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STATEMENT OF NORMAN P. STEIN

ON

"BUILDING A SECURE FUTURE FOR MULTIEMPLOYER PENSION PLANS"

BEFORE THE

COMMITTEE ON HEALTH, EDUCATION, LABOR AND PENSIONS

UNITED STATES SENATE

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Mr. Chairman and members of the committee, I am Norman Stein, and I teach tax and employee benefits law at the Earle Mack School at Drexel University in Philadelphia.

Thank you for inviting me here to speak to you this morning on the critically important subject of multiemployer pension plans, which have provided millions of American working people with the opportunity to enjoy an adequate income in retirement. As I will explain, the subject should be of interest not only to the hardworking men and women who continue to rely on these plans for their retirement, but also to policymakers who believe that as a society we should, can, and must do better to help Americans prepare for retirement than give each of them a savings account and tell them you are on your own. For such a system to work, participants must have Spartan discipline, a Harvard investment degree, and a Cassandra-like ability to predict not only the direction of different investment markets but also the precise date of their own death.

Such a system would not work well in an ideal world, and the world that most of us inhabit is far from ideal. As I said, we should, can, and must do better. And an important step in doing better is to build a secure future for multiemployer pension plans.

I will divide my testimony into four parts.

The first part will explain why defined benefit plans are worth preserving, not only to provide a secure retirement for American workers, but also because such plans are the most fiscally responsible means of preparing Americans for retirement.

The second part will provide some observations on multiemployer pension plans that are germane to today's topic. Here I will show that the problems of such plans are not quite as severe as some claim and that those problems that do exist are not the fault of participants or mismanagement, but of structural changes in the economy and the financial meltdown caused by Wall Street.

The third part will explain why the legislation proposed by Senator Casey on partition—especially if it were modestly amended—is both equitable and economically responsible.

The fourth part will detail some other legal changes for multiemployer plans that we believe will contribute positively to retirement policy.

I. Defined Benefit Plans Are Worth Preserving

Almost all pension experts agree that from a worker's perspective, defined benefit pension plans are the best type of retirement vehicle. They do not require workers to figure out how much to contribute to a plan or how to invest their contributions. They do not require workers to monitor investment performance, to periodically rebalance, or to pay high fees. They do not tempt workers to dip into their retirement savings before retirement. And they do not require retired workers to devise strategies to make their retirement savings last until they die. In addition, defined benefit plans save workers time and anxiety—they are a true automatic pilot mechanism for employees to prepare for retirement. They worked well for our parents and they can work well for our grandchildren.

Some commentators however, have claimed that our employment markets have spoken and that the verdict is clear: employers and employees no longer want defined benefit plans. But that is simply not the case. It is true that many employers have frozen or terminated their plans because of concerns about funding volatility. But that does not mean that workers do not value defined benefit plans. Indeed, in our experience, working people do value defined benefit plans greatly in segments of the economy where they still exist. Unions continue to bargain for them and public-sector workers advocate for their continuation. And that is especially true today, when investment markets and high fees have devastated so many 401(k) accounts. In short, workers know that defined benefit plans work.

But are they too expensive? In fact, they are in many ways less expensive than defined contribution plans. Investment fees are lower and economists such as Jeff Brown have demonstrated that annuitization—which defined benefit plans provide—is generally welfare maximizing.

Moreover, defined contribution plans also have a steep future economic cost to society. It was hardly costless when the market meltdowns of the last decade destroyed hundreds of billions of dollars in 401(k) accounts. For example, many millions of older workers will have to delay retirement if they are physically able to keep working, depriving younger workers of jobs and job advancement. And when workers do retire with lower savings than needed, there will be economic costs as government is called upon to widen the safety net for older Americans and children and grandchildren will be asked to take up the slack. We should not lose sight of the fact that there is an enormous unfunded retirement liability for participants in 401(k). Moreover, defined benefit plans tend to provide a more patient source of capital than do 401(k) plans.

Sound retirement policy requires that we determine ways to preserve the defined benefit plans we have and expand them if possible. Multi-employer plans figure prominently in the current defined benefit plan universe. And many believe that multi-employer plans can furnish a template for new defined benefit vehicles outside the collective bargaining arena. For these reasons, I applaud this Committee’s concern with preserving multiemployer plans.

II. Some Observations on Multi-Employer Plans

(i) Approximately ten million Americans, who live in every state, rely on multi-employer plans. Their continuation is vital to their retirement security and the spending power the plans provide to retirees is vital to our economy.

