different geographic areas.

Nevertheless, as a result of a cautious approach to asset management and plan design, even the plans that were most heavily dependent on the traditional freight industry were able to grow and prosper and throughout the 1980's and 1990's made substantial progress towards the objective of full funding. For example, Central States was approximately 97% funded going into the first of the two "once-in-a-lifetime" market contractions of this past decade, despite carrying the additional burden of a substantial cash-flow deficiency largely attributable to the "orphan" retiree population. Even after suffering significant losses between 2000 and 2002, the fund had constructed a plan that eventually would enable it to reach full funding. The second "once-in-a-lifetime" market was much more devastating, however, and, coupled with a continuing cash flow deficit, has placed the prospects of long-term plan solvency under normal operations out of reach.

Though not precisely the same, the story of the decline in the fortunes of the mining industry has some striking similarities. The UMWA and bituminous coal industry have a long and significant history as the having created the most influential of all multiemployer plans in the nation's history. Their health plans brought the residents of Appalachia out of the worst conditions in the country and into the 20th century as a result of their construction of the Appalachian regional hospital system. Similarly, the pension plans sponsored by the coal industry brought dignity to millions of those whose sacrifice brought this nation our primary source of energy since it issued the first pension check to Horace Ainscough of Rock Springs, Wyoming on September 9, 1948. These funds had also benefited from the structure of ERISA's funding rules and despite experiencing fluctuating fortunes in the 1970's, ultimately achieved full funding during the

1990's. However, the employment base that enabled the coal industry to accumulate was also adversely affected by government policy. The Clean Air Act virtually eliminated the production of high sulfur coal East of the Mississippi (especially in the state of Illinois) and with it the jobs that generated the contributions to the fund. Instead the production has been moved to the largely non-union coal fields of the Powder River Basin where fully one-third of the country's entire production is now mined. Rather than tens of thousands of active miners on whose hours contributions were made to the plans in the 1980's, there are now approximately 11,000. The assets of the plan that were invested in a diversified portfolio adopted pursuant to the Department of Labor's guidance were also severely eroded as a result of the 2008 market performance.

Coupled with a severe cash flow shortfall, this mature plan is also facing insolvency without direct intervention.

Proposed Solution

By definition under either the existing or proposed legislation, partition is only available to plans that are projected to be insolvent; plans that, in the absence of intervention, represent certain and unavoidable liabilities for the PBGC at the point such insolvency is reached. To place this topic in its proper context, we are not discussing a proposal that would impose additional liabilities on the PBGC; rather partition is a tool that, if managed properly, will actually **reduce** the risk of substantial loss to all stakeholders, including PBGC.

While the proposal contained in the Create Jobs and Save Benefits Act contains provisions to limit the acceleration of cuts that have been a characteristic of prior partitions, to date participants whose plans have been partitioned have suffered immediate reductions to the PBGC guaranty levels. Without partition, it is a virtual certainty that *all* of the participants in such plans will suffer significant, if not catastrophic reductions in benefits. Similarly, contributing employers will face potentially enormous withdrawal liabilities, ironically, imposing (at best) crippling financial burdens upon the same employers that have provided a financial safety net for thousands, if not tens of thousands of workers in an industry who may never have worked for them; the same safety net that, in the single employer universe is provided by the PBGC. Truly, this is a classic example of the old adage that "no good deed goes unpunished."

