Testimony of

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before the

JOINT SELECT COMMITTEE ON SOLVENCY OF MULTIEMPLOYER PENSION PLANS

Hearing on

"THE STRUCTURE AND FINANCIAL OUTLOOK OF THE PENSION BENEFIT GUARANTY CORPORATION"

May 17, 2018

Chairmen Hatch and Brown, and Members of the Committee. Thank you for the opportunity to appear before you today to discuss the Pension Benefit Guaranty Corporation (PBGC) and the challenges it faces in protecting pensions of American workers. We are grateful to the members of the Committee for undertaking this important work.

PROTECTING PENSIONS

Every American worker should have the opportunity to earn a secure retirement. A vital part of retirement security for nearly 40 million private-sector workers, retirees, and beneficiaries comes from traditional defined benefit pension plans. For decades they have been an efficient vehicle for a secure retirement. Traditional defined benefit plans provide lifetime retirement income that does not depend on a participant's investment choices or the market price of annuities when the participant retires.

PBGC's mission is to protect the lifetime retirement income that comes from private-sector pension plans when employers are unable to make contributions to the plans sufficient to fund the promised benefits. Today, about 1.5 million current and future retirees and beneficiaries depend on PBGC for pensions they earned for years of work but may have lost without PBGC.

Congress established PBGC as part of the Employee Retirement Income Security Act of 1974 (ERISA). By law, PBGC is financed from premiums and, in the case of the Single-Employer Program, assets from failed plans. PBGC is administered by a Director. PBGC has a three-member Board of Directors consisting of the Secretary of Labor, who is Board Chair, and the Secretaries of the Treasury and Commerce.

PBGC operates two separate insurance programs: one for single-employer plans (the Single-Employer Program) and one for multiemployer plans (collectively bargained plans with more than one employer) (the Multiemployer Program). While each program is designed to protect participants' pension benefits when plans fail, they differ significantly in the level of benefits guaranteed, how the guarantee is provided, the event that triggers payment of the guarantee, and premiums paid by insured plans. By law, the two programs are financially separate. Assets of one program may not be used to pay obligations of the other.

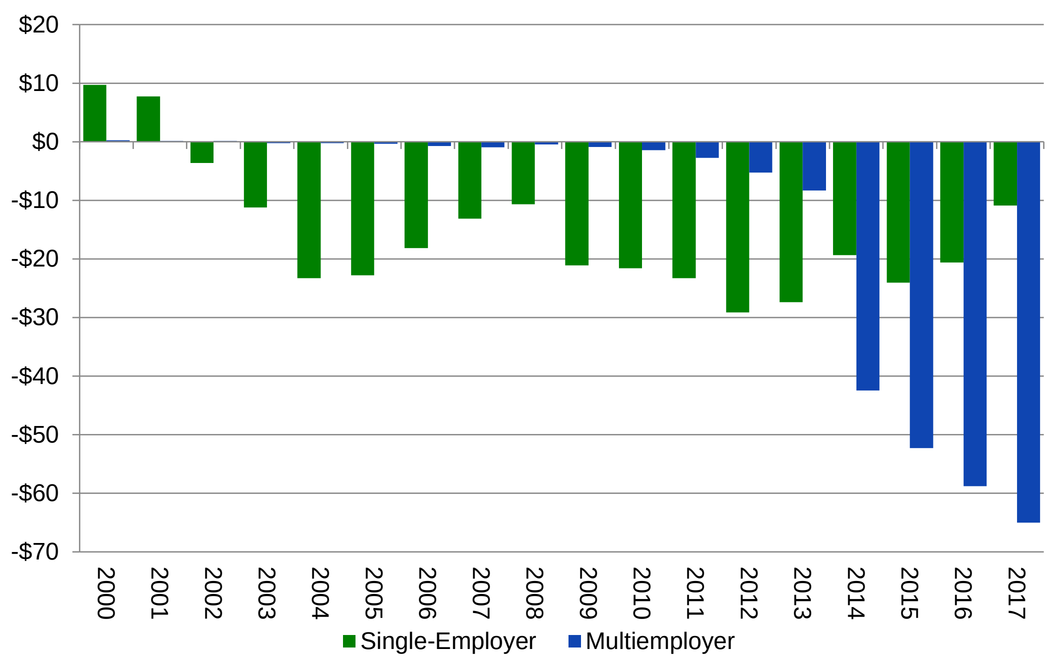
Both programs have been in a deficit position for fifteen years or longer, meaning that, for each of our two insurance programs, assets are less than liabilities. While the financial condition of the Single-Employer Program has been improving, the Multiemployer Program's financial condition has been deteriorating rapidly and without action the changes required to remedy the deficit become more difficult (see Figure 1).