(ii) The PBGC’s estimated multiemployer plan liability is considerably smaller than that of the single-employer plan program. Multiemployer pension plans cover approximately 25% of all Americans participating in PBGC-covered pension plans, but multiemployer plans comprise less than 3% of the PBGC’s current deficit. And this is true despite multiemployer plans being almost alone among private-sector pension plans in occasionally providing cost-of-living adjustments to retirees.

(iii) The funding problems currently being experienced by multiemployer plans are attributable primarily to two causes: the Wall Street created financial meltdown and structural changes in the economy, which have devastated certain industries. The problems are not the responsibility of so-called overreaching unions or poor management by plan trustees. Indeed, at the start of this decade, most multiemployer plans were overfunded. And unlike businesses sponsoring single-employer plans, which sometimes enter bankruptcy to strategically shift unfunded liabilities to the PBGC, employers who contribute to multiemployer plans must pay steep withdrawal liability if they leave a plan.

(iv) The heavy legacy costs that have resulted from structural changes in certain industries—such as the trucking and coal extraction industries—are being paid for by today's surviving businesses and their workers. Employees in the Central States Pension Fund currently have $16,000 of their wages contributed to the Fund each year. And the resulting financial stress on surviving firms in these troubled industries—industries that are critical to our nation's economy and security--threaten their economic viability.

(v) Some observers incorrectly claim that multiemployer plans imprudently increased benefits during the 1990s. But this claim misses two key points. First, tax laws virtually dictated that overfunded multiemployer plans use surplus assets to provide improved benefits. Second, unlike most single-employer plans which are based on final pay and thus automatically adjust to reflect inflation, benefits in multiemployer plans are typically stated in nominal terms. Often, benefit improvements did little more than adjust benefit formulas to reflect inflation.

(vi) Unlike the PBGC guarantees for benefits in single employer plans, the guarantees for benefits in multiemployer plans are not adjusted to reflect inflation. The multiemployer guarantees are today approximately 1/5 of the guarantees for single employer plans.

III. Partition Proposals

Firms and employees in multiemployer plans are responsible to provide benefits to employees of firms that gone out of business and have not contributed their share of funding for their former employees. This is an ordinary structural feature of multiemployer plans and plans are ordinarily protected by the ERISA's withdrawal liability provisions. But in a few troubled industries, many firms became insolvent while in contribution arrears and without paying their withdrawals liability. The remaining employers and employees are now paying the liabilities left over from these dead firms. Compounding the problem is that these industries have a low ratio of active workers to retirees and are unable contribute their way to plan solvency. If we do nothing, these plans—and perhaps the employers who are now forced to cover liabilities of their former competitors—will ultimately fail and responsibility for the plan's benefit liabilities will be shifted to the PBGC.

The legislation proposed by Senator Casey would deal with this problem in a few financially stressed industries by allowing—under very limited conditions—a plan to partition off liabilities attributable to bankrupt firms (and other firms that went out of business without paying withdrawal liability). The plan would transfer the liability for these benefits—and certain assets paid to the plan by those dead firms—to the PBGC.

Senator Casey's proposal is a classic "stitch in time saves nine" approach, for it will make it probable that the plan itself will be financially viable for the long term. By taking on some liability now, the PBGC will avoid taking on much larger liabilities later and will improve the future viability of troubled but critically important industries, such as trucking and mining.

I would, however, suggest two related changes to the legislative proposal: partitioned retirees should be treated identically to the participants in the parent plan—before and after partition. This should mean that the benefits for which they are eligible immediately after partition are determined under the parent plan's then current provisions, and that if the parent plan ultimately fails, their benefits will be subject to the same benefit reductions that are applicable to the participants in the parent plan. In other words, the participants in the partitioned portion of the plan should fare no worse but no better than the participants in the parent plan.

This is not only a matter of fair treatment of all participants in the pre-partitioned plan, but also provides important protections for the PBGC.

IV. Other Multiemployer Changes

(i) PBGC guarantees for multiemployer plans should be improved and in the future automatically increased to reflect increases in the cost of living.

(ii) The red zone provisions that allow plans to reduce already earned benefits should be repealed. These provisions are unfair to employees and retirees, who played by the rules and should not be subject to retroactive benefit reductions at a time in their life when they cannot make up their losses.

(iii) The PPA changes to the funding rules should be revisited for ongoing plans, to allow for greater actuarial smoothing and longer amortization periods for experience gain and loss. Indeed, we think similar changes are desirable for non-frozen single-employer plans.

