Curing Troubled Multiemployer Pension Plans

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Summary

The PBGC estimates that there are 100 multiemployer pension plans (MEPP's) in critical and declining status who will become insolvent if MPRA benefit reductions are not approved and would require the PBGC to loan these plans amounts necessary to pay the PBGC guaranteed benefits. These plans have $100 billion in promised benefits to approximately 1 million participants, but only $40 billion in assets. The PBGC projects that it will become insolvent in 2026 and will be unable to pay such guarantees. Further, on a fair-value basis, the Congressional Budget Office projects that the value of claims for PBGC financial assistance, net of premiums received over the 2017-2036 period totals $101 billion.

The potential impact of the MEPP failures and PBGC insolvency would be extraordinary to the affected participants (promised pensions of several thousand dollars per month reduced to almost zero), the U.S. economy (billions of dollars not spent by participants), and the federal government (reputation risk of allowing a federal corporation to fail and increased demands for welfare relief).

The following "shared sacrifice approach" provides a potential solution that provides MEPP's and the PBGC with financial assistance that is not a bail-out. The proposal consists of two parts, which work best when implemented together, but could be implemented separately. However, preliminary estimates are that the PBGC financial assistance portiondoes not solve the problem on its own (the loan proposal does).

- Increase PBGC revenue so that it is capable of supporting "orphan" MEPP participants (those whose employer left a MEPP without paying its full withdrawal liability). This could be done with increased PBGC premiums, employee, union, and employer surcharges, and federal government funding.
- Troubled plans could receive a low interest, long term loan to cover its cash flow shortage for 5 years. Benefits would be reduced up to 20%. This allows plans to have a realistic chance to earn their way out of the funding shortfall. Loan repayments would begin after 5 years (interest only for first 5 years).

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Part 1 – Increase PBGC revenue; guarantee "orphan" benefits

To prevent MEPP insolvency, the cash flow of troubled plans must be addressed, so the sooner in the process that the PBGC gets involved, the better the financial health of the MEPP.

Increase funding to the PBGC so that it has adequate resources to pay directly to the MEPP's the amount of the PBGC benefit guarantee for "orphan" participants – those whose employers no longer participate in the MEPP and who did not pay their full

withdrawal liability (and are not in the process of paying it over time). The MEPP would pay the remainder of the benefit owed to the participant. This significantly improves the cash flow of all MEPP's. It is estimated that there could be as many as 2 million "orphan" participants with average PBGC-guaranteed benefits of $8K-$10K annually.

> As an example of this approach, if a MEPP had an identified orphan participant with a $1500/month benefit and the PBGC guarantee amount for this person was $1072.50/month, then the MEPP would only be responsible for the $427.50 portion of the benefit.

It has also been learned that the definition of orphan is sometimes unclear and that there does not exist an accurate source of information about orphan liabilities. An alternative is to use a proxy for each plan's orphan liability. The PBGC would provide direct financial assistance according to a formula. (# inactive participants at beginning of year x 1/3 x $6,435). The $6,435 is the PBGC annual guarantee amount for a participant with 15 years of service and the 1/3 is an estimate of the number of orphans in pay status in the inactive population. Using this approach, the estimated total of annual payments for critical and declining status plans is approximately $1.2 billion.

> As an example, a MEPP reported on its 2015 Form 5500 that it had 100,000 total participants at the beginning of the year and that 30,000 of those were active. That means 70,000 were inactive.
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> PBGC orphan relief = 70,000 x 1/3 x $6,435 or $150.1 million annually. This approach does not require any analysis by the MEPP to identify the orphan participants and calculate the amount of the PBGC guarantee for each. The MEPP uses the PBGC orphan relief calculated above to reduce its cash flow obligations across the payment population.

