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CAN PBGC SAVE MULTIEMPLOYER PLANS?

By Alicia H. Munnell and Jean-Pierre Aubry*

Introduction

Multiemployer pension plans – defined benefit plans established through collectively bargained agreements between labor unions and two or more employers – have been weakened by two financial crises and a slow recovery from the recession. These plans also have very few active workers relative to retired and separated participants and a burden of orphaned workers from employers that have left the plans. Despite these challenges, the majority of troubled multiemployer plans have required the bargaining parties to negotiate higher contribution rates and some have cut the rate of future benefit accruals; these actions, combined with a strengthening economy, have improved their long-term financial position. But a number of plans, despite significant steps taken to address their funding problems, face the possibility of insolvency. These plans will require financial assistance from the Pension Benefit Guaranty Corporation (PBGC), the federal agency established under the Employee Retirement Income Security Act of 1974 (ERISA) to protect benefits of workers covered by insolvent plans. But the PBGC projects that its multiemployer program is highly likely to be insolvent itself within a decade. This *brief*, the third in a series of four on multiemployer plans, explores the role that the PBGC can play in addressing multiemployer plan insolvencies.

The discussion proceeds as follows. The first section describes the nature of the PBGC program for multiemployer plans and how it differs from that for single employer plans. The second section summarizes PBGC activity to date. The third section presents the PBGC's most recent projections of its multiemployer program's finances. The fourth section explores various options that have been offered to address the PBGC's impending funding crises and enhance its ability to assist severely weakened multiemployer plans. The final section concludes that the PBGC is unlikely to be able to meet the financial needs of severely underfunded plans, much less provide a reasonable level of guaranteed benefits.

PBGC's Multiemployer Program

When Congress enacted ERISA in 1974, no multiemployer plan had ever terminated, so the legislation gave the PBGC discretion over whether or not to insure these plans. During the period when insurance was discretionary, three multiemployer plans sought PBGC protection. These terminations revealed that multiemployer plans could fail and that employers

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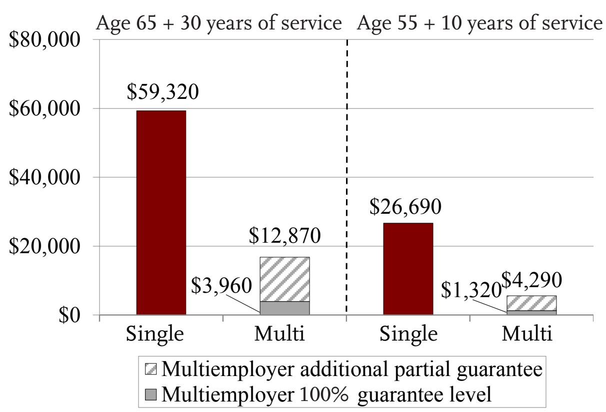
who withdrew from a plan had no further financial obligation to it, providing an incentive to exit at the first sign of trouble. Thus, Congress introduced some form of withdrawal liability for exiting employers in 1980 and extended insurance protection to multiemployer plans.[1] The PBGC insurance program for multiemployer plans, however, is much more modest than that for single employer plans.

In 2014, multiemployer plans pay an insurance premium of $12 per participant to the PBGC, while single employers pay $49. Both premiums are indexed for inflation. In addition, single employer plans pay a variable rate premium of $14 per 1,000 of unfunded vested liabilities, with a cap of $412 per participant. Multiemployer plans do not pay an additional variable rate premium.

Figure 1. PBGC Benefit Guarantees for Single Employer and Multiemployer Plans, 2014



Source: Pension Benefit Guaranty Corporation (2014).

