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United States Joint Select Committee on the Solvency of Multiemployer Pension Plans
The History and Structure of the Multiemployer Pension System
Wednesday, April 18, 2018

Questions for the Record for Ted Goldman

Introduction

On behalf of the Pension Practice Council of the American Academy of Actuaries, I appreciate the opportunity to provide the following responses for the record to questions provided us pursuant to the Joint Select Committee on the Solvency of Multiemployer Pension Plans hearing, *The History and Structure of the Multiemployer Pension System,* on April 18, 2018.

Thank you again for the opportunity to provide input to the Committee. The Pension Practice Council of the American Academy of Actuaries stands ready to help you at each step of the way with objective and nonpartisan input.

Sincerely,

Ted Goldman, MAAA, FSA, EA
Senior Pension Fellow
American Academy of Actuaries

Follow-up information requested at the hearing:

Question #1

Please describe what employer's withdrawal liability responsibility is a mass withdrawal event?

Withdrawal Liability in General

When a contributing employer withdraws from an underfunded multiemployer pension plan, it must pay "withdrawal liability," which represents the employer's share of the plan's unfunded vested benefits. The amount of the plan's overall unfunded vested benefits is determined annually by the plan actuary.

Under the Employee Retirement Income Security Act of 1974 (ERISA), when an employer withdraws from a multiemployer pension plan, it is not obligated to pay its withdrawal liability in a lump sum. Rather, the statute requires the employer to pay down its withdrawal liability obligation, with accumulated interest, through periodic payments. The amount of the periodic payment is determined based on the employer's historical contribution rates and contribution base units, such as covered hours or wages.

In general, the statute limits an employer's withdrawal liability payments to 20 years; this is often called the "20-year cap." In other words, if the statutory periodic payments are not sufficient to pay down the employer's allocated withdrawal liability, with accumulated interest, the payments stop after 20 years. Any unpaid withdrawal liability must be reallocated among the remaining employers in the plan.

Withdrawal Liability in a Mass Withdrawal

A mass withdrawal has occurred for a multiemployer pension plan when every employer—or substantially every employer—has withdrawn from the plan. In a mass withdrawal situation, different rules apply to how employer withdrawal liability is calculated.

- The plan's overall unfunded vested benefits must be calculated based on assumptions prescribed by the Pension Benefit Guaranty Corporation (PBGC) for plan termination situations. These conservative assumptions could substantially increase the amount of unfunded vested benefits allocated to each employer.

- The other notable difference under a mass withdrawal is that the 20-year cap ceases to apply. In many mass withdrawal situations, the removal of the 20-year cap means that employers will be obligated to make their statutory withdrawal liability payments indefinitely.

Question #2

Where do pension obligations fall in the order of priority in bankruptcy?

The status of withdrawal liability claims against an employer that has filed for bankruptcy protection is not expressly dealt with in either the U.S. bankruptcy code or ERISA. However, in our observation, courts have generally held that a claim for withdrawal liability is not entitled to priority status as an administrative claim. As a result, withdrawal liability does not have priority status and withdrawal liability is treated as a general unsecured claim.

Questions from Senator Hatch

Senator Hatch, Question #1
Funding Standards

In our initial review of the issues surrounding the multiemployer pension plans, one of the primary concerns the committee plans to investigate are the funding standards for these plans. The issue is whether the funding standards are adequate, providing the proper level of assets to cover the future liabilities of the plans. As a preliminary, can you describe the funding methods for the multiemployer plans prior to the enactment of the Employee Retirement Income Security Act? What new funding standards were established by ERISA, and what impact did these standards have on the funding of the plans?

Before discussing statutory funding standards and funding methods, it may be helpful to define certain terms commonly used in pension funding. The "normal cost" is the value of benefits being attributed to the coming plan year, and it often includes an adjustment for expected administrative expenses. The "actuarial liability" is the value of benefits that are attributed to prior plan years, in other words, past service liabilities. To the extent that plan assets are less than the actuarial liability, there is an "unfunded liability."

Prior to the 1976 effective date of ERISA, there were no federal statutory funding standards. Actuaries would advise plan sponsors as to whether contributions and benefits were in balance. In simplified terms, it was desirable for contributions to cover plan costs, which included the normal cost and some amortization of the unfunded liability. To the extent contributions equaled or exceeded plan costs, the plan would be projected to become 100 percent funded over time.

ERISA imposed new minimum funding requirements on private sector pension plans. The minimum requirements are determined annually based on a notional "funding standard account." Under the funding standard account calculations, employer contributions must cover plan costs, which include the normal cost and amortizations of changes in the unfunded liability over a fixed period. Currently, the amortization period is generally 15 years from inception, though there are legacy layers of liability that have a longer outstanding period. To the extent that accumulated contributions exceed accumulated plan costs, the funding standard account will develop a "credit balance." If, however, contributions fall short of plan costs, there will be an "accumulated funding deficiency," meaning the plan is not meeting its minimum funding requirements. In that case, excise taxes on contributing employers and other penalties may apply until the deficiency is corrected.

Focusing only on multiemployer pension plans, the funding standards under ERISA—as amended by the Pension Protection Act of 2006 (PPA)—have provided a framework to target improving funding levels and work toward restoring a credit balance for plans that are facing a funding deficiency. Overall, funding levels for multiemployer pension plans have improved in recent years, after the damage rendered by the poor investment performance of the early 2000s and the recession of 2008–09. Today, more than 60 percent of the nearly 1,300 multiemployer plans are in the "green zone" under PPA. However, approximately 100-120 plans approaching insolvency will not be able to pay promised benefits without a legislative solution or enhanced access to regulatory approval of the restructuring remedies provided by the Multiemployer Pension Reform Act of 2014 (MPRA).

Senator Hatch, Question #2
Discount rates

In your testimony, you note that the majority of multiemployer plans remain healthy. Is this actually the case, when in fact PPA zone status reflects pension liabilities discounted at the plans expected long-term investment return assumption? Given a low return investment environment, is the use of a long-term, higher, discount rate appropriate? Would your assessment of the relative health of the multiemployer plans change if we used investment return assumptions that reflect current market valuations or other more conservative measures?

Two major concepts are implicit in these questions: (1) the selection of an investment return assumption and (2) how different measurements can inform an assessment of the health of a multiemployer pension plan.

Investment Return Assumptions

Under actuarial standards of practice (ASOPs) No. 27, the *purpose of measurement* is an important factor in selecting a reasonable and appropriate interest rate or investment return assumption. For example, an investment return assumption may be used as a discount rate—often referred to as the valuation interest rate—to determine the actuarial present value of benefits under a pension plan. Alternatively, an investment return assumption may apply to the rate of return expected to be earned on plan assets over a period of time. For some purposes, the valuation interest rate and the assumed rate of return on plan assets are the same; for others, they are necessarily different.

The following are three common measurements relevant to multiemployer pension plan funding, each of which uses a different investment return assumption.

- *Actuarial accrued liability*. This is the measurement of the plan's accrued liability for benefits earned to date and is based on a valuation interest rate assumption that represents the expected return on plan assets over the long term. Under ERISA, the assumption is the actuary's best estimate. For most multiemployer plans, the assumption is in the range of 7.0 and 7.5 percent, which is set considering the plan's investment policy, asset class expectations, and other factors. The actuarial accrued liability generally serves as the basis for determining ERISA minimum funding requirements, budgeting for long-term sufficiency of contribution rates, and PPA zone status.

- *Current liability*. This is a measurement of the plan's accrued liability and is based on a discount rate and mortality tables prescribed by statute. Current liability is used for certain disclosures and for determining maximum tax-deductible limitations. It is also similar—but not identical to—an assessment of the value of plan liabilities in a settlement or immunization situation. The current liability interest rate represents a weighted average of 30-year Treasury securities, which is considered to be a proxy for current risk-free interest rates. In other words, the current liability interest rate is set independent of the expected return on plan assets. For 2017, current liability interest rates were slightly above 3.0 percent.