Figure 1

PBGC Single-Employer and Multiemployer Insurance Programs

Net Positions FY 2000-2017

($ in billions)



As of September 30, 2017, the Single-Employer Program had liabilities of $117.1 billion and assets of $106.2 billion, resulting in a $10.9 billion deficit, down from a $20.6 billion deficit at the end of FY 2016. Continued improvement in the Single-Employer Program is projected but not a certainty.[1]

In sharp contrast, the Multiemployer Program had liabilities of $67.3 billion and assets of only $2.3 billion, resulting in a deficit of about $65 billion. The Multiemployer Program is projected

[1] PBGC uses stochastic modeling that produces a probability distribution of potential outcomes for the future financial condition of PBGC's two insurance programs. The FY 2016 Projections Report continues to show a wide range of potential outcomes.

to fail in just a few years, and without action the changes required to remedy the deficit become increasingly difficult.

MULTIEMPLOYER PROGRAM

PBGC's Multiemployer Program provides financial assistance to multiemployer plans that have run out of money so that they can pay benefits at PBGC guaranteed levels.[2] The program is funded by premiums paid by the plans. Our financial assistance is technically a loan to the insolvent plan. But because the plans have already run out of money, repayment of financial assistance loans is highly unlikely. To date, only one loan has been repaid, and that loan was made in the circumstance of a plan having a temporary financial need rather than a permanent need.

PBGC's FY 2016 Projections Report shows a projected FY 2026 year-end mean deficit of about $78 billion (in nominal dollars) in the Multiemployer Program, even assuming that some plans use benefit suspensions and partitions as allowed under the Multiemployer Pension Reform Act of 2014 (MPRA) to avoid insolvency (see Figure 2 below).

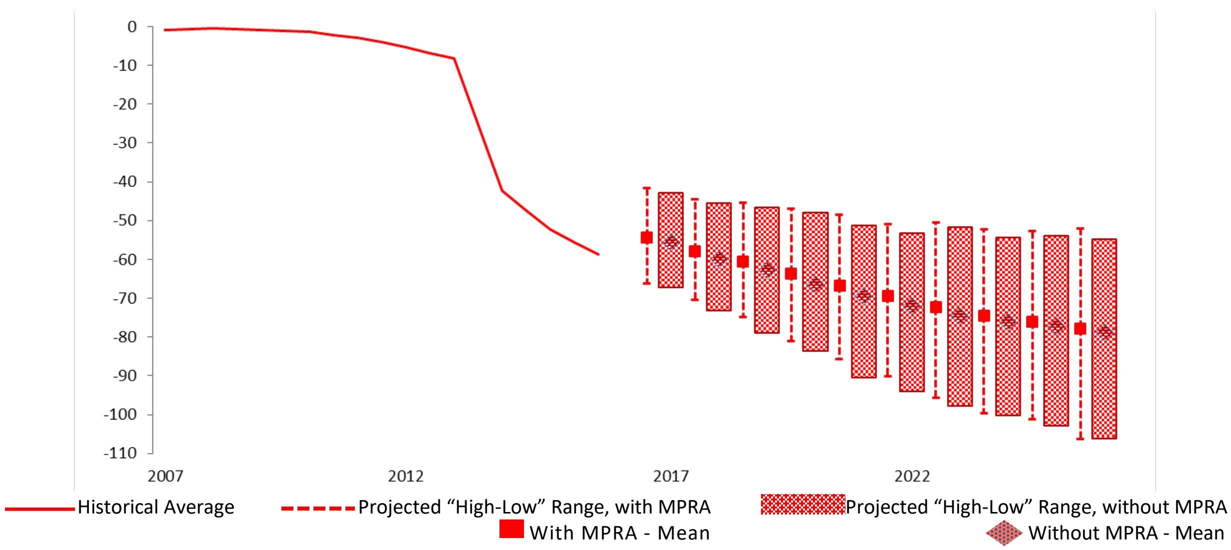
Figure 2

Multiemployer Program Net Position

($ in billions)

Reflecting Assumed MPRA Suspensions / Partitions

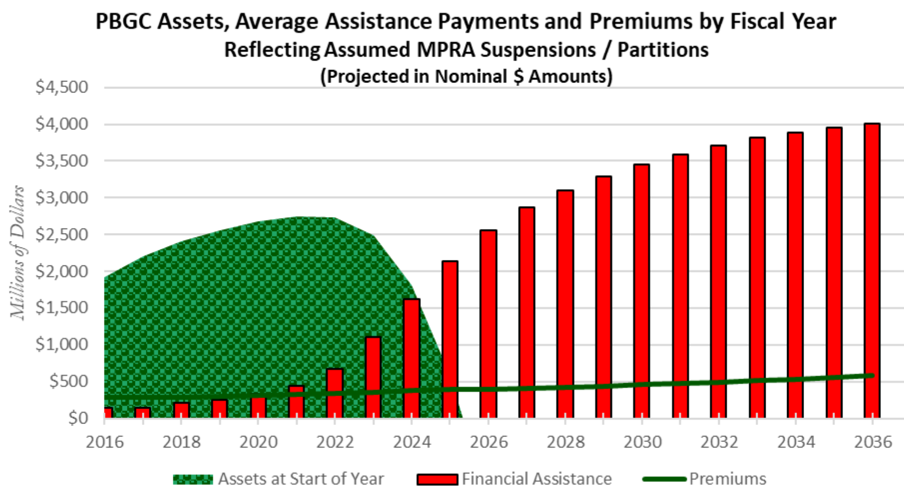
Historical Experience 2007-2016 and Nominal 2017-2026 Projections



The assets and income of PBGC's Multiemployer Program are only a small fraction of the amounts PBGC will need to support the guaranteed benefits of participants in plans expected to become insolvent during the next decade. Projections show that the Program is more likely than not to become insolvent by the end of FY 2025, absent changes in law (see Figure 3 below).