When billions of dollars in 401(k) savings simply evaporated, older Americans were faced with a choice

I will divide my testimony into five sections. The first section discusses is not a coherent retirement policy. , poor utilization, for all Americans than provide tax-advantaged personal accounts only to the many men and women who rely on these plans for their retirement income, but My name is The economic crisis has hit American workers and American companies hard. We are here this morning to discuss funding standards for defined benefit pension plans both in the context of this crisis and for the longer haul.

But it is also important to note at the outset that the same economic crisis that has presented new challenges for defined benefit plans has also vividly demonstrated their enormous value to their participants. While millions of Americans have seen their 401(k) retirement savings plans plummet in value, workers and retirees covered by defined benefit plans have been able to continue their lives secure in the knowledge that they have a guaranteed source of stable retirement income to supplement Social Security.

These retirees and workers are living illustrations of what retirement experts have always known: that defined benefit plans, by shifting unacceptable risks away from individual workers and retirees, are the gold standard of retirement plans. We need to support those companies that stood against the tide and maintained active defined benefit plans for their employees. Our support for them will allow those plans to continue.

Overview of the Issues

There is currently discussion in the pension community and on Capitol Hill on the subject of whether and when to grant emergency short-term funding relief to some companies, whether temporarily to ease some of the harsh Pension Protection Act (PPA) restrictions automatically reducing participant benefit accruals if a single employer plan's funding falls below a specified trigger point, and whether some of the more unreasonable portions of the PPA should be permanently modified or repealed. My testimony today provides our views on these questions. In addition, my testimony also touches on some issues relating to multiemployer plans and on the use of qualified defined benefit plans to unfairly provide special benefits to selected top executives through so-called Q-SERPs, or qualified supplemental executive retirement plans.

To summarize our positions:

1. We believe that Congress should make short-term emergency funding relief available for companies that continue to sponsor defined benefit plans that allow employees to continue accruing new benefits. Such relief will allow these valuable plans to weather the economic crisis, benefiting employees and employers alike. Such relief, however, should be reserved for employers who agree to conditions to protect employees and the Pension Benefit Guaranty Corporation. Funding relief should not be a free lunch.

2. Short-term funding relief should not be extended to companies that are sponsoring "frozen" plans – meaning those that have plans that have ceased accruals for current employees. The substance of such relief would be to force the Pension Benefit Guaranty Corporation (PBGC) and employees to accept risky IOUs from employers. The argument that a broad grant of relief to frozen plans will preserve jobs is unsupported by facts and does not stand up to even modest scrutiny. Moreover, such plans are currently eligible for funding waivers. We would support streamlining the process for applying for funding waivers for companies that have frozen plans which we discuss below.

3. The Pension Protection Act includes several ill-advised provisions, which should be revised or repealed. We support a permanent repeal of the mandatory freeze on benefit accruals for plans that fall below a 60% funding level. We also support a more traditional actuarial approach to pension funding, with somewhat lengthier amortization periods than mandated by the PPA. And we believe that the PPA provision that treats plan termination as the date that an employer enters bankruptcy is ill-advised, upsetting reasonable expectations of plan participants (particularly in collectively bargained plans) and decreasing the likelihood that the plan will be preserved as the employer emerges from bankruptcy.

4. We support certain proposed changes to the funding and PBGC rules related to multiemployer plans, especially an increase in the PBGC guarantee levels.

5. We believe that Congress should end the ability of plan sponsors to amend qualified plans to create enhanced benefits for executives only.

Short Term Funding Relief for Active Defined Benefit Plans

We support funding relief for companies that sponsor defined benefit pension plans under which employees continue to earn benefit accruals. We do so for two related reasons.

First, as the economic recession has reminded us, defined benefit plans are the best retirement vehicles for assuring a secure source of income in retirement. Such plans provide retirees with a guaranteed stream of income for life and are not subject to the kind of catastrophic failure that has decimated the retirement prospects of so many Americans who rely primarily on their section 401(k) plans. It is appropriate, and necessary, for Congress to take action to ensure the continued existence of these plans. We fear that without funding relief, some companies will terminate or freeze their plans.

Second, the companies who stood by their defined benefit programs while other abandoned them deserve support from Congress.

The type of relief we favor is to permit an extended amortization period for losses attributable to the recession. The risk of employer default would be borne by employees, so it is appropriate that relief be conditioned on certain commitments to employees. Thus, we support conditioning funding relief to companies with ongoing plans that:

(i) agree that plan participants will continue to receive future benefit accruals until the end of the amortization of the recessionary investment losses;

(ii) agree to amend their plan to prohibit reversions of "excess" assets if the plan becomes overfunded in the future; and

(iii) have secured the consent of any unions whose members are participants in the plan.