- *Actuarial projections*. When performing projections of future solvency or funding levels, actuaries often use an investment return assumption that is the same as the valuation interest rate. Increasingly, however, actuaries are performing projections under different investment return assumptions. For example, actuaries may perform sensitivity projections reflecting higher or lower expected returns on plan assets over the short term. There is no statutory requirement to perform sensitivity projections, but actuaries may do so to reflect the expectation that investment returns will be lower in the near-term than their historical averages in the current low interest rate environment. Additionally, actuaries may perform sensitivity projections—such as sensitivity analysis, scenario testing, and risk tolerance—for purposes of plan sponsor education and planning.

Assessing Plan Health

When assessing whether a multiemployer pension plan is "healthy," it is often helpful to consider more than one single number or perspective. The following are metrics often considered when evaluating the health of a multiemployer pension plan.

- *Statutory requirements*. Minimum funding requirements and PPA zone status are largely based on a funded percentage (assets divided by the actuarial liability) and the current and projected funding standard account. These measurements are designed to support the determination of a contribution amount that balances considerations of long-term stability and sufficiency.

- *Market-based measurements*. Additional metrics can provide further insight into the health of a plan. For example, valuations can be performed using current bond market interest rates rather than expected returns. Such an approach can provide greater comparability across plans that have different investment allocations or capital market expectations. It can also help to illustrate the extent to which expected future investment returns are relied upon to provide for the targeted benefits outlined in the plan. The current liability measure mentioned earlier is an example of a market-based measure calculated and disclosed for multiemployer pension plans.

- *Current and projected funding levels*. Rather than focusing solely on the current funded status of a multiemployer pension plan, an assessment of plan health should also consider what its funding levels are projected to be in the future. For example, consider a plan that is currently 90 percent funded and projected to remain about 90 percent funded in all future years. Next, consider a plan that is currently 80 percent funded and projected to become 105 percent funded within the next 15 years. All other factors being equal, one may argue that the second plan is healthier than the first, in that its upward trajectory makes it more likely to be resilient to future adverse experience.

Senator Hatch, Question #3
Plan experience gains and losses

In examining the financial status of the multiemployer plans, the Committee is compiling plan data on experience gains and losses. Is this data gathered by plan administrators or trustees?

Actuarial gains and losses represent the differences between actual plan experience and the actuarial assumptions. Actuaries review gains and losses each year as part of the annual actuarial valuation process. Historical gains and losses are often summarized in the actuarial valuation reports, which are presented to the plan trustees and retained by plan administrators.

When reviewing data on gains and losses, it is important to distinguish between those arising from demographic sources and those arising from investments. For multiemployer pension plans, investment experience tends to be much more volatile than demographic experience (such as mortality and retirement experience).

Annual gains and losses from demographic sources are usually relatively small when compared to those related to investment returns. It is also important to note that gains and losses related to contribution levels may have a relatively small impact on a plan's *current* funding level, but they can have significant effects on *projected* funding levels. To get a more complete picture of experience gains and losses and their impact on projected funding levels, it is important to understand how contribution levels have changed over time, and how they have compared with assumed levels over the years.

Senator Hatch, Question #4
Mortality

In general terms, what are the mortality assumptions used by these plans and how have these assumptions changed since 2000? How are these assumptions established, and are they subject to any manner of oversight, or legal or professional standards?

In general, actuaries who practice in multiemployer pension plans use mortality assumptions that are based on published tables. In rare cases involving very large plans that can demonstrate that experience is fully credible and significantly different from the mortality rates under the published tables, the actuary may develop a table of mortality rates based on plan experience.

When setting a mortality assumption based on published tables, actuaries who work with multiemployer pension plans may make adjustments to rates in the published tables based on industry trends, individual plan experience, and professional judgment. For example, actuaries who practice in multiemployer plans often use the "blue collar" version of the published mortality table, which may be a better representation of anticipated experience for the participant population than the "white collar" or general tables.

The published mortality tables most commonly used by actuaries are developed by the Retirement Plan Experience Committee (RPEC) of the Society of Actuaries (SOA). Since 2000, the RPEC has published the "RP-2000" and "RP-2014" mortality tables, along with a series of different scales to project future improvements in life expectancies. In general, the studies that the RPEC has published have shown improvements in mortality over time—in other words, increasingly longer life expectancies.

When selecting actuarial assumptions to be used in determining minimum funding requirements under ERISA, actuaries must operate in accordance with actuarial standards of practice (ASOPs). ASOP No. 35 deals with the selection of mortality assumptions and was recently updated to provide actuaries with more specific guidance related to selecting the appropriate mortality table, making adjustments to the table as appropriate, and projecting future improvements in life expectancies.

An actuary who is believed to have violated the ASOPs may be reported to the Actuarial Board for Counseling and Discipline (ABCD). After reviewing the situation, the ABCD may recommend disciplinary action if the actuary is found to have violated the ASOPs or the Code of Professional Conduct. Discipline may include reprimand or recommendation of suspension of credentials by the issuing actuarial organizations.

How do mortality assumptions for multiemployer plans compare to the prescribed single employer /current liability mortality tables? Have these assumptions changed in any manner since 2000?

In late 2017, the Department of Treasury and Internal Revenue Service issued a new rule regarding mortality tables that must be used in determining minimum funding requirements for single-employer pension plans. The same mortality tables must also be used for determining current liability for multiemployer plans. In general, the new mortality tables must be used for plan years beginning on or after Jan. 1, 2018.

The prescribed current liability mortality tables are based on the RP-2014 mortality tables, adjusted for expected future improvement in life expectancies. Mortality assumptions for determining minimum funding requirements for multiemployer plans will vary plan by plan—again, based on industry trends, plan experience, and reflecting the actuary's professional judgment. For that reason, the extent to which the plan's own assumptions will differ from the prescribed current liability tables will also vary plan by plan. The following are some common differences between the current liability mortality tables and the mortality assumptions developed by actuaries for purposes of multiemployer plan minimum funding:

- *Blue collar adjustments.* Current liability mortality tables are based on the general population, in other words, all pension plan participants regardless of occupation. Many actuaries use a mortality assumption that reflects a "blue collar" adjustment in multiemployer plans to reflect the individual plan's demographic characteristics. Based on the tables published by the RPEC, blue collar populations tend to have shorter life expectancies than the general population.

- *Plan-specific adjustments*. Similarly, currently liability mortality tables include no provision to adjust for actual observed plan experience. If experience for a multiemployer pension plan is credible and differs from the mortality rates in the published tables, the actuary may make appropriate adjustments to those rates when setting the mortality assumption.

- *Projected improvements*. The current liability mortality tables include a full projection of expected future improvement based on the scale published by the RPEC. Many actuaries working with multiemployer plans use a mortality assumption that includes a provision for future improvement, but not all do. It is difficult to predict how much mortality rates will improve in the future. Rising obesity rates and the opioid epidemic are frequently cited as factors that may shorten life expectancies, at least for certain segments of the population. Additionally, recent mortality improvements in the general population have been heavily weighted toward higher-income individuals, with substantially less improvement observed in lower-income groups.

In reviewing the actual mortality experience of these plans, do you have any aggregate or summary data on the mortality gains and losses for these plans since 2000? Is there any information available that you could share or provide us access to that would show to what extent actual deaths that have occurred or didn't occur versus changes to the underlying mortality assumptions?

The American Academy of Actuaries Pension Practice Council does not track data regarding mortality gains or losses.

What actual mortality developments (whether within a plan or in the wider population) cause plans to change their mortality assumptions?