[2] Financial assistance also covers reasonable administrative expenses.

Figure 3



As insolvency of the insurance program grows closer, the changes required to prevent insolvency become more disruptive.

MULTIEMPLOYER PLANS

A multiemployer plan is a pension plan maintained through a collective bargaining agreement between employers and a union. The employers are usually in the same or related industries. Multiemployer plans provide benefits for people in industries such as transportation, construction, mining and hospitality.

Multiemployer plans have provided retirement benefits to millions of American workers for more than half a century. Today, America's 1,400 multiemployer plans provide retirement security to more than 10 million participants and their families.

There are multiemployer plans and participants in every state. Multiemployer plans range in size from small local plans with a hundred or fewer participants to large national plans covering hundreds of thousands of participants. Businesses of all sizes, including hundreds of thousands of small businesses – doing business in every state – participate in multiemployer plans.

Multiemployer plans provide pension portability, allowing workers to accumulate benefits earned for service with different employers throughout their careers. They pool longevity risk, which provides much lower-cost annuities than those available in the individual market, and they spread the risk of any individual employer's failure across many firms.

Benefits to Employers

Among the advantages of this type of plan is that assets are pooled among employers in a single consolidated trust. Efficiencies of scale broaden and diversify investment opportunities and lessen the administrative and investment costs of operating a separate single-employer plan. Investment professionals manage the plans' assets, helping to reduce risks for contributing employers, employees, and retirees.

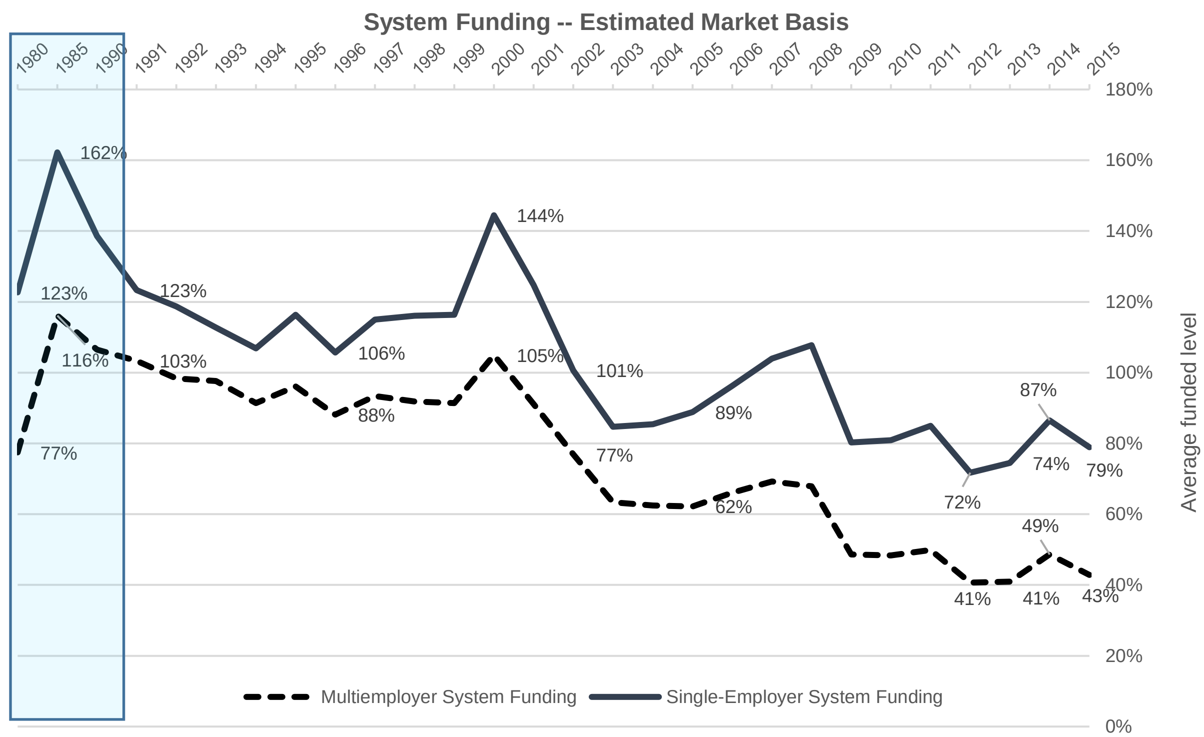
Importance to Small Businesses

Multiemployer plans enable employers to provide retirement benefits to their employees without imposing administrative burdens on any individual employer. Employers generally need only to remit contributions set by collective bargaining and are relieved from the responsibilities of operating a plan, which are handled by an independent joint board of trustees, consisting of equal representatives from labor and management. Consequently, these plans have historically offered employers, especially small businesses, an affordable way to provide pensions to their employees, without the administrative burdens.