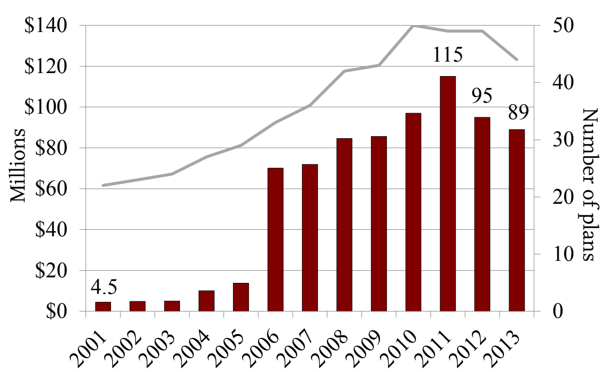
Not surprisingly, given the low premiums, the PBGC's benefit guarantee for participants in multiemployer plans is significantly less generous than for those in single employer plans. First, the guaranteed amount is very low, even though the average benefit for multiemployer plans is only slightly lower than that for single employer plans ($12,600 versus $15,700). For an individual with 10 years of service, PBGC guarantees 100 percent of the pension benefit up to $1,320 per year; with 30 years of service, $3,960 (see Figure 1). PBGC guarantees 75 percent of benefits in excess of that level but only up to $12,870 for an individual with 30 years of service. By comparison, for single employer plans, the guaranteed annual benefit at age 65 is $59,320. Second, the PBGC multiemployer guarantee is prorated based on years of service, while the single employer guarantee does not change whether a participant has 10 or 40 years of service. Third, PBGC guarantees are indexed for inflation in single employer plans, but not in multiemployer plans. Fourth, unlike the single employer plans, the multiemployer guarantee is not actuarially increased for retirement after age 65. Not surprisingly, about 80 percent of single employer participants in terminated single employer plans received their full vested benefits, while multiemployer participants generally receive only a fraction.[2]

In addition to differences in benefit guarantees, the nature of PBGC involvement is also quite different for multiemployer plans than for single employer plans. In the case of single employer plans, the PBGC takes over the assets and liabilities of terminated underfunded plans as a trustee and pays benefits directly to participants. In the case of an insolvency of a multiemployer plan, the plan remains an independent entity managed by its board of trustees and the PBGC steps in only after all the plan's assets are exhausted to provide "loans" to pay any remaining insured benefits.[3] Although the loans are required by law to be repaid, in practice plans never recover from insolvency and therefore the loans are never repaid.

PBGC Assistance to Multiemployer Plans To Date

Multiemployer plans had little need for the PBGC during the 1980s and 1990s; the stock market soared, participants had plenty of work, and employers were making good profits. But since the turn of the century, the total amount of assistance has increased sharply (see Figure 2).[4]

Figure 2. Multiemployer Plans Receiving PBGC Financial Assistance and Amounts Received, 2001-13



Sources: Pension Benefit Guaranty Corporation (2013a); and U.S. Government Accountability Office (2013b).

Loans to insolvent plans account for the bulk of payments, but the PBGC has also helped a couple of "partitions." A partition allows a multiemployer plan to carve out plan liabilities attributable to orphaned employees of employers that have filed for bankruptcy and turn that liability over to the PBGC, while keeping the remainder in the plan.[5]

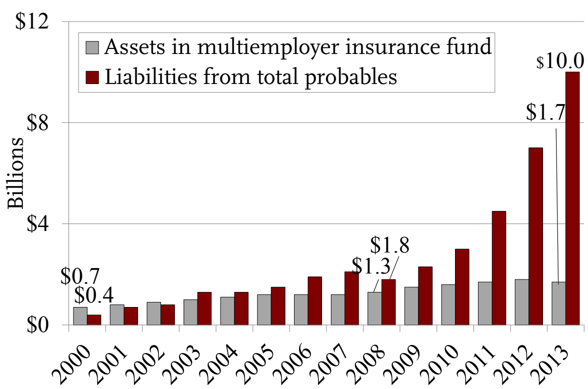
Projections for the Future

The PBGC projects its finances into the future. The projections come from the agency's Annual Financial Report, which identifies potential plan insolvencies, and from an Actuarial Report that simulates future liabilities under a number of scenarios.[6]