As described earlier, actuarial gains and losses represent the differences between actual plan experience and the actuarial assumptions. Actuaries review gains and losses each year as part of the annual actuarial valuation process. If a pattern of consistent gains or losses emerges, the actuary would be compelled to do a closer review of plan experience and update the assumption if appropriate. This review applies to all demographic actuarial assumptions, including mortality. In addition, when new mortality tables are published, many multiemployer plan actuaries will review the new tables to see if they may offer a better representation of anticipated plan experience.

Senator Hatch, Question #5
Benefit Accruals and Contributions

Could you provide information on the benefit accrual rates in the multiemployer plans? Similarly, is there any information available on the contribution levels of these plan for each year since 1974? Do you have information comparing plan contributions to other all other compensation in CBAs that govern these programs?

Benefit accrual rates vary widely plan by plan, industry by industry, and region by region. Often, the health of a plan can affect the accrual rate. For example, an underfunded plan that must devote more from each contribution dollar to pay down its unfunded liability will likely have less left over to provide for future benefit accruals. How the bargaining parties prioritize pension benefits within the overall wage package is another important factor. Two otherwise identical plans could have significantly different accrual rates due to decisions made by bargaining parties over time.

The Academy's Pension Practice Council does not track historical data on contribution rates and levels for multiemployer plans. Furthermore, most plans themselves do not track this sort of information that many years in the past (going back to 1974). Most analyses of aggregate trends among multiemployer pension plans are based on data from Form 5500 filings. Form 5500 data is available on the Department of Labor (DOL) website, but only from 1999 or 2000 forward. Furthermore, while the Form 5500 data includes the aggregate amounts of contributions made to the plan each year, it is limited in what it can tell us about contribution rates and accrual rates for multiemployer pension plans. It is also important to note that Form 5500 data does not provide information pertaining to the overall wage package.

With those caveats, Form 5500 data[1] does show the following noteworthy trends in employer contributions made to multiemployer pension plans since 2000:

- Aggregate employer contributions to all plans were about $28 billion in 2015. For comparison, aggregate contributions to all plans were about $11 billion in 2001. Note that these aggregate amounts are affected by changes in covered employment levels as well as increases in employer contribution rates. These amounts may also include employer withdrawal liability payments.

[1] The figures that follow are based on an analysis of historical Form 5500 data performed by Horizon Actuarial Services LLC. This analysis serves as the basis for the *Multiemployer Retirement Landscape* reports published by the International Foundation of Employee Benefit Plans.

- While Form 5500 data does not include robust information on contribution rates, it may be instructive to evaluate contributions per active participant—in other words, the plan's contributions in a given plan year divided by the number of its active participants. Focusing on this measure, median contributions per active participant increased 187 percent from 2000 to 2015, which represents an average compounded increase of 7.3 percent per year over that 15-year period.

In your experience, is it possible for plans to track what benefits are attributable to which service and with which employers? Likewise, is it possible to track the level of contributions each employer has made in each plan in each year?

The ability to track which benefits are attributable to different employers will vary from plan to plan. Some plans maintain very detailed records to determine which specific portions of each participant's benefits are attributable to service with different employers. Other plans maintain records sufficient to determine the total amount of each participant's benefit, but they may have difficulty attributing portions of the total benefit to service with different employers.

As for the level of contributions each employer has made to the plan in each year, multiemployer pension plans do track this information, as it is required for determining employer withdrawal liability. The historical periods for which this data is readily available may vary from plan to plan, due to a number of factors, including the plan's withdrawal liability allocation method. For example, some plans may need to track historical contribution data (including contribution rates and contribution base units) for the past 10 or 11 plan years in order to accurately calculate employer withdrawal liability. Other plans may need to track contribution data for the past 25 years or more.

Workers are protected under ERISA and the Tax Code to receive the full benefit they are promised. What steps have plans and employers taken to guarantee workers receive the full benefit they are promised? Are liabilities calculated by actuaries in such a way as to guarantee that workers will receive the full benefit they are promised? If not, and it is in fact employees who bear much of the risk under the current multiemployer system, are workers and retirees aware of that risk? How is the risk disclosed to them?

<u>Statutory Framework</u>

As its name indicates, the Employee Retirement Income Security Act of 1974 (ERISA) was intended to secure the retirement benefit promises made to workers. It is important to understand, however, that while ERISA provides a framework intended to ensure that participant pension benefits are adequately supported, it does not provide an absolute guarantee of these benefits.

ERISA first established minimum funding standards for private sector pension plans. It also created the "anti-cutback" rule, protecting workers from reductions to benefits they had already accrued. However, ERISA contains provisions to address the possibility that some plans might fail to fulfill their promised benefits. It established the PBGC to assist insolvent plans in paying benefits, up to "guaranteed" levels. ERISA also addresses what happens in the event that PBGC itself might not be able to provide full support to insolvent plans. If this event were to occur, ERISA provides that PBGC will provide support not to the "guaranteed" levels, but only to the extent its available resources will allow.

Both PPA and MPRA provided further exceptions to the concept of an ironclad benefit guarantee for multiemployer pension plans. Most notably, for plans in critical status, PPA provides for reducing "adjustable benefits." PPA also permits plans to target delaying insolvency—rather than emerging from critical status—but only if the plan sponsor has determined that all reasonable corrective measures have been exhausted. Perhaps more significantly and subject to certain restrictions, MPRA enabled sponsors of plans in critical and declining status to reduce already-accrued benefits if doing so would enable the plan to avoid insolvency. (These developments are described in more detail in our responses to other questions from the Committee.)

<u>Steps Taken by Plan Sponsors</u>

When evaluating the steps that multiemployer pension plan sponsors have taken over the years to ensure benefit promises were kept—as well as in reviewing how actuaries measure plan liabilities—it is important to also consider how statutory, financial market, and economic conditions have changed over the past few decades.

- ERISA was passed in 1974 and became effective in 1976, first establishing funding standards for private sector pension plans—a comprehensive contribution framework that is intended to ensure that participant benefits are adequately supported. Most multiemployer plan sponsors have taken steps to fulfill the benefit promises made to workers in the form of having contributions exceed ERISA requirements. (By definition, if a plan has a credit balance in its funding standard account, historical contributions have exceeded historical funding requirements.)

- At the time ERISA was passed, most actuaries were using conservative interest rate assumptions, around 5 percent, to determine minimum funding requirements. In about 1980, actuarial interest rate assumptions began to receive scrutiny for being *too* conservative. Market interest rates were in the double digits, and many argued that lower interest rate assumptions were overstating plan liabilities. From a federal tax perspective, employers were overfunding their pension plans, and were therefore taking greater tax deductions on contributions than was justified. By the mid-1980s, most actuarial interest rate assumptions had been raised to the range of 7 to 8 percent.

- The investment returns of the 1980s and 1990s were strong. Most private sector pension plans were close to full funding, and many were overfunded. The Internal Revenue Code at the time, however, limited the tax-deductibility of employer contributions to plans that were fully funded. This point is important, because as pension plans invest in assets that have volatile returns, they need to be able to build up funding surpluses following investment gains, so they can buffer against investment losses that will inevitably follow. In the case of multiemployer pension plans, many plan sponsors decided to increase benefit levels in order to preserve the tax-deductibility of already-negotiated employer contributions.

- The 2000s brought investment losses, with the "dot-com bubble burst" from 2000 to 2002 and the financial market collapse from 2008 and early 2009. Having entered the decade without much of a cushion, most multiemployer plan sponsors spent the next several years developing strategies to restore funding to its pre-2000 levels. At the same time, many industries faced declining contribution bases, which were worsened by the 2008-2009 Great Recession. These factors made a path to recovery even more challenging.

- While the American Academy of Actuaries Pension Practice Council does not possess comprehensive data, anecdotally, the Pension Practice Council has observed that multiemployer plans that were hit hard by the economic climate of the 2000's have responded with significant corrective measures. It is not unusual to see plans where the contribution rates have more than doubled while the rate of benefit accrual applicable to future service is less than half of what it was previously. For a majority of plans, these measures are expected to be sufficient to ensure that all benefits will be paid. However, some plans that have been hit the hardest by the economic downturn will be unable to recover despite taking draconian measures to protect benefits.