FUNDED STATUS OF MULTIEMPLOYER PLANS

Multiemployer plans overall are less well funded than single-employer plans. The disparity between the funded status of single-employer plans and multiemployer plans has existed for many years (see Figure 4).

Figure 4



Plan Zone Status

The Pension Protection Act of 2006 categorized multiemployer plans based on funded status, compliance with minimum funding standards, and time until likely insolvency: Endangered Status, (commonly referred to as "Yellow Zone"), Seriously Endangered Status ("Orange Zone"), and Critical Status ("Red Zone"). The Multiemployer Pension Reform Act of 2014 (MPRA) created a subcategory of Red Zone plans -- Critical and Declining; these plans project that they will run out of money within 15 to 20 years. Plans that do not fall within these categories are categorized as Not in Distress ("Green Zone"). Table 1 summarizes the criteria for each zone status.

Table 1

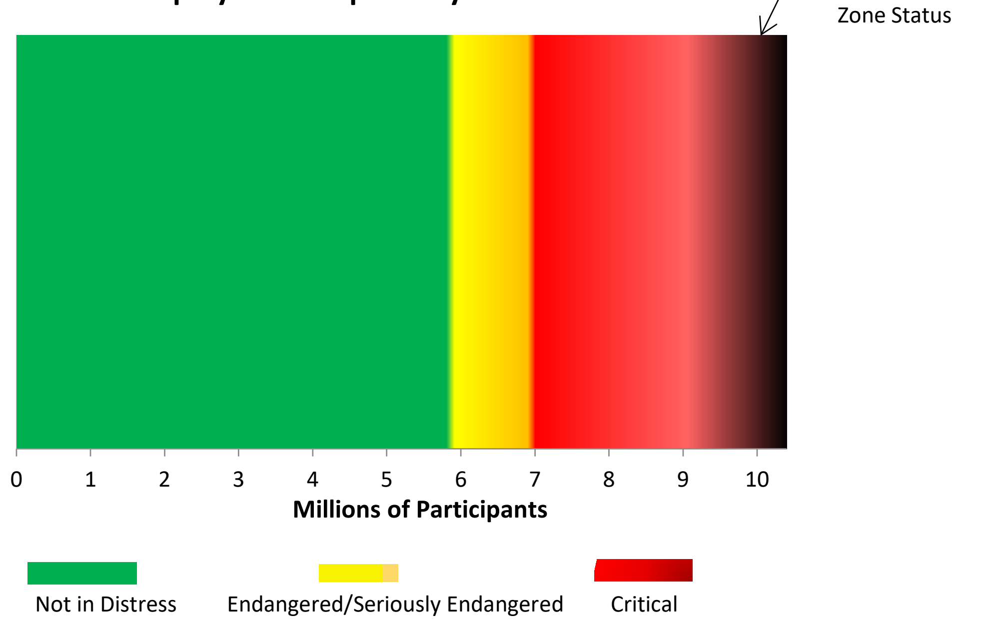
Summary of Plan Zone Status Criteria

Not in Distress (Green Zone)	- Not Yellow, Orange, or Red Zone
Endangered (Yellow Zone)	- Plan is less than 80% funded or a funding deficiency is projected within 7 years
Seriously Endangered (Orange Zone)	- Plan is less than 80% funded and a funding deficiency is projected within 7 years
Critical (Red Zone)	- Various alternative criteria indicating severe funding or liquidity issues—generally less than 65% funded ratio, insolvency projected within 5-7 years, or a funding deficiency is projected within 4-10 years
Critical and Declining (Red Zone subset)	- Plan is projected to become insolvent within 15 years (20 years if the plan is less than 80% funded or there is less than one active for each inactive participant)

The majority of multiemployer plan participants are in Green Zone plans. A significant minority of multiemployer plans – about 130 plans, some very large – covering 1.3 million participants, are in Critical and Declining Status (see Figure 5). The underfunding in Critical and Declining plans totals about $100 billion on a market basis.

Figure 5

Multiemployer Participants by Plan Zone Status



Causes of Multiemployer Plan Underfunding

Lower funding levels in multiemployer plans in part reflect the less stringent funding rules that have always applied to multiemployer plans. For many years, multiemployer plans were widely considered to be inherently more financially stable than single-employer plans because they rely on contributions from many employers, unlike single-employer plans that generally rely on one employer. If an employer failed, others were there to make contributions to fund the promised benefits. Perhaps because risks were pooled in this way, the law allowed plans to take more time to pay down underfunding created by benefit improvements or adverse experience, such as investment returns that were lower than anticipated or industry declines.