The PBGC would be required to pay the orphan liabilities through the MEPP after an application by the MEPP is made to do so. It is intended that all plans, regardless of funded status could receive such PBGC assistance. There are four potential ways to increase PBGC MEPP revenue that spread the burden across employees, employers, MEPP's and unions:

- Increase premiums paid by the MEPP's themselves – all MEPP's pay increased premiums (regardless of funded status) and all would have the PBGC pay the guaranteed amount for orphans so that there is a benefit to improving all MEPP's, even healthy ones. Just doubling the current premium from $28 annually to $56 annually would generate approximately $280 million more each year. Raising premiums to just $84 annually would generate an additional $560 million from the current level.
- Require employer surcharges – contributing employers would pay an additional amount to MEPP's (beyond what is contained in collective bargaining agreements)

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which the MEPP will forward to the PBGC. Proposed amounts are $10 per month per active participant. There are approximately 10 million participants in MEPP's and roughly one third are active. This would be approximately $400 million annually.

- Require participant "membership fees" – participating employees would have a $10 per month fee withheld by their employer or MEPP for payment to the PBGC. The fee would be paid from active members (assumed to be 3.3 million) and retires (assumed to be the same number). This would generate approximately $800 million annually.
- Require union MEPP surcharges – unions with active participants in MEPP's would be required to pay a per member monthly fee of $10. This would generate an additional $400 million in PBGC premiums.

The actual amount of each of the fees discussed above would need to be adjusted after a better understanding of the PBGC orphan requirements. However, the amounts shown above illustrate that a shared approach can generate a significant amount of funding and improve the cash flow of MEPP's when the PBGC pays the orphan guaranteed amount (or a proxy amount). Until ERISA section 4005(c) was repealed on July 6, 2012, the PBGC had the authority to borrow up to $100 million from the U.S. Treasury. ERISA Section 4005(c) should be reinstated and the limit should not be capped at a fixed amount, but rather should allow the PBGC to borrow as much as is needed to provide the orphan relief described above if the surcharges are insufficient.

<u>Part 2 – Low Interest Loans and Up to 20% Benefit Reductions</u>

Eligible Plans may submit an application to the DOL. A plan is eligible if its actuary certifies that it is in critical and declining status as defined in MPRA. The plan's actuary must also certify at that time that the loan will correct the funding issue and can be repaid[1].

Assumed rate of return to be set forth in the statute (e.g., that expressed in the most recently published Horizon Survey of investment forecasts).

Approval must be made within 30 days of filing application and is deemed approved if no action is taken. Approval is automatic unless the plan uses a different rate of return assumption or its investment strategy/policy falls outside generally accepted principles for appropriate risk management. There is no participant voting process.

Initial loans to be provided within 60 days of application approval. The remaining portions of the loan are made on a monthly basis as cash flow to pay benefits to eliminate investment risk.

[1] Plan actuaries are required to conform to applicable Actuarial Standards of Practice (primarily numbers 27 and 35 in this context) and Code of Professional Conduct or face discipline by the American Academy of Actuaries.

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Loans to be in the amount calculated by the plan's actuary to pay the "shortfall" for the next 5 years. The shortfall is equal to 5 times the projected income from contributions and earnings minus the projected benefit payments (not reduced) and reasonable plan administrative expenses. The earnings are based on the projected asset value as of the first day of the next plan year times the statutory rate of return assumption. The contributions and benefit payments are those of the immediately preceding plan year.

Loans shall be made at a 1% interest rate and amortized over 30 years. Loan repayment commences immediately but interest payments only for the first 5 years.

Benefit payments to be reduced up to 20% for all participants in pay status effective as of 60 days following application approval. Such reductions may reduce a participant's benefit below the PBGC guarantee (there could be a floor for reductions in plans with relatively small benefits). Upon an application's approval, the plan shall send each affected participant a notice informing them of the amount of their benefit reduction. In addition, benefit accruals for active participants in the plan will also be reduced by the same percentage as those in pay status. Nothing about PPA rehabilitation or funding improvement plans will be affected.

Because the amount of the reduced benefit payments are not included when calculating the shortfall, the fund has the opportunity to improve its funded status through investment performance. The amount of the benefit reductions will stay in the general asset pool so the fund has the opportunity to grow the asset base which in turn increases future investments earnings to shore up the cash flows.