Disclosures

ERISA requires the disclosure of "current liability," which is a proxy for risk-free liability measurements (i.e., current liability). ERISA, however, does not require that plans fund to current liability levels. A risk-free funding approach would make participants' benefits more secure, but it would also dramatically reduce benefit levels, and pension funding often involves striking a balance between security and cost-efficiency.

ERISA also contains various disclosure requirements directed at participants, but these requirements do not contain significant information on benefit security risks.

Senator Hatch, Question #6
Plan Resilience

What are the consequences to the plans if the stock market has a downturn / low returns over two or three years sometime in the next five years?

If there is another market downturn, multiemployer pension plans will no doubt be put under further stress. Many plans are in a strong enough position to be able withstand another downturn, but others are not. Even some plans currently in the "green zone" have increased employer contribution rates and reduced participant benefit levels as much as they reasonably can. These plans have limited remaining actions they can take to cope with further adverse market events.

Which large plans are vulnerable if a handful of participating employers encounters financial difficulties or withdraws (even paying their full share of withdrawal liability)?

The Academy's Pension Practice Council has not done an analysis of which specific large plans are most vulnerable to the distressed withdrawal of a small number of employers.

If another economic downturn similar to the 2008—2009 downturn were to occur again within the next 10 years, are plans prepared to survive it? What about plans in the green zone? What steps are plans, and their actuaries, taking to properly assess risk in response to the lessons learned from '08, which you have cited as a major cause of the downfall of certain plans such as Central States?

If another economic downturn similar to the 2008–2009 recession were to occur, some plans would be able to develop continued strategies to recover. Many other plans would not be able to recover, however, including many plans currently in the "green zone." As described earlier, the reality is that most multiemployer plans have taken significant corrective action in recent years to improve plan funding, including reducing the rate of future benefit accruals and increasing employer contribution rates. While some plans have the ability to take further corrective action if needed, others cannot reasonably make significant changes on top of those they have already made.

Many actuaries working with multiemployer pension plans are actively discussing risk with plan sponsors, quantifying how projected funding levels may be affected by future adverse events. A new actuarial standard of practice (ASOP No. 51[2]) provides guidance on how pension actuaries should be discussing risk with plan sponsors, to the extent they have not already been doing so.

You testified that "[plans take money from actives and pay retiree benefits, the contributions on behalf of actives are not going towards guaranteeing their pension promises]." Is this a structurally sound model moving forward? Are employees fully aware that the contributions coming out of their paycheck each week are not in fact going towards their future retiree benefits? What other investment plans use this model?

Contributions made to multiemployer pension plans are tied to work performed by active participants. A portion of incoming contributions will go toward paying for benefits being earned by the active participants, and a portion will go toward further securing benefits that have already been earned. (The portion of contributions going toward securing benefits could go either to paying down underfunding or to building up a funding cushion against future adverse experience.) This is how pension plan funding works at a fundamental level.

It is important to note that qualified pension plans under ERISA—including multiemployer pension plans—must be prefunded. In other words, the intent is for contributions, accumulated with investment earnings, to prefund benefits as they are being earned. When experience is worse than anticipated, however, the plan may become underfunded, and a portion of incoming contributions must go toward paying down that unfunded liability. Once the plan is restored to full funding, however, ongoing contributions from active participants will not be needed to pay down the unfunded liability, but rather to further secure the overall funding of the plan or to pay for additional benefits being earned by active participants.

To contrast, other benefit programs—such as Social Security and Medicare—are not prefunded, but rather, largely pay-as-you-go. By their design, these programs rely more heavily on incoming

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[2] http://www.actuarialstandardsboard.org/asops/estimating-future-costs-prospective-propertycasualty-risk-transfer-risk-retention/

contributions from the current active generation to pay benefits that were earned by prior generations. Additionally all insurance programs pool risk and therefore involve a sharing of program assets across all participants.

Senator Hatch, Question #7
Withdrawal liability

Are you familiar with and would you have access to information on which employers have withdrawn from multiemployer plans in each year since 1974? Is there any aggregate or plan specific information available on the amount of these withdrawal liability payments? (Preferably by employer to each such plan.)

The Academy's Pension Practice Council does not track data on which employers have withdrawn from multiemployer plans. We are also not aware of any aggregate or plan-specific information on withdrawal liability payments. Focusing on Form 5500 filings, limited information on employer withdrawals and withdrawal liability assessments can be found on the Form 5500 Schedule R. However, this information has only been required since 2009.

In general terms, how do withdrawal liability payments compare to each withdrawing employer's share of the unfunded liabilities on an actuarial basis?

The amount of an employer's statutory withdrawal liability payments (as defined under Section 4219 of ERISA) is not directly related to its assessed withdrawal liability amount, which represents the employer's allocated share of the plan's unfunded vested benefits. In general, the amount of the payment increases as employer contributions increase. (Under MPRA, contribution rate increases required under a rehabilitation plan that take effect after 2014 are excluded from determining withdrawal liability payments.) In the case of a plan with a relatively small unfunded vested liability, the employer's statutory withdrawal liability payments will pay down its withdrawal liability assessment, including applicable interest, in less than 20 years.

In general, the statute limits withdrawal liability payments to 20 years, often referred to as the "20-year cap." (The 20-year cap does not apply in a mass withdrawal situation.) Therefore, if a plan is deeply underfunded, 20 years of statutory payments will often not pay down the employer's withdrawal liability assessment. In general, the worse funded the plan, the bigger the unfunded liability that will not be covered by the statutory withdrawal liability payments.

Senator Hatch, Question #8
Assets

Is there information available on the portion of each ME plan's assets that have a readily ascertainable market value such as publicly traded stock, Treasury bonds, or cash versus items whose value is not readily ascertainable?

There is limited publicly available data regarding the asset allocations for multiemployer pension plans. Perhaps the best data source is the Form 5500 Schedule R, which was recently updated to require plan sponsors to provide basic information regarding their asset allocations.

The following table provides the average asset allocations for multiemployer pension plans, based on the asset classifications on the Form 5500 Schedule R. Note that the allocations are expressed as percentages of plan assets, and only plans with at least 1,000 participants are included. Results are for Form 5500 filings for plan years ending between June 1, 2016, and May 31, 2017.

Average Asset Allocations for Multiemployer Pension Plans				
Stocks	Investment Grade Debt	High Yield Debt	Real Estate	Other
47.7%	18.9%	5.1%	9.6%	18.7%

Senator Hatch, Question #9
Liabilities

When valuing plan liabilities, are actuaries routinely given information regarding employers in the plans? If not, would it be helpful for them to have this information to better assess risk of the plans and ability of employers to pay should the plan become insolvent?

Plan sponsors do not generally have information regarding the financial health of its participating employers, as there is no statutory requirement for employers to provide such information to the plans in which they participate. It is also important to keep in mind that providing financial information could be quite burdensome for small or privately held companies. While detailed financial information on contributing employers could help multiemployer plans assess employer-related risks, the practical aspects of gathering and analyzing this information could make such assessments extremely complex, time-consuming, and expensive.

Senator Hatch, Question #10
Plan Alternatives

For employees who do not wish to take on the risk that is disclosed to them, would there be a way of providing the employees with different options to bear less risk going forward, such as the choice of having their contributions going either into a separate pool with lower discount rates, or a 401(k) plan in which the employee can make his or her own retirement decisions?

We are not aware of any examples where employees covered under a multiemployer defined benefit pension plan can opt out of that plan and into an alternative arrangement. There have been a small number of opt-out arrangements in the public plan sector and single-employer plans to allow employees to move into a defined contribution arrangement.