Many other factors – financial, economic, and demographic – also have contributed to underfunding in multiemployer plans and the financial distress of some multiemployer plans.

Before the decade of the 2000s, defined benefit plans, including multiemployer plans, earned historically high rates of return, which kept plans well-funded without large employer contributions. High investment returns financed benefit improvements, such as increased benefit accrual rates, past service credit, new or increased early retirement subsidies, and disability pensions.[3] These new obligations elevated plan liabilities in the late 1990s in a way that was difficult to reduce later.

The significant market losses in the early 2000s and especially in the 2008 market crisis and Great Recession took a huge toll. Average funded ratios (market value of assets divided by liabilities discounted using a standardized PBGC interest factor that reflects group annuity prices) exceeded 90% in the 1990s, then dropped to the mid-60% range in the mid-2000s and fell below 50% after the 2008 market crisis.

Even before the 2008 market crisis, Congress recognized the seriousness of multiemployer plan underfunding and enacted the Pension Protection Act of 2006 (PPA). Under PPA, plans classified as Critical Status (Red Zone) generally must establish a Rehabilitation Plan detailing how they intend to emerge from Critical Status (generally within 10-13 years), through actions such as increasing contributions and reducing or eliminating future accruals or adjustable benefits. If they are not projected to emerge from Critical Status during the rehabilitation period after exhausting all reasonable measures, they must develop an alternative scenario that allows them to emerge at a later time or to otherwise forestall possible insolvency.

A significant number of plans were not able to recover, including some very large plans covering thousands of participants and in a few cases hundreds of thousands. As the financial markets and the economy improved, many plans became better funded, and the percentage of participants in plans that were Not in Distress (Green Zone plans) increased markedly. But the percentage of participants in Critical Status plans declined only slightly, reflecting the stagnant or shrinking contribution base and high percentages of retirees that characterize struggling plans (see Figure 6). About one-third of the participants in Critical Status plans are in Critical and Declining Status plans.

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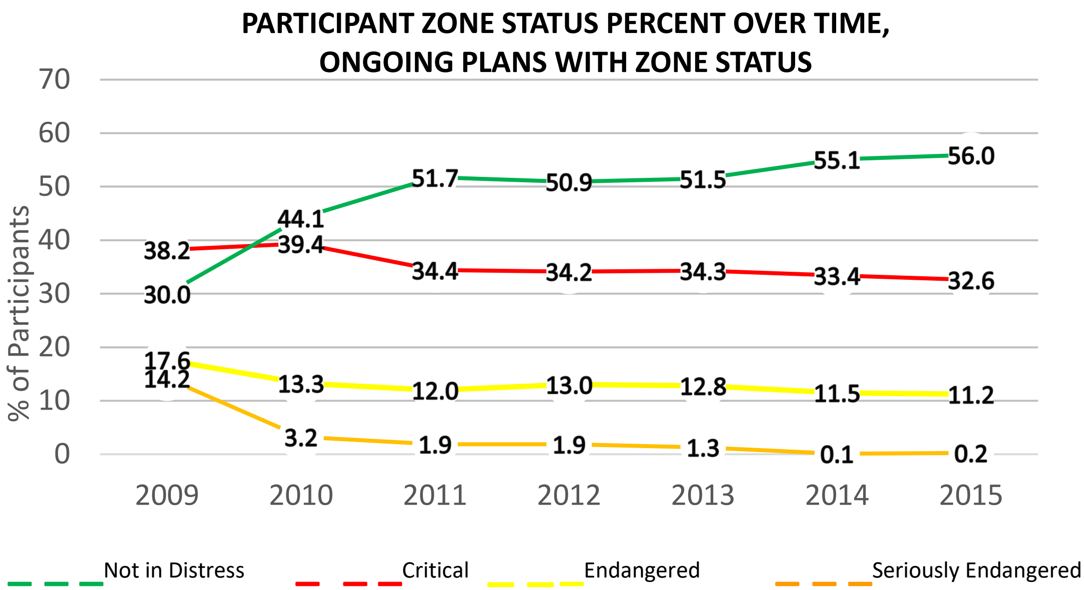
[3] Because of maximum deductible limits, some plans increased benefits during this period to avoid losing deductible treatment of employer contributions for federal income tax purposes, which also contributed to longer-term cost. These limits were raised in the Pension Protection Act of 2006.

Figure 6



Factors such as declines in unionized employment, competitive pressures from non-unionized businesses, and declines in demand for products or services, caused some companies to go out of business. They left behind the unfunded benefits of their inactive and retired workers (sometimes referred to as orphan liabilities).

Today, the ratio of active to inactive participants is at its lowest point ever. Among multiemployer plans in the aggregate, fewer than four out of every ten covered participants are actively employed by a participating employer.[4] In addition, contributions by downsized companies that remained in business declined.

As underfunding in these plans deepens, remaining employers are faced with a difficult choice: higher contributions if they stay; higher payments for their allocated share of plan underfunding withdrawal liability if they leave (withdrawal liability). And if they do leave, the plan will be at greater risk of failure.