Let there be no misunderstanding, the notion of arbitrarily allowing the value of a participant's service to be reduced by plan sponsors after the fact strikes at the very heart of the multiemployer system and must be avoided wherever possible. The concept has been abundantly clear since the enactment of ERISA. A participant in a defined benefit plan ***must have a definitely determinable benefit***. For the multiemployer system to work, participants whose work patterns require regular movement from one employer to another must have the assurance that the credits they earn throughout their careers will be protected. Although the Pension Protection Act enables critical status plans to reduce certain "adjustable" benefits in certain narrowly defined circumstances, the labor and employer representatives who worked cooperatively through that process to address the issues confronting the survival of their businesses and plans were united from the beginning in endorsing the principle that normal retirement benefits at normal retirement age must remain fully protected. For plan sponsors to have discretionary authority to reduce the value of such benefits of participants, including pensioners already in payment status, whose service was earned working with employers who no longer exist or are no longer required to contribute would destroy the multiemployer system and is unacceptable as a general notion - with one exception. That exception arises when a plan has passed the “point of no return” and would otherwise become “Wards of the State” through the PBGC. In that instance, partition becomes a vehicle to preserve the portion of the plans that can continue to be self-sustaining. It has been described as analogous to a medically necessary amputation of a limb that is required to save the life of the patient. While there will be plans that cannot be salvaged, for a limited number of others, partition can reduce the ultimate cost to the PBGC, protect the benefits of a portion of the participants, and enable the remaining contributing employers to continue to meet their funding obligations to the remaining participants.

In addition to the direct benefits to the stakeholders, partition would present indirect benefits to the countless other plans to which these same contributing employers contribute. Many of these employers contribute to dozens and in some examples, hundreds of other plans in the retail food and construction industries, among others. If faced with massive additional contribution requirements, the other plans to which these employers contribute may find them unable to make their required contributions further disrupting those plans as well.

Increasing PBGC Guarantees

The PBGC guarantee program serves a different function for multiemployer plans than for single employer plans. For single employer plans, the agency is the insurer of first resort. In the event a single employer is unable to meet its funding obligations, the PBGC must step in and take over the plan liabilities and administer the plan. For multiemployer plans, however, the pool of contributing employers assumes that role and the agency acts as insurer of last resort, becoming involved in the funding of a plan only when it becomes insolvent[5]. Further, the PBGC never assumes the administration of multiemployer plans, but delegates the administration to the fund trustees.

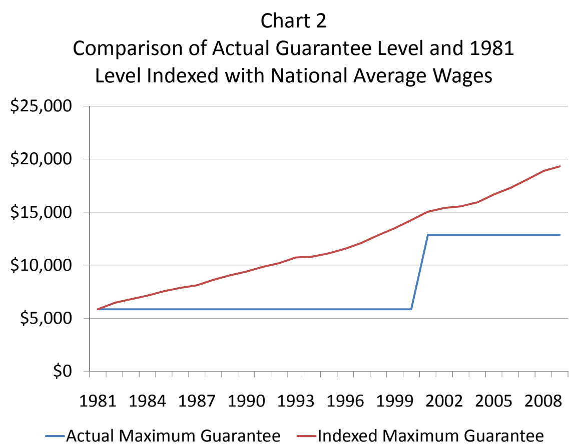
This system has worked reasonable well, given the limited number of plan terminations of multiemployer plans in comparison to their single employer counterparts, however, the recent market upheaval has increased the likelihood of a small number of plan failures. The number of such plans is uncertain and could be favorably influenced by both of the interventions described above.

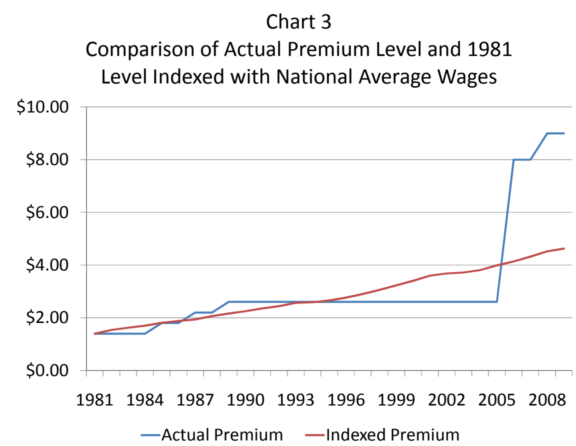
The level of benefit guarantees under the PBGC multiemployer guaranty program were set at $5,850 per year for participants with 30 or more years of service in 1981. The corresponding premium for that coverage was $1.40 per participant per year and was raised several times from then through 1989 when it was set at $2.60. It remained at that level until 2006 when it was raised to the current level of $9.00 and was indexed to inflation going forward. These premiums were more than adequate for most of the history of the guaranty program, emerging from a deficit to a surplus position in 1982 and remaining there until falling to a deficit in 2002. The benefit was raised only once in its 30 year history, going to $12,870 in 2001. Putting this into