When evaluating alternative plan designs, it is important to consider the risks associated with those designs—to both the plan sponsor and the employee. Specifically:

- *Defined contribution plan.* With a defined contribution plan (such as a 401(k)-type plan), the employee has reduced or eliminated risk associated with the financial health of the participating employers or industry in which they work. In exchange, the employee now bears all the investment risk and longevity risk for the rest of his or her life. Without the pooling of risk inherent in a defined benefit pension plan, the employee is now subject to risk factors such as the ability to invest wisely and his or her own life expectancy.

- *Lower-risk defined benefit plan.* The sponsor of a multiemployer pension plan could elect to move toward a more conservative investment policy, which would provide a lower expected return but also lower volatility. Such a move would lead to a lower discount rate associated with the actuarial funding measurements. This arrangement would increase the likelihood that the plan would be able to deliver the promised benefit amount. However, with a lower expected return on plan assets, either the promised level of plan benefits would be lower, the level of contributions needed from employers would be higher, or both. In other words, under a more conservative defined benefit arrangement, an employee would have a higher degree of certainty in the promised benefit being delivered, but the level of that promised benefit would be lower.

If the Joint Select Committee wishes to consider an "opt out" provision, there are many factors to be considered, including participant education, whether the options provide lifetime income, anti-selection (participants selecting the option most beneficial to them, thus raising costs and diluting the benefits of pooling risks), and the possibility of individuals making decisions that are not in the interest of their long-term financial security. If employees are allowed to opt out to a defined contribution plan, the contribution base available to support the benefits of the remaining active employees in the defined benefit plan will be reduced, which increases the risk to those choosing to remain in the defined benefit plan. The potential administrative complexities related to providing participant choice between different defined benefit and defined contribution options is another important consideration.

Questions from Senator Brown

Senator Brown, Question #1

Please describe the advantages and disadvantage to the various discount rates that could be used for valuing the liabilities of multiemployer pension plans for minimum funding purposes, such as the current rate based on long-term investment return expectations, the rates applicable to single employer plans based on corporate bond yields, and rates based on Treasury bond yields.

In addition to the response below, we refer to the response to Question #2 from Senator Hatch, which covers similar topics.

Actuarial methods and assumptions should be appropriate for the purpose of the particular measurement. It is critical to note that the advantages and disadvantages of a discount rate *for minimum funding purposes*, which is what the question asks and this response provides, may be very different in other contexts. The same quality that supports one measurement objective may be contrary to a different objective. Comprehensive understanding of plan dynamics is unlikely to be derived from any single measurement.

Two American Academy of Actuaries pension issue briefs[3]—released in November 2013 and July 2017—compared and contrasted various liability measurements. These papers made use of the following terminology.

Purpose	Discount Rate Assumption
Budget Value	Expected long-term investment return
Immunized Value	Current corporate bond yields
Solvency Value	Current Treasury bond yields

As noted in the November 2013 issue brief, using the expected long-term investment return determines a "Budget Value." The Budget Value is the theoretical asset amount that would be expected to be sufficient to pay all currently earned (and future) plan benefits if that amount is invested and earns the anticipated return of the plan's investment portfolio, assuming that the current asset allocation remains in place.

The "Immunized Value" is an amount that is theoretically required to fully immunize benefit payments accrued to date with a dedicated high-quality bond portfolio. This is a common measurement for an employer to use to value the pension obligations from single-employer defined benefit pension plans under Financial Accounting Standards Board (FASB) Accounting Standards Codification (ASC) Topic 715.

The "Solvency Value" is a current market-based measurement that determines the amount that a pension plan theoretically would need to invest in risk-free securities in order to provide the accrued benefits with certainty to the affected participants, assuming no additional contributions.

Key advantages and disadvantages of these discount rate assumptions for minimum funding purposes follow:

Expected long-term investment return

Advantages:

- Liability provides the asset value necessary to provide promised benefit payments if the expected return is realized in each future year.
- May provide greater stability for minimum required contribution amounts than other approaches.

Disadvantages:

- Presumes that the sponsor can make additional contributions if the assumed return is not achieved.
- May incent a more aggressive asset allocation to decrease the measurement of the liability.
- Not comparable across plans with different investment allocations.
- Return expectations are subjective and can vary widely.

[3] Measuring Pension Obligations, Discount Rates Serve Various Purposes http://www.actuary.org/files/IB_Measuring-Pension-Obligations_Nov-21-2013.pdf and Assessing Pension Plan Health, More Than One Right Number Tells the Whole Story http://www.actuary.org/files/publications/IB-RightNumber07.17.pdf

Corporate bond rates

Advantages:
- Liability reflects what would be held on a corporate balance sheet for a similar promise, if considered very low in default risk.
- Greater comparability of liabilities across plans.
- Less incentive for risky investment.

Disadvantages:
- Does not reflect the investment policy of the plan. If the plan is fully funded with this liability measure and a typical investment mix is used, the plan sponsor is likely to have contributed more than is actually necessary to pay benefits.
- Discount rate and resulting liability may be quite volatile, presenting challenges for collective bargaining and other plan management functions.

Treasury bond rates:

Generally the same advantages and disadvantages as for corporate bond rates, but the liability reflects the value of a promise with no default risk (as opposed to very low default risk), consistent with Treasury bond pricing.

Senator Brown, Question #2

Please describe in detail the role that the trustees of multiemployer pension plans, employers, and unions representing employees have in setting benefit and contributions levels for plan participants and employers. If there is a range of customary practices, please describe the most prevalent practices.

Contributions to multiemployer pension plans are collectively bargained, and workers typically forgo some direct compensation in exchange for contributions to retirement plans. In turn, employers are required to fund the plans in accordance with their collective bargaining agreements and subject to certain regulations. The contribution rate is usually a specific amount per hour or other unit worked by or paid to the employee. When a plan becomes underfunded, the trustees may establish minimum contribution rates as part of their funding improvement or rehabilitation plans.

Traditionally, plan boards of trustees have sole authority to determine the plan design and level of benefits that will be supported by negotiated contributions. However, in some cases, collective bargaining agreements may describe the plan design and benefits. In these situations, the trustees are given the authority to collect sufficient contributions to fund the benefits.

Senator Brown, Question #3

Please describe the procedures by which trustees are selected to serve as such for a multiemployer pension plan.

Multiemployer plans' boards of trustees consist of an equal number of employer trustees and union trustees. The employer trustees are selected by the contributing employers, or from associations that represent those employers. The union trustees are selected by the participating union or unions. Multiemployer plans are typically governed by trust agreements that can contain varying levels of detail regarding the process that is followed for appointing trustees.

Senator Brown, Question #4

Please describe what an investment policy is for a multiemployer pension plan, including how it is created and how it is used.

An investment policy is a vital document for multiemployer pension plan governance. As the trustees of a multiemployer pension plan are fiduciaries to the plan, they must act with care and in the best interest of plan participants and beneficiaries in all matters – including those related to plan investments. For that reason, the investment policy is important in documenting the objectives, duties, policies, procedures related to the plan investments.

A plan's investment policy is typically created by the plan's board of trustees, with guidance from professional advisors such as the investment consultant and legal counsel.

Some of the key features of an investment policy include the following:

- *Objectives*: The general investment-related goals for the plan, which may include the targeted annual return, minimization of volatility, and adequate liquidity to pay benefits and expenses.

- *Duties*: Who is responsible for making certain decisions and taking certain actions related to plan investments? Parties typically include the board of trustees, an investment committee of the board of trustees, the plan administrator, the investment consultant, investment managers, or custodian.

- *Asset allocation*: The targeted percentage allocations to various asset classes (such as stocks, bonds, and alternative investments) designed to meet the goals of the investment policy. Typically, the policy will also define acceptable ranges for the asset allocation, as well as procedures for rebalancing the portfolio.

- *Manager selection*: The policies and procedures for selecting investment managers – the firms responsible for investing a portion of plan assets according to a specified strategy, the manager's approach (for example, active versus passive) and fees, are important considerations.