Contagion

Some have asked whether the failure of a multiemployer plan could cause failure of other multiemployer plans in which the affected employers also participate ("contagion"). This situation would most likely occur as a consequence of the insolvency of a very large plan. We have not yet experienced the failure of a very large plan, so it is too early to test the contagion theory, but it seems plausible. Some also have asked whether failure of an employer that contributes to more than one multiemployer plan could lead to failure of multiple plans (another type of contagion). This would most likely occur as a consequence of the failure of a company that is a dominant employer in multiple plans. Here also the theory seems plausible. We are aware of at least one instance where bankruptcy of a major contributor to multiple plans put financial stresses on those plans.

[4] Active participants account for about 35 percent, separated vested participants about 35 percent, and retired participants about 30 percent.

Severity of the Problem

PBGC's Financial Statements[5] reflect the serious underfunding in multiemployer plans that are in financial distress. Our Projections Report[6] shows how this underfunding is likely to result in a growing deficit and, more important, the inability of the Multiemployer Program to provide the financial assistance to cover guaranteed benefits.

In FY 2017, PBGC paid $141 million in financial assistance to 72 insolvent multiemployer pension plans, covering the benefits of over 63,000 retirees with another 30,000 people entitled to benefits once they retire. In the coming years, the demand for financial assistance from PBGC will increase as more and larger multiemployer plans run out of money and need help to provide benefits at the guarantee level set by law.

As of September 30, 2017, the Multiemployer Program had assets of $2.3 billion to cover $67.3 billion in liabilities in 187 plans. The liabilities[7] consist of:

- $2.7 billion for the 72 plans currently receiving financial assistance (about 93,000 participants)
- $2.0 billion for 68 plans that have terminated but have not yet started receiving financial assistance payments from PBGC (about 78,000 participants). Terminated multiemployer plans no longer have employers making regular contributions for covered work, though some plans continue to receive withdrawal liability payments from withdrawn employers
- $62.7 billion for 47 plans that are ongoing (i.e., have not terminated), but PBGC expects they will exhaust plan assets and need financial assistance within 10 years (about 1,160,000 participants).[8]

The last two categories—terminated plans and ongoing plans expected to need financial assistance within 10 years—are classified as "probable" obligations of the Multiemployer Program.

The $67.3 billion in Multiemployer Program liability is an increase from $61.0 billion in FY 2016. In addition to the $67.3 billion booked as a liability in our financial statements, there is $14 billion in underfunding in ongoing multiemployer plans projected to become insolvent in the next 10 to 20 years; these plans, which are not booked as liabilities, are classified as "reasonably possible" future obligations.

As noted earlier, our most recent projections show that, absent a change in law, the mean 2026 deficit is about $78 billion (in nominal dollars), and Multiemployer Program assets are likely to be exhausted in 2025.[9]

[5] PBGC FY 2017 Annual Report: https://www.pbgc.gov/sites/default/files/pbgc-annual-report-2017.pdf
[6] PBGC FY 2016 Projections Report: https://www.pbgc.gov/sites/default/files/fy-2016-projections-report-final-signed.pdf
[7] The liabilities add to $65.4 billion rather than $67.3 billion due to rounding.
[8] The liability for ongoing plans includes a small probable bulk reserve of $1.1 billion.
[9] PBGC FY 2016 Projections Report: https://www.pbgc.gov/sites/default/files/fy-2016-projections-report-final-signed.pdf

HELPING PLANS AVOID INSOLVENCY: PREVIOUS LEGISLATIVE EFFORTS

Congress enacted two pieces of legislation to address underfunding in multiemployer plans: the Pension Protection Act of 2006 (PPA), discussed earlier, and more recently, the Multiemployer Pension Reform Act of 2014 (MPRA).

MPRA defined a subcategory of Critical Status plans that are "Critical and Declining." These are Critical Status plans whose actuaries project that plan insolvency will occur within the current plan year or any of the 14 succeeding plan years (or in certain situations, within 19 succeeding plan years).

MPRA gives the trustees of Critical and Declining plans additional options to address the risk of insolvency. Under MPRA, Critical and Declining plans may take steps to improve long-term solvency by reducing benefit promises to participants and beneficiaries if they meet certain requirements, including application to and approval by the Department of the Treasury[10]. MPRA permits participants' benefits to be reduced to 110 percent of the PBGC guaranteed amount, subject to statutory protections that prohibit or limit reductions for participants who are disabled or elderly. These statutory protections from MPRA benefit cuts for the disabled and elderly do not extend to insolvent plans that receive financial assistance from PBGC.

MPRA also changes PBGC's ability to provide early financial assistance to plans, either by assuming part of the plan's liabilities via a plan partition or by providing assistance to facilitate a merger. To receive partition assistance, the plan must take all reasonable measures to avoid insolvency including the maximum benefit reductions allowed by MPRA (i.e., reduction to 110% of the PBGC guarantee, with the MPRA protections for the disabled and elderly), if applicable.