Financial Report

The PBGC identifies plans that may need assistance in the future and assesses the impact of the projected insolvencies on the multiemployer insurance fund. Both the number of plans and the PBGC's potential liability have increased sharply. For example, the liability associated with "probable" plans rose from $1.8 billion in FY2008 to $10.0 billion in 2013 (see Figure 3). Probable plans fall into three categories: 1) plans where PBGC payments have already begun; 2) terminated plans where benefits exceed assets plus revenues;[7] and 3) ongoing plans that are likely to terminate in the next 10 years (see Table 1).

Figure 3. PBGC Assets in Multiemployer Insurance Fund and Liabilities from "Probable" Plans, 2000-13, Billions



Sources: Pension Benefit Guaranty Corporation (2013a); and U.S. Government Accountability Office (2013b).

Table 1. Classification of PBGC's Probable Plans, 2013

Classification	Definition	Number of plans
Current	A plan known to be insolvent that has received or will begin receiving financial assistance.	44
Terminated future	A terminated plan where current assets and future payments will be insufficient to cover plan benefits plus expenses.	65
Ongoing future	An ongoing plan with a projected insolvency date within 10 years.	64

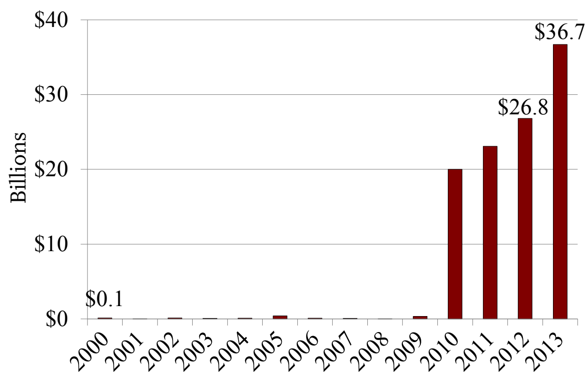
Source: Pension Benefit Guaranty Corporation (2013a).

The PBGC also has a "reasonably possible" category in its contingency list; these are ongoing plans with a projected insolvency date between 10 and 20 years of the valuation. This category, which involves large liabilities, has increased dramatically (see Figure 4 on the next page).

In 2012, virtually all of the $27 billion of liabilities was attributable to the potential insolvency of two large plans – Central States Teamsters and United Mine Workers. Central States, which is classified as "critical" in terms of its financial health, has more than 400,000 participants, an actuarial funded ratio of 54 percent and a current funded ratio of 35 percent, and a ratio of active to total participants of 17 percent. United Mine Workers, which is classified as only "endangered," has about 115,000 participants, an actuarial funded ratio of 72 percent and a current funded ratio of 43 percent, and a ratio of actives to total of 9 percent.[8] Interestingly, targeted legislation has been proposed to help each of these plans.[9]

The 2013 estimates of "reasonably possible" plans continue to assume that these legislative initiatives for the Central States and United Mine Workers will not come to pass. In addition, the PBGC increased

Figure 4. PBGC Loss Exposure to "Reasonably Possible" Terminations of Multiemployer Plans, 2000-13



Sources: Pension Benefit Guaranty Corporation (2000-2012, 2013a).

its potential loss exposure by an estimated $10 billion from 2012 with the addition of 28 new – presumably relatively small – plans to the list.[10] Overall then, as of 2013, the PBGC reported projected contingent liabilities of $47 billion – covering plans in both the probable ($10 billion) and reasonably possible categories ($37 billion).