[5] The multiemployer community was divided over the need for a guarantee fund at all, with some arguing that maintaining this fund would amount to a tax on plans for no benefit, as multiemployer plans would never fail

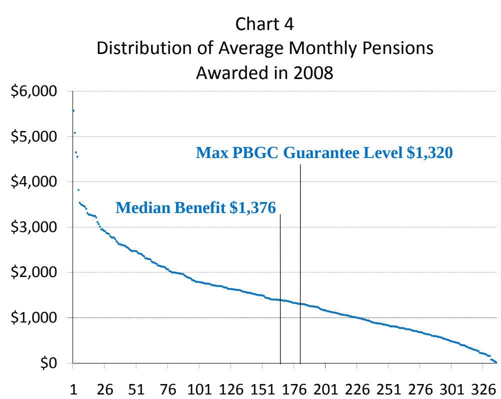
perspective, *the federal poverty level for a family of two is $1,700 higher than the maximum guaranteed amount for workers with 30 or more years of service.* Also unlike the single employer program, the benefit is not indexed. Furthermore, the benefit guarantee formula was designed to combat the "moral hazard" of encouraging plan sponsors from simply abandoning plans to the PBGC by imposing a formula that guarantees 100% of only the first $11 of benefit accrual, falling to 75% of the next $33, with no level of guarantee for benefits paid above that amount.

Charts 2 and 3 show the relationships between the current benefit and premium levels when compared with the 1981 levels, adjusted for inflation at the national average wage rates. They clearly demonstrate that, had these simply been indexed for the modest adjustments in wages over the 30 year period, maximum benefits would have been nearly $20,000 and premiums would have been less than $5.00.





Furthermore, over time the fixed benefit provided by this formula has become less adequate with greater and greater portions of the participant's benefit becoming "at-risk" as accruals were increased through the 1990's. While it is true that very few plans have had to avail themselves of the PBGC guaranty program, for those plans that face insolvency, the current benefit level is unacceptably low. As shown in the following Chart 4, over one-half of all new pensions awarded in 2008 exceeded the maximum level at which benefits are protected, before adjusting for years of service.



In response, the Coalition proposed adding one more layer to the existing formula in a manner consistent with the current formula to avoid the question of moral hazard. Under the proposal, the benefit levels would be increased by 50% of the next $40 of accrual. The total annual benefit guarantee level for a participant with 30 years of service would be $20,070. The protection against sponsors irresponsibly dumping plans to the PBGC is the extent to which benefits would be reduced. For example, the same participant with 30 years of service, and an accrual rate of $74 per month per year of service would forfeit approximately one-third of his benefit. Persons with higher accrual rates, or fewer years of service would suffer greater reductions, but a maximum benefit of $20,070 is considerably better than $12,870.

S. 3157 proposes paying for the benefit increase with an increase in the annual premium level from the current $9 per employee, to $16. We support the proposal and urge passage of S. 3157 as introduced.

CONCLUSION

We appreciate the opportunity to provide you with this testimony and to separate the facts from much of the rhetoric regarding multiemployer pension plan funding. As representatives of a Coalition of stakeholders that include groups as diverse as the member unions of the AFL-CIO and Change to Win and their employer association counterparts in the diverse industries that sponsor multiemployer plans; the U.S. Chamber of Commerce; UPS; Bechtel; and the Washington Group, to name a few, we believe it is critical to understand the need for comprehensive funding relief for multiemployer defined benefit plans as a means of preserving the financial viability of tens of thousands of small, medium sized and large employers and the jobs they provide. The continuation of this system and the protection of all of the stakeholders is in the balance.

We look forward to speaking with the members of the Committee at the upcoming hearing and welcome any questions you may have.

Respectfully submitted,

Randy G. DeFrehn

Executive Director