Mergers can stabilize or increase the base of contributing employers, combine plans' assets for more efficient investing, and reduce plans' administrative costs. Under MPRA, PBGC is authorized to help plans merge with other multiemployer plans. Plans may request technical assistance, and Critical and Declining plans may also apply for financial assistance to facilitate a merger, if necessary to avoid plan insolvency. Importantly, a partition, or any facilitated merger, must reduce PBGC's expected long-term loss and cannot impair its ability to provide financial assistance to meet existing obligations to other plans.

To date, nineteen troubled plans have applied for benefit reductions, with five also seeking financial assistance from PBGC in the form of a partition to remain solvent. One joint application for a suspension and partition, and three applications to reduce benefits (without partition), have received all the required approvals and authorizations to proceed. One suspension-only application has been approved, with authorization to implement the suspension dependent on a participant vote. Two joint suspension-partition applications and four suspension-only applications are under review.

MPRA can help some Critical and Declining plans but cannot help all of them. In some cases, underfunding is so large relative to future cash inflows that benefit suspensions and partition cannot keep the plan solvent long-term.

[10] Prior to MPRA, reduction of benefits already accrued was generally prohibited by the "anti-cutback rule."

The United Furniture Workers Pension Plan A is an example of a plan that is helped by MPRA. The Road Carriers Local 707 Pension Fund is an example of a plan for which MPRA could not work because of the plan's severe underfunding and inadequate projected cash inflows. Outcomes for both plans are described below.

United Furniture Workers Pension Plan A

The United Furniture Workers Pension Plan A ("UFW Fund"), based in Nashville, Tennessee, is using MPRA to avoid plan insolvency. In August 2017, PBGC approved the partition of the plan in conjunction with approval by Treasury of benefit suspension under MPRA. This was the first MPRA partition approved by PBGC. With this early financial assistance from PBGC, along with required benefit reductions, the UFW Fund is projected to avoid insolvency and pay benefits above the guarantee level to nearly 10,000 participants and beneficiaries over the long term. Under the law, benefits of approximately 7,100 participants and beneficiaries were not reduced, because MPRA includes statutory limitations that protect against cuts for certain participants and beneficiaries based on age, disability status (as defined by the plan), and whether benefits are not more than 10% greater than PBGC guarantees would provide. The remaining approximately 2,800 participants will see future benefit reductions to 110% of the PBGC guaranteed amount, averaging a 12.7 percent cut in benefits.

Road Carriers Local 707 Pension Fund

The Road Carriers Local 707 Pension Fund ("707 Fund"), which is based in Hempstead, New York and covers nearly 5,000 participants, was unable to use MPRA to avoid insolvency. The 707 Fund applied for a MPRA benefit suspension and a PBGC partition in order to preserve benefit payments above PBGC guarantee levels. But projected future contributions and other income were insufficient to avoid insolvency, even with the maximum benefit reductions allowed under MPRA and a PBGC partition.

As a result, the 707 Fund became insolvent early in 2017, and PBGC began providing financial assistance to the plan to cover benefits at PBGC guaranteed levels.[11] For nearly one-half of all 5,000 participants in the plan, the guarantee covers less than 50 percent of the benefits earned.

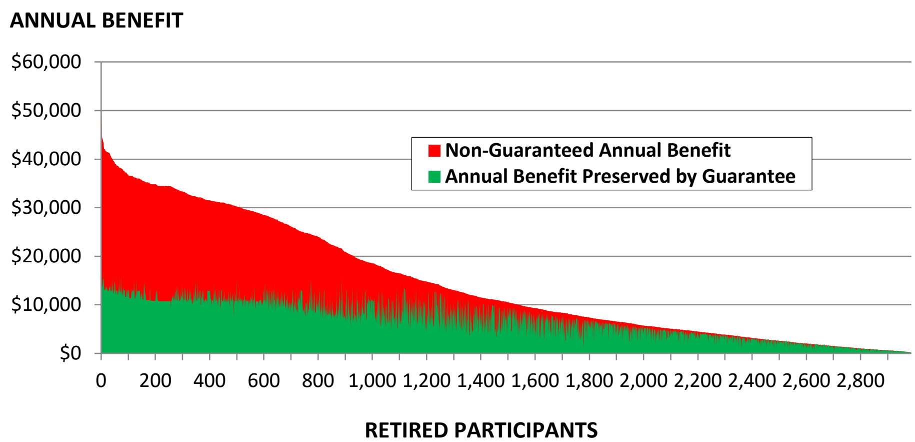
The red area in Figure 7 below shows the benefit losses for the 707 Fund's 3,000 retired participants as a result of the plan insolvency (approximately one-third experienced benefit cuts of over 50 percent). The green area shows what PBGC will pay as long as we have sufficient assets to pay the current guarantee.

The benefit losses will result in hardship for many of the plan's participants and beneficiaries. There also will be economic effects that go beyond these individuals and their families. They will have less money to spend in the local economy and they will pay less in federal and state income taxes. In some cases, they will need to rely on social programs to provide basic needs that they previously had paid for with their earned pension benefits.