An Actuarial Analysis

The PBGC also makes projections for the next decade and beyond using its Multiemployer Pension Insurance Modelling System, running 500 simulations of the economy and how plans react.[11]

The results for 2013, reflecting significant changes to the model, show a dramatic increase in the mean present value of the deficit over the next ten years.[12] To gauge the extent of these changes, applying the new model and assumptions to the prior year would have increased the projected ten-year deficit from $26 billion to $80 billion (see Table 2).[13]

Table 2. Mean Present Value Deficit in Multiemployer Program, Before and After Changes to PBGC Model (Billions)

	Before changes	After changes
2012-2022	$26.2	$79.6
2013-2023	–	$49.6

Source: Pension Benefit Guaranty Corporation (2014).

The reasons that the mean projected deficit drops from $80 billion for 2012 to $50 billion for 2013-2023 are the strong asset returns during 2013, other improvements in the economy, and more favorable data in the plan reports.

Reasonable people could question whether the situation is as dire as claimed by the PBGC. Indeed, the actuaries undertake some sensitivity analysis but examine only the downside. For example, the report shows that if interest rates used to calculate liabilities were 33 basis points lower, the deficit would be $2.5 billion higher. But interest rates are more likely to be higher than lower: if rates rose by one percentage point, the ten-year deficit would be $7 billion lower. More importantly, if the economy continues to improve, market returns remain high, and the plans continue to report improved numbers, the deficit could drop further.

Even if the most recent projections exaggerate the magnitude of the problem, the PBGC will not be able to cover its scheduled payments over the next ten years with its $1.7 billion of assets and $90 million in annual contributions (present value of about $1.2 billion). This $3 billion of resources falls short of the projected mean present value of required financial assistance of $6.1 billion for the next ten years. The actuarial model projects that it is more likely than not that the program will be insolvent by 2022, with a 90-percent chance of insolvency by 2025.

Once the fund is exhausted, the PBGC would have to rely on annual premium receipts and would be forced to pay only a fraction of its paltry guaranteed benefit. One estimate is that a retiree who once received a monthly benefit of $2,000 and whose benefit was reduced to $1,251 under the PBGC guarantee would see the monthly benefit decline to $125.[14] The exhaustion of the multiemployer insurance fund could also undermine confidence in the entire system.

What Can Be Done?

The challenges to the multiemployer program are substantial. The first question is whether the PBGC can do anything to forestall the impending insolvencies of a number of multiemployer plans. The second question is what the PBGC can do to forestall its own insolvency and perhaps improve the meager level of guarantees.

Partition of Orphan Participants

Several experts suggest that the PBGC be given the authority and resources to head off insolvency by allowing partitions.[15] A partition would allow a plan to transfer to the PBGC the liability for orphan participants whose employer has left the plan, which would put the plan in a better position to fund ongoing costs with contributions. On average, orphan participants account for roughly 20 percent of the total, and one troubled plan reported that about 40 percent of benefit payments go to orphans.[16] Removing orphaned participants has a lot of appeal; it has been clear for decades that the withdrawal liability procedure is flawed and bankrupt firms often pay little to nothing.[17] It seems unfair to burden current workers and their employers with legacy costs over which they had no control.

The partition approach, however, has some drawbacks. Most of the proposals would limit eligible orphans to those whose employer has gone bankrupt, which would still leave plans with many orphans whose withdrawing employer ended up paying an inadequate amount. The second issue is that some of those workers transferred to the PBGC would experience a big reduction in benefits to the PBGC guarantee level. And it is not clear that partitioning would be a permanent fix in some cases. Most importantly, the PBGC does not have the resources to cover orphaned liabilities for all severely underfunded plans and partitioning would accelerate PBGC's projected insolvency because financial assistance is given immediately, rather than at a later date when the plan would otherwise become insolvent.