At the end of the 5 years following the loan initiation, the plan's actuary must certify whether the plan remains in critical and declining status. If it is, the shortfall is recalculated (without including the benefit reductions) and a new 5 year loan amount is calculated and provided by the government in monthly payments. If the plan is no longer in critical and declining status, then the loan principle begins to be repaid.

Benefit reductions remain in place until the plan is projected to become a green zone plan with the benefits restored (could even occur while the loan is being repaid). Plans would be required to assess the ability to restore all or a portion of the benefit reductions annually. Troubled plans may only apply for 3 consecutive loans. At the end of the third loan cycle, the principle and interest on the loan begin to be repaid no matter what the financial condition of the plan is at that time. This means that the plan may use assets to repay the loan if employer contributions and investment returns are insufficient.

The employer contributions will remain as they would under the plan's red-zone rehabilitation plan provisions.

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Withdrawal liability calculations during the period of any outstanding loans will be made as if the loan and benefit reductions had not been made. This proposal does not reduce withdrawal liability because of the loan.

According to the Government Accountability Office, at the end of FY 2014, the federal government had over $1.1 trillion in outstanding federal direct loans[2]. Based upon 2015 Form 5500's for critical and declining status MEPP's, it is estimated that these plans would need a range of approximately $22-30 billion in loans.

In the event that a MEPP had submitted an application to reduce benefits under MPRA and it was approved prior to this proposal becoming effective, the plan could still apply for the loan(s) and instead of reducing benefits like other plans, it could restore benefits to the level that they would have been reduced if the MPRA application had not been approved.

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[2] A direct loan is "a disbursement of funds by the government to a nonfederal borrower under a contract that requires the repayment of such funds with or without interest." (as defined in Section 502(1) of the Federal Credit Reform Act of 1990).

Example:

XYZ Multiemployer Plan (the "plan") is certified by the plan's actuary to be in critical and declining status as of January 1, 2017. The plan is anticipated to become insolvent in 2026.

The plan applies to the government for the first loan on April 1, 2017.

The first loan amount is calculated as follows:

Loan #1:		
Estimated earnings on 1/1/2018 assets at the rate defined by the statute (6.5%)	6.5% times $7,573M	$492M
2017 contributions		$350M
2017 benefit payments		$1,500M
Shortfall	Benefit payments less contributions less estimated earnings	$658M
Loan amount	5 times shortfall	$3,290M paid in 60 equal installments of $55M per month starting in 2017

During the 5 year period that the loan is being paid, benefits are reduced by 20% and the plan is required to pay 1% interest on the outstanding balance.

During the period from 2017 through 2021, the plan's asset returns are as expected and no significant employers withdraw from the plan.

As of January 1, 2022, the plan's actuary certifies that the plan is still in critical and declining status, but the projected insolvency date has now been extended to 2039.

The plan applies to the government for the second loan on April 1, 2022.

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The second loan amount is calculated as follows:

Loan #2:		
Estimated earnings on 1/1/2023 assets at the rate defined by the statute (6.5%)	6.5% times $9,860M	$641M
2022 contributions		$290M
2022 benefit payments		$1,530
Shortfall	Benefit payments less contributions less estimated earnings	$599M
Loan amount	5 times shortfall	$2,995 paid in 60 equal installments of $50M per month starting in 2022

During the 5 year period that the 2nd loan is being paid, benefits are reduced by 20% and the plan is required to pay 1% interest on the 1st and 2nd outstanding loan amounts.

During the period from 2022 to 2026, the plan's asset returns are as expected and no significant employers withdraw from the plan.

Beginning 2027, the plan begins to repay both loan amounts. The repayment of both loans at a rate of 1% is approximately $241M annually.

As of January 1, 2027, the plan's actuary certifies that the plan is no longer in critical and declining status. The plan is projected to remain solvent for the next 38 years. However, the plan is still not in the green zone, so benefits are not restored. The 20% reduction in benefits and accruals remain in effect.

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