[11] News Release: PBGC Provides Financial Assistance to Road Carriers Local 707 Pension Fund - Participants' Benefits Payments Cut to PBGC Guaranteed Levels. https://www.pbgc.gov/news/press/releases/pr17-02

Figure 7

CUT BACKS to MULTIEMPLOYER GUARANTEE LIMIT at PLAN INSOLVENCY
Road Carriers Local 707 Pension Fund



Where MPRA is a viable option, the degree to which plans will attempt to extend solvency through requests for benefit reductions and early financial assistance remains unknown.

Outlook for PBGC Multiemployer Program

In modeling projected insolvency dates and deficits for the Multiemployer Program, PBGC looked at scenarios where some plans use MPRA benefit suspensions or early financial assistance and where no plans used such MPRA tools. The mean year for Multiemployer Program insolvency was FY 2025 in both scenarios. The mean FY 2026 deficit in nominal dollars differed only slightly by scenario—$77.8 billion with MPRA and $78.8 billion without use of MPRA.

CONSEQUENCES OF MULTIEMPLOYER PROGRAM INSOLVENCY

Insolvency of the Multiemployer Program will dramatically reduce the already relatively low guarantee for multiemployer plan participants. Under current law, when Multiemployer Program assets are exhausted, the only money available to provide financial assistance for benefit payments will be incoming multiemployer premiums. Multiemployer premium income in FY 2017 was under $300 million, and the annual premium rate, $28 per participant for 2017 and 2018 plan years, will increase only by indexing.

The Multiemployer Program will soon be spending more in financial assistance than it receives in premium income. Funds in the Multiemployer Program will represent only a small fraction of the amount required for current guarantee levels. Under the program's authorizing legislation,[12] PBGC would submit to Congress, in advance of Multiemployer Program insolvency, a schedule of reduced basic-benefit guarantees which would be necessary in the absence of a premium increase. Such reduced guarantees would result in participants in failed multiemployer plans,

[12] ERISA section 4022A(f)(2).

receiving a very small fraction– an eighth or less, on average – of the current guarantee level, no matter when their plan became insolvent.

Even if the Multiemployer Program were adequately funded, a remaining challenge to benefit security is the guarantee for multiemployer plans. Multiemployer guarantees are much lower than single-employer guarantees. The multiemployer guarantee has not increased since 2001 and is not indexed for inflation. For example, the maximum guaranteed benefit for a retiree with 30 years of service is $12,870 annually. In contrast the maximum guaranteed benefit for a retiree in a single-employer plan is $65,045 annually. The Single-Employer guarantee is indexed for inflation. The single-employer guarantee typically protects full benefits of approximately 85 percent of participants in terminated plans. While the multiemployer guarantee has provided similar protection in the past, lack of indexing has eroded severely the value of the guarantee.

NEED FOR LEGISLATION

We work with troubled multiemployer plans and their sponsors who come to us seeking to prevent plan insolvency. We provide advice and assist them in whatever way we can. But the tools PBGC has to address the multiemployer crisis are very limited. We have been working with stakeholders and policy makers to find new ideas for shoring up the program.

Legislation is needed to address the looming insolvency of PBGC's Multiemployer Program and again make the PBGC guarantee something American workers and retirees, and their families, can count on. A number of proposals have been put forward. Some are designed to help plans avoid insolvency and thus help PBGC indirectly. Others are designed to help PBGC avoid insolvency.

The President's FY 2019 Budget includes a proposal to shore up the PBGC's Multiemployer Program. The Budget proposes adding a variable-rate premium on unfunded benefits, similar to the Single-Employer Program, with provision for waiver to avoid accelerating insolvency in the most troubled plans. The proposal also includes an exit premium on companies that withdraw from multiemployer plans. The proposal is estimated to raise an additional $16 billion over the ten-year budget window and is expected to be sufficient to fund the Multiemployer program for the next 20 years. However, additional actions may be necessary to address all the problems facing the broader multiemployer plan system.

CONCLUSION

While the Single-Employer Program is improving, the Multiemployer Program is headed toward insolvency – more likely than not by the end of 2025.

If the PBGC Multiemployer Program is allowed to become insolvent, the only money available to provide guaranteed benefits will be incoming premiums. Only a small fraction of the current, very modest guarantee will then be funded. The result will be catastrophic for many people—current and former workers, retirees, beneficiaries, and their families. These losses have consequences beyond the immediate parties, increasing demands on social programs. Employers are also concerned and are pushing for action to prevent further damage in the system.

As more time passes, it is increasingly difficult to craft a solution that can be viewed as fair, or that is even viable.

I appreciate the leadership of the members of this Committee in addressing the challenges faced by multiemployer plans and the PBGC Multiemployer Program. I look forward to continuing to work with you to ensure that PBGC's guarantee is one that workers and retirees can count on in the future.

I am happy to answer any questions.