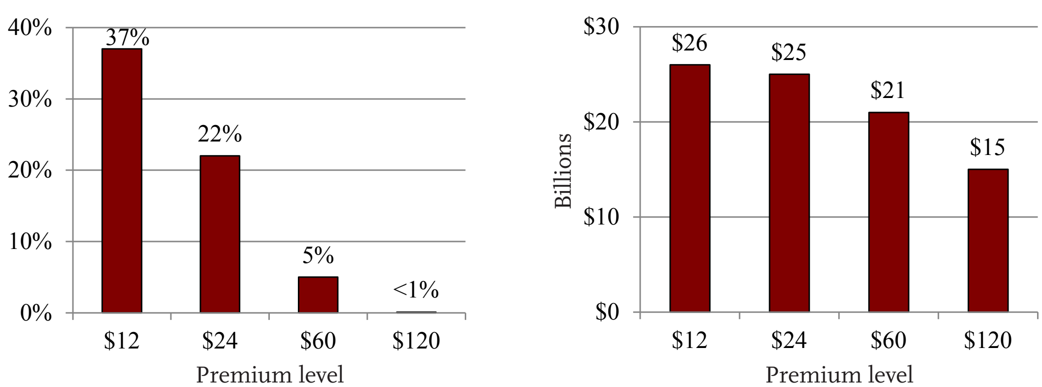
Raise Additional Revenues

Even without supporting partitions, the PBGC multiemployer program itself is scheduled for insolvency. To meet its present commitments – much less provide more reasonable levels of guaranteed benefits – the program needs more money. Since by law the PBGC's insurance programs must be self-supporting, without some exogenous source of money, additional resources must come from raising premiums.

Estimates suggest that the required increase in premiums is substantial. As shown in Figure 5, doubling the PBGC insurance premium from $12 to $24 would reduce the likelihood of insolvency in 2022 from 37 percent to 22 percent; a tenfold increase to $120 would eliminate insolvency in 2022. But according to the PBGC, even a tenfold hike would not prevent a substantial increase in the agency's deficit from $5.2 billion in 2012 to $15 billion in 2022. And it does not provide any additional revenues to improve the guarantees. Therefore, to solve the problems on a self-financing basis, the relevant premium may be closer to $240 than $120.

While current premiums are not a significant percentage of plan costs, premiums of $120-$240 could place a significant burden on severely underfunded plans where employers have already seen substantial contribution increases. One plan trustee suggested the following real world example. The plan has $5.5 billion in assets and 225,000 participants. Current administrative expenses are $13.9 million and current PBGC premiums $2.7 million. A tenfold increase would raise the PBGC premium to $27.0 million; a 20-fold to $54 million. These increases translate to a $0.014 per hour cost going to a $0.146 or $0.292 per

Figure 5. Probability of Multiemployer Program Insolvency within 10 Years and Projected Deficit in 2022 (Billions of Dollars), By Premium Level



Source: Pension Benefit Guaranty Corporation (2013b).

hour cost. The concern is that adding this increase on to what employers are already paying for their rehabilitation plan may be enough to incent employers to withdraw. Very careful analysis would be required to ensure that raising premiums does not create a death spiral: as premiums go up, more employers withdraw, leading to greater insolvencies and the need for ever higher premiums. It does seem like the ability of the PBGC to finance the required support for multiemployer plans is indeed limited.

Conclusion

Multiemployer plans that are in difficult financial shape can receive help from the PBGC. However, the PBGC's guarantees for multiemployer plans are very low compared to single employer plans. And the PBGC steps in only after a multiemployer plan has exhausted its assets. Moreover, projections of the need for PBGC assistance are cause for concern for two reasons. First, estimates of the agency's potential loss exposure from troubled multiemployer plans have soared in recent years. Second, the PBGC is not expected to be able to cover its scheduled payments to troubled plans over the next decade, which means that benefits paid to participants – already meager – could be reduced dramatically.

To address this brewing crisis, some experts propose allowing troubled plans to transfer the responsibility for orphan participants to the PBGC in an effort to restore their fiscal health. Such proposals, however, tend to limit the orphans who would be eligible and would result in deep benefit cuts to some of those transferred. More importantly, the PBGC does not have sufficient resources to cover orphaned liabilities for all severely underfunded plans. Bolstering the finances of the PBGC itself by raising employer premiums runs the risk of incenting employers in troubled plans to withdraw. In short, the PBGC, as currently structured, will not be able to stave off insolvencies or protect workers in plans that become insolvent.