We also support a tiered approach to funding relief for employers who have frozen the plan for new entrants or who have engaged in a soft freeze.[1] These plans should be allowed to amortize only a portion of the recessionary losses or be permitted to amortize them over a shorter period of time than would otherwise be available.

In addition, funding relief should be conditioned on the company amending executive deferred compensation plans that involve segregation of company assets in such vehicles as a rabbi trust. Contributions to these plans, no less than contributions to qualified plans, result in fewer operating assets to the company. Moreover, payments from executive compensation plans strip the company of assets that could help fund the company's qualified plan. We thus would

[1] A soft freeze occurs when a benefit formula that is amended to deny credit for future years of service continues to reflect future increases in compensation.

recommend conditioning funding relief on companies amending "funded" executive deferred compensation plans so that they cannot receive new funding, and amending all executive deferred compensation plans so that they cannot pay benefits until the company has fully funded its qualified plan.

Companies With Frozen Plans Should Receive No Additional Funding Relief

Funding relief is not free: it is essentially an unsecured debt forced upon participants and the PBGC. If the plan is not eventually brought up to fully funded status, it is the participants and PBGC (and perhaps taxpayers) who will bear the financial burden of funding "relief." Thus, we do not believe that emergency funding relief should be made available to plans in which employees are no longer earning new benefits.

Some have argued that extending relief to such plans will save jobs, but the factual predicate for this argument is weak. There is nothing in any of the many proposals we have seen that would ensure that the funding relief – the money saved by not being used for pensions – would be used for creating and preserving jobs. The money could be used for any purpose, including moving jobs overseas, automation, or executive compensation.

We believe that the best argument for granting funding relief is not to save jobs – which is a rhetorical argument not supported by the weight of evidence – but instead (as we argued above) because targeted funding relief would serve a constructive societal purpose in preserving pension plans which provide secure and adequate retirement income to working men and women. Also, pension plans invest company contributions (and interest) in the capital markets, creating long-term investment capital that ultimately is an effective way to expand the economy and ensure the preservation and creation of jobs.

It should also be noted that there are provisions in current law that allow employers to request a funding waiver if they can show temporary substantial business hardship and that failure to grant a waiver would be adverse to the interests of plan participants. Moreover, frozen plans have already benefited from generous funding relief provided by the Internal Revenue Service and Congress.

We would support providing the IRS with resources to streamline the process to review waiver requests, perhaps by setting up a special temporary funding review board and requiring that a waiver be ruled upon within 60 days of request. A company with a frozen plan that wants further funding relief could qualify for that relief by unfreezing the plan and accepting the conditions we described above.

Repeal Certain Pension Protection Act Provisions

- Repeal the PPA provision mandating the automatic freeze of benefit accruals in single-employer plans that are less than 60 percent funded. Plan participants should not be penalized because employers have not funded the plan. Alternatively, the PPA provision should be a temporary suspension of benefit accruals rather than a freeze, with the accruals resuming once a plan has attained a specified funding level. (There should be relief from the freeze provision during the current recession if Congress does not want to consider permanently amending the Pension Protection Act at this time.)

- Repeal the PPA provision that allows the PBGC to set the date of a distress termination as the date the plan sponsor filed bankruptcy rather than the date the plan is officially terminated by the bankruptcy court. When the PBGC uses the earlier date, the agency effectively cuts workers benefits by not counting additional accruals under the plan.
- Modify the PPA to allow plans at least ten years to amortize unfunded liabilities.

- ***Protections for Employees in Multiemployer Plans***

    - Raise the benefit amount guaranteed by the PBGC to at least $20,000 for a full career worker.
    - If multiemployer plans in the future find their way out of the current crisis and become overfunded by a significant amount, Congress should explore ways to reinstate subsidized early retirement benefits (and subsidized survivors benefits) that may have been eliminated under the "Red Zone" (critical status) provisions of the PPA.

Eliminate Q-SERPs

Two years ago, the *Wall Street Journal* revealed a practice in which benefits in qualified plans were amended to provide increased benefits for a few executives. The enhanced benefit formulas for a privileged few were known as qualified supplemental executive retirement plans, Q-SERPs. These provisions were an inequitable use of plan assets and may have contributed, at least at the margins, to the current funding problems of some plans. Congress should eliminate Q-SERPs and should also adjust the plan asset allocations in Title IV of ERISA to ensure that Q-SERP benefits receive the lowest priority if the plan terminates.

Conclusion

The economic meltdown of the last year has shown the tremendous value of defined benefit plans to employees and retirees. Congressional response to the economic crisis should be to help ensure the survival of existing defined benefit plans and to stand by those companies that stood by their defined benefit plans in an era when too many companies abandoned them.