- *Monitoring and review*: The metrics for regularly evaluating the performance of the overall strategy relative to the stated goals, and the performance of individual investment managers relative to specified benchmarks.

Senator Brown, Question #5

Please explain the risk to the multiemployer system in the aggregate if an employer that participates in numerous multiemployer plans goes bankrupt.

If a major contributing employer that participates in numerous multiemployer plans goes bankrupt, each of those plans will be left with unfunded "orphan" liabilities, as well as a diminished contribution base. These factors will create additional strain on those plans.

The Academy's Pension Practice Council has not done an analysis of the possible impact to the multiemployer pension system in the aggregate if a single employer that participates in several plans were to go bankrupt. The magnitude of the risk to the multiemployer system depends on the size of the employer, the number of plans in which the employer participates, and the current strength of those plans.

Senator Brown, Question #6

Please describe the characteristics of better-funded plans from those that are facing financial troubles.

The current funded status of a multiemployer pension plan is likely to have been shaped by many factors, both internal and external. Decisions by the board of trustees with respect to the plan's investments, participant benefit levels, and employer contribution rates all contribute to the current and future health of the plan. There are also significant factors in play that are beyond trustees' control, such as market volatility, plan maturity, overall industry strength and activity, and the financial health of participating employers.

- *Investment performance*: Some multiemployer pension plans have performed better than others with respect to investment returns. That said, the vast majority of plans – which by and large are invested in diversified, balanced asset portfolios – were similarly affected by market volatility in recent decades.

- *Benefit and contribution levels*: Many boards of trustees have taken proactive measures to strengthen plan funding levels in recent years through a combination of increases in employer contribution rates and reductions in participant benefit levels. It is important to note, however, that some plans are so distressed that no reasonable corrective measures available under current law can restore them to good health.

- *Plan maturity*: One measure of plan maturity is the ratio of the number of inactive and retired participants to the number of active participants: this is often called the "support ratio." In other words, more mature plans have more inactive and retired participants supported by fewer active participants. Plan maturity is perhaps the most significant factor in distinguishing healthy plans from those in distress. The mere fact that a plan is mature does not mean that the plan will be distressed, but mature plans tend to be less resilient to adverse experience.

- *Industry activity*: "Industry activity" is a term often used to refer to overall covered employment levels. Declining industry activity can accelerate plan maturity – it causes there to be fewer active participants in the plan and a smaller contribution base, and also increases the support ratio described above. Plans in declining industries tend to be less resilient to investment volatility, due to the diminished impact any changes to future contribution rates or benefit accrual rates will have on the trajectory of the plan.

- *Employer health*. A factor related to industry activity is the financial health of participating employers. If employers are distressed, they will be less able to afford increases in contribution rates to strengthen plan funding levels. They are also less likely to be able to pay their full withdrawal liability obligation in the event of a withdrawal, creating unfunded orphan liabilities that must be absorbed by the remaining employers.

Senator Brown, Question #7

Please explain whether it benefits a multiemployer pension plan to have diversity in the industries represented by its participating employers.

Multiemployer pension plans cover workers in a variety of industries, such as construction, service, transportation, retail food, manufacturing, and entertainment. In most cases, multiemployer plans cover workers in a specific industry; they are not usually diversified across industries.

Diversification is an important element in reducing risks associated with multiemployer plans – both in pooling of risk among employers, as well as in structuring a balanced asset portfolio. Diversification across industries or trades may have similar benefits for multiemployer plans, in that it would make them more resistant to forces that may adversely affect one industry but not another. That said, structuring multiemployer plans to cover workers in a variety of industries, trades, or unions would represent a major shift in how these plans are created and maintained.

Senator Brown, Question #8

Please describe the current rules that allow multiemployer plans to merge with other pension plans.

A merger is when two or more multiemployer plans join to create a single ongoing plan. The plans are often in similar industries or geographic regions and often have employers that contribute to both plans. The trustees of both plans have to make a decision on whether a merger is in the best interest of their plan and its participants, and among other things decide on the future benefits and levels of contributions and whether the underfunding, if any, is made up by the individual plans or managed on a combined basis. The PBGC has provided regulations for allocating unfunded vested benefits for merged plans, where the individual liability is phased out over time.

Section 4231 of ERISA lays out several rules for mergers and transfers between multiemployer plans. That is, the plan must notify the PBGC 120 days prior to merger date, accrued benefits cannot be reduced, benefits are not reasonably expected to be subject to suspension under Section 4245 (insolvent plans), and an actuarial valuation must be completed for each of the affected plans before the merger date.

PBGC may provide assistance to facilitate a merger if it's in the best interest of the participants and beneficiaries of at least one of the plans and is not reasonably expected to be adverse to the overall interests of the participants and beneficiaries of any of the plans. PBGC's facilitation may include financial assistance, training, technical assistance, mediation, communication with stakeholders, and support with related requests to other government agencies.

PBGC may provide financial assistance to facilitate a plan merger if: (1) at least one plan is critical and declining, (2) financial assistance will reduce PBGC's expected long-term losses from the plans involved, (3) financial assistance is needed for the merged plan to become or remain solvent, (4) PBGC confirms the financial assistance will not impair its ability to meet existing obligations, and (5) any financial assistance is paid out of the PBGC multiemployer guarantee fund.

Senator Brown, Question #9

Please describe the steps, if any, that individual workers could have taken to prevent multiemployer plan funding shortfalls. Please describe if it were possible for workers to anticipate or prevent the insolvency of the multiemployer plans in which they participate.

We are not aware of any actions individual workers could have taken that would have had a significant effect on preventing multiemployer pension funding shortfalls.

Questions from Senator Portman

Senator Portman, Question #1

Mr. Goldman, you noted that it is not uncommon for employers to pay a negotiated withdrawal liability in the form of a lump sum settlement that is often well below the amount of the employer's withdrawal liability that would be otherwise be calculated under the statute. You further indicated that in reality, an employer's actual payment is often based its ability to pay, since as you said, "it is better to get something than nothing."

To further crystalize this point, what is your analysis of the approximate percentage of employers who negotiate a lump sum withdrawal, and how much of their full withdrawal liability is that negotiated amount?

Additionally, among employers that pay their withdrawal liability in annual installments, about what percentage have their withdrawal liability forgiven after 20 years, and among these employers, how much is typically forgiven?

Specific data on withdrawal liability payments is not readily available. However, we can provide some anecdotal observations.

- In very well-funded plans, there is no withdrawal liability. In moderately well-funded plans, the withdrawal liability is paid off in less than 20 years. In distressed plans, however, withdrawal liability payments are often limited by the 20-year cap.

- The typical lump sum settlement amount is usually some percentage (for example, 80 to 90 percent) of the present value of the future withdrawal liability payments. Any settlement below 100 percent of the present value of future payments would likely reflect the uncertainty of the employer's ability to make its required withdrawal liability payments many years into the future. In evaluating proposed settlements, plan trustees often weigh the amount of the discount against the added certainty of receiving the entire amount upfront.

- A very wide range of settlement terms have been negotiated between withdrawn employers and multiemployer funds, and unfortunately there is no data available that summarizes these agreements.

Senator Portman, Question #2

To follow up regarding the rate of return that multiemployer plans currently assume in discounting their liabilities, how often in the past thirty years have multiemployer pension plans achieved a market rate of return of over 7%?

When reviewing investment returns for multiemployer pension plans (or retirement plans in general, for that matter), it is important to keep in mind that annual returns can be quite volatile, even with a well-diversified portfolio. It is also important to note that historical data on investment returns for multiemployer pension plans is not broadly available.

With that said, we have prepared an analysis of historical median investment returns for multiemployer pension plans. This analysis draws on publicly available Form 5500 data where it is available, specifically for calendar years from 2000 through 2016. For calendar years from 1982 through 1999, and for calendar year 2017[4]. (Note that this data may include multiemployer plans other than defined benefit pension plans.) For calendar years prior to 1982, investment return data for multiemployer plans was not readily available. Therefore, for those years, the analysis uses a 50/50 blend of index returns for the S&P 500 and bond markets.