The fourth, and final, *brief* in this series will analyze another alternative, a controversial proposal to allow plans facing impending insolvency to cut benefits of current retirees to spread the pain among all participants.[18]

Endnotes

1 Multiemployer Pension Plan Amendments Act of 1980 (MPPAA).

2 Pension Benefit Guaranty Corporation (2006).

3 Plans are deemed insolvent if they cannot provide benefits at the PBGC guaranteed level for a full year.

4 The figure makes it appear that, more recently, cash flow needs have been declining. This pattern emerges because cash flows in 2011 and 2012 were higher than normal. For example, in 2011 the PBGC provided $13.7 million to support two plan partitions and $15.1 million to help plan sponsors close out five plans (U.S. Government Accountability Office 2013a).

5 A small amount of funds in 2011 also went to help plan sponsors merge their plans, which can reduce administrative costs.

6 PBGC (2013a) and PBGC (2014).

7 A plan can terminate by mass employer withdrawal or by plan amendment. A mass withdrawal termination occurs when all employers withdraw or are no longer obligated to contribute to the plan. A plan amendment termination occurs when the plan stipulates that participants will receive no credit for service after a specified date.

8 A "critical" plan is one with a projected funding deficiency within 4-5 years or a near-term cash flow problem. An "endangered" plan faces less serious problems.

9 Under the Create Jobs and Save Benefits Act of 2010, which was not adopted, the Central States Teamsters plan would have been eligible to transfer the liability for its orphan participants to the PBGC through a separate, partitioned plan. Under the Coalfield Accountability and Retired Employee Act, introduced in 2013 and still pending, the United Mine Workers plan would be allowed to tap surplus assets from a separate source – the Abandoned Mine Land Fund – to alleviate its funding woes.

10 Pension Benefit Guaranty Corporation (2013a).

11 This actuarial exercise must use "reasonable" assumptions, while the financial report must comply with Generally Accepted Accounting Principles.

12 Here "deficit" is, at any point in time, the net present value of financial assistance for plans estimated to become insolvent within 10 years of that date.

13 The dramatic increase in the deficit for 2012-2022 is almost entirely due to three changes to the model:

- No longer assume that critical plans – both those that have given up (exhausted all reasonable measures) and those that have not – will eliminate all future benefit accruals or roll back improvements made over the past 60 months. For those that have given up, also no longer assume they will eliminate early retirement subsidies and future temporary supplements; other critical plans will continue to do so.
- Limit increase in per capita contribution rate for critical plans to 12 percent per year (7 percent for plans that have exhausted all reasonable measures).
- Cap aggregate contributions (indexed for wage inflation) relative to base year, so that they do not more than double in the first six years, triple in the next six years, or exceed 3.5 times the base thereafter. For plans that have given up, the limit is 1.5 times the base amount.

14 U.S. Government Accountability Office (2013b).

15 U.S. Government Accountability Office (2013b). To date, PBGC has performed only three partitions: the Council 30 of the Retail, Wholesale, and Department Stores Union plan in 2010; the Chicago Truck Drivers Union Pension Plan in 2010; and former Hostess Brands' employees in the Bakery and Sales Drivers Local 33 Industry Pension Fund in 2014. In these cases, instead of administering payments for the orphaned participants, the PBGC provided the funding to the plan to cover the orphaned participants' guaranteed benefits. As noted, the Create Jobs and Save Benefits Act of 2010, which was not adopted, would have specifically authorized the use of partitions for plans meeting certain requirements.

16 Solis, Geithner, and Gotbaum (2013); and U.S. Government Accountability Office (2013b).

17 U.S. General Accounting Office (1985).

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