Based on the above data and indexes:

- Focusing on the 30-year period from 1988 through 2017, median investment returns met or exceeded a 7.0% benchmark return in 19 of 30 years. The annualized return for that 30-year period is 7.7%. It is important to note that even over a 30-year period, these statistics can be endpoint sensitive. In other words, these stats may change noticeably by simply shifting the period forward or backward by one year.

- Investment returns for multiemployer plans have varied by decade, sometimes significantly. Median annualized returns were: 6.7% for the 1970s; 13.1% for the 1980s; 11.2% for the 1990s; and 2.7% for the 2000s. The median annualized return so far this decade (for the eight years from 2010 through 2017) has been 8.2%.

[4] The analysis is based on market data for multiemployer benefit plans gathered by Segal Marco Advisors, an investment consulting firm in the industry

Questions from Representative Scott

Representative Scott, Question #1

Please describe in detail the funding rules of the single employer pension plans and the multiemployer pension plans.

Below is a comparison of the general funding rules for single-employer plans and multiemployer plans:

Comparison of U.S. Single-Employer and Multiemployer Pension Plan Minimum Funding Rules

	Single-Employer	Multiemployer
Relevant Internal Revenue Code Sections	Sections 412, 430, 436	Sections 412, 431, 432
Actuarial Assumptions:		
Economic Assumptions	**Selection subject to Actuarial Standard of Practice No. 27[5] (ASOP 27)**	
Assumed Rate of Return on Investments	Generally based on expected return over a long-term investment horizon (typically 20 or more years) for the actual or target investment portfolio held in trust. Actuary selects assumption. Only used in calculation of Actuarial Value of Assets, and limited to third segment rate (i.e., the average yield on high-quality corporate bonds with maturity of 20 years or more).	Generally based on expected return over a long-term investment horizon (typically 20 or more years) for the actual or target investment portfolio held in trust. Actuary selects assumption. Used in the calculation of Actuarial Value of Assets and Actuarial Liability.
Discount Rate	Prescribed, based on 24-month average of high-quality corporate bond yields. However, statutory relief measures adopted following the 2008 financial crisis have broken the link with current market rates by extending the averaging period to 25 years.	Selection is subject to ASOP 27, with a "best estimate" standard. The discount rate is based on the expected long-term rate of return on investments that will be used to pay all future benefits (including those not yet accrued). For current liability, a four-year average of 30-year Treasury bond yields is prescribed.

[5] http://www.actuarialstandardsboard.org/asops/selection-economic-assumptions-measuring-pension-obligations/

Comparison of U.S. Single-Employer and Multiemployer Pension Plan Minimum Funding Rules

	Single-Employer	**Multiemployer**
Other Economic Assumptions Such as Inflation or Assumed Rate of Future Salary Increases	Actuary selects assumptions.	Actuary selects assumptions.
Demographic Assumptions	**Selection subject to Actuarial Standard of Practice No. 35[6] (ASOP 35)**	
Mortality	Prescribed	In general, actuary selects assumption, however, "Current Liability" measurement uses prescribed assumptions.
Other Demographic Assumptions	Actuary selects assumptions, using a "best estimate" standard.	Actuary selects assumptions, using a "best estimate" standard.
Funding Method	**Selection subject to Actuarial Standard of Practice Nos. 4 and 44 (ASOPs 4 and 44)**	
Actuarial Cost Method	Prescribed, a traditional Unit Credit method that results in a Target Liability and Target Normal Cost.	Selection subject to ASOP 4[7] and pre-PPA rules. Most common methods are Entry Age Normal and traditional Unit Credit.
Asset Valuation Method	Actuarial Value of Assets (AVA) is Fair Market Value or may be calculated under a restricted number of alternative methods outlined in Internal Revenue Service (IRS) Notice 2009-22 which recognize market returns over not more than 24 months, with AVA limited to within 10% of Fair Market Value.	Selection subject to ASOP 44[8] and various rules promulgated by the IRS. Reflection of market returns over a period of five years is allowed, with AVA limited to within 20% of Fair Market Value.
Amortization of Unfunded Liabilities	Generally over 7 years; temporary amortization relief permitted extended amortization periods of up to 15 years for certain years between 2008 and 2011.	Generally over 15 years; certain pre-PPA amounts amortized over longer periods may continue to be amortized over the remainder of those periods.

[6] http://www.actuarialstandardsboard.org/asops/selection-of-demographic-and-other-noneconomic-assumptions-for-measuring-pension-obligations/
[7] http://www.actuarialstandardsboard.org/asops/measuring-pension-obligations-determining-pension-plan-costs-contributions/
[8] http://www.actuarialstandardsboard.org/asops/selection-use-asset-valuation-methods-pension-valuations/

Comparison of U.S. Single-Employer and Multiemployer Pension Plan Minimum Funding Rules

	Single-Employer	Multiemployer
Calculation of Minimum Required Contribution (MRC)	Target Normal Cost (the value of benefits expected to be earned in the year plus plan administrative expenses expected to be paid from plan assets during the year), plus amortization of unfunded Target Liability (referred to as the Funding Shortfall). If the AVA exceeds the Target Liability, any Excess Assets reduce the Target Normal Cost.	Normal Cost plus amortization of unfunded liabilities.
Credit Balances Available to Offset MRC	Plan sponsor may elect to apply contributions in excess of MRC to "Prefunding Balance" (PFB), which may be used to offset future MRC contributions. Plan assets are reduced by PFB and any pre-PPA Carryover Balance (COB) when MRC is calculated, and use of COB/PFB is generally precluded if plan is less than 80% funded. Interest is credited annually on unused balances based on the actual return on plan assets.	Accumulated past contributions in excess of MRC can be used automatically (to the extent needed) to offset MRC for current and future years. Plan assets are not reduced by credit balance when determining funded percentage. Interest is credited based on the discount rate.
Annual Certification of Funded Status by Enrolled Actuary	Annual Adjusted Funding Target Attainment Percentage (AFTAP) Certification required.	Annual "Zone Status" Certification required. Satisfactorily funded (generally 80% funded with no projected inability to pay MRC in next seven years) plans in Green Zone. "Endangered" plans (generally less than 80% funded or projected unable to pay MRC) in Yellow Zone. Critical plans (generally projected inability to pay MRC in near future) in Red Zone. A critical and declining subset are projected to become insolvent within 20 years (or within 15 years for certain plans).
Consequences of Lower Funding Levels	Plans with AFTAP less than 80% funded are subject to restrictions on payment of (accelerated benefit distributions (most commonly lump sums), amendments increasing plan benefits, and unpredictable contingent event benefits. Plans less than 60%	Plans not certified as Green by Enrolled Actuary must adopt plan of action to reduce benefits and/or increase employer contributions to improve plan funding and emerge from current zone status. Red Zone plans have benefit improvement restrictions.

Comparison of U.S. Single-Employer and Multiemployer Pension Plan Minimum Funding Rules

	Single-Employer	Multiemployer
	funded must freeze benefit accruals. Additional restrictions apply for plans with an AFTAP less than 100% where sponsor is in bankruptcy. Accelerated contributions may also be required if plan deemed “At-Risk” or to remove benefit restrictions in some cases.	
Quarterly Contribution Requirement	Generally, plans less than 100% funded must make quarterly payments toward the MRC.	Quarterly contributions not required. Contributions are generally made throughout the year pursuant to collective bargaining agreements.
Failure to contribute MRC	Excise taxes, notification of participants, the DOL, IRS and PBGC, possible lien against plan sponsor’s assets if aggregate unpaid amounts exceed $1 million.	Excise taxes and other penalties apply. However, plans in the Red Zone operating under a Rehabilitation Plan generally qualify for waiver of excise tax.

What are the main differences between the two?

The main differences between the single-employer plan and multiemployer plan funding rules are the following:

Differences between U.S. Single-Employer and Multiemployer Pension Plan Funding Rules

	Single-Employer	Multiemployer
Discount Rate	Prescribed, based on modified (“stabilized”) high-quality corporate bond yields.	Selection is subject to ASOP 27. Typically the discount rate is based on the expected long-term rate of return on investments. Current liability discount rate prescribed based on 30-year Treasury rates.
Mortality	Prescribed	Selection Subject to ASOP 35, however, “Current Liability” measurement uses prescribed assumptions.
Asset Valuation Method	Investment gains/losses smoothed over no more than 24 months; AVA limited to within 10% of Fair Market Value.	Investment gains/losses smoothed over no more than five years; AVA limited to within 20% of Fair Market Value.
Amortization of Unfunded Liabilities	Generally over 7 years.	Generally over 15 years.

Credit Balances	Available only when plan funded at 80% or higher in the prior year. Applied based on plan sponsor elections. Existing balanced offset AVA in some cases when determining funded status measures. Unused balances marked to market by crediting interest based on actual return on plan assets.	Automatically applied as needed to meet minimum funding requirements, regardless of plan funded status. Credit balances do not offset plan assets in funded status measures. Unused balances carried at book value by crediting interest based on discount rate (i.e., expected return on plan assets).
Consequences of Lower Funding Levels	Plans less than 80% funded are subject to restrictions on accelerated benefit distributions, amendments increasing plan benefits, and payment of unpredictable contingent event benefits. Plans less than 60% funded must freeze benefit accruals. Additional restrictions when plan sponsor is in bankruptcy. Accelerated contributions may be also be required if plan deemed "At-Risk" or to remove benefit restrictions in some cases.	Plans not certified as Green by Enrolled Actuary must take actions to reduce benefits and/or increase employer contributions to improve plan funding. Benefit improvements are restricted for Red Zone plans.

What would be the key impacts to plans, employers, and participants if multiemployer pension plans were funded like single employer plans?

<u>Plans</u>

Use of the single-employer plan funding rules would generally result in significantly lower funded status percentages.[9] Many multiemployer pension plans would be subject to accelerated funding requirements and restrictions on benefit payments. Some plans would be required to freeze benefit accruals due to being under 60 percent funded. Plans could see a resulting decline in active participation as bargaining units negotiate out of plans where their members will receive no additional accruals.

<u>Employers</u>

Use of the single-employer plan funding rules would generally result in increased and unstable contribution requirements. Increases to the contributions would need to be negotiated, and instability would severely hamper employer viability, especially in construction and other competitive industries. Failure to negotiate contribution increases may result in excise taxes and other penalties owed by the employers. If unfunded vested benefit liability were calculated using the single-employer liability assumptions, the exposure to withdrawal liability in some plans would increase for many employers

[9] Note that funded status is only one measure of plan funding or financial health. Different measures of funded status may be used for different purposes, but are only estimates of the relative values of plan assets and liabilities at a point in time, using a specified set of assumptions to estimate the plan's liabilities. The true cost of a defined benefit plan is based on the actual benefits that come due to participants in the future, the pattern of which will inevitably differ from any estimate developed to measure the cost of those payments.

(depending on the actuarial basis used), and the instability of ongoing funding could lead to a wave of employer withdrawals that would result in additional plans becoming insolvent.

Participants

Future participant benefits would likely be reduced from current levels. Plans less than 60 percent funded under the single-employer rules would be required to freeze benefits. Plans over 60 percent funded may still need to reduce future benefit accruals in order to meet the accelerated amortization of unfunded liability. Members would be pressured to give up more of their wages to help meet higher funding requirements, and be far less likely to support continued plan participation.

Additional Details on the Primary Differences Between the Single Employer and Multiemployer Plan Funding Rules

Discount Rate(s)

Single-Employer: The single-employer funding rules require discounting of future expected pension benefit payments using rates based on the yields on high-quality corporate bonds, regardless of the plan's actual investments, in order to develop the actuarial present value of accrued benefits as of a valuation date. Under the original PPA 2006 rules, the bond rates could either be based on a full yield curve incorporating a one-month average of bond yields, or could be based on three "segment rates" derived from a 24-month average of rates. The three segment rates represent the average yields for periods less than 5 years (the first segment rate), 5 to 20 years (the second segment rate), and 20 years and beyond (the third segment rate).

The Pension Relief Act of 2010 (PRA) was the first of several funding relief measures in the wake of the 2008–2009 financial crisis. PRA allowed plan sponsors to extend the amortization period of the funding shortfall for any two of the years 2008 through 2011, inclusive. In 2012, the Moving Ahead for Progress in the 21st Century Act (MAP-21) provided for "Segment Rate Stabilization," which limited the segment rates to within a corridor defined by a decreasing percentage (starting at 30 percent and reducing in 5-percentage-point increments to 10 percent) of the 25-year average of the original PPA segment rates for calculation of the MRC and AFTAP used to determine the applicability of the PPA benefit restrictions. Segment Rate Stabilization raised the allowable segment rates, which significantly decreased minimum required contributions and provided relief from benefit restrictions for single-employer plans. The phase-out of the corridor based on 25-year average rates has been extended subsequent to MAP-21 by the Highway and Transportation Funding Act of 2014 and again in the Bipartisan Budget Act of 2015.

Notably, Segment Rate Stabilization did not apply to the funded status measurements required to determine whether reporting to the PBGC under ERISA Section 4010 was required by a plan sponsor, and also did not apply to the calculation of the unfunded vested benefits used to compute a plan's PBGC variable premium. Thus, since enactment of the PRA many plan sponsors have been able to satisfy the minimum funding requirements but are faced with PBGC variable premiums sufficiently large that a significant incentive exists for the sponsor to fund at a higher level than the MRC (which may not be affordable for some plan sponsors) or to remove liability from their plans through pension risk transfer transactions (e.g., lump sum windows or annuity purchases).

As of March 31, 2018, the segment rates applicable for various purposes are shown in the table below. For comparison purposes, the "effective interest rate," which is the single discount rate that would produce the same target liability as the segment rates, will typically fall between the second and third segment rates.

Measurement Purpose	Averaging Period	Segment Rate		
		First	Second	Third
Minimum Required Contribution and PPA Benefit Restrictions	25 years[10]	3.92%	5.52%	6.29%
PBGC ERISA Section 4010 Reporting Applicability	24 months	1.94%	3.66%	4.46%
PBGC Variable Rate Premiums	One month	2.91%	3.99%	4.43%

Multiemployer: Multiemployer plan actuaries generally use a discount rate to value plan liabilities equal to the expected long term rate of return on plan assets. Selection of this assumption is subject to ASOP No. 27. Since most multiemployer plans invest in a diversified portfolio that includes return-seeking asset classes such as equities, discount rates tend to be higher than the single-employer discount rates, even with Segment Rate Stabilization. The average discount rates reported on the IRS Form 5500s used by multiemployer plans in 2015 was approximately 7.4%.

<u>Mortality</u>

Single-Employer: The mortality rates (and allowance for improvement over time) to be used to calculate the Funding Target and Target Normal Cost are prescribed. These rates are generally based on studies performed by the SOA, but until a recent update in 2018 were based on a study published in 2000 and had not been revised since PPA was enacted. The mandated assumptions do not vary by industry, geographical area or other plan-specific demographics. Only very large plans may use their own mortality experience to set assumptions, if they can show that their plan experience is statistically significantly different from the mortality rates under the standard prescribed tables.

Multiemployer: The selection of the mortality tables and improvement scales to be used for multiemployer plans is subject to ASOP No. 35. The recent SOA studies published in 2014 (with subsequent updates to the improvement scales in 2015, 2016, and 2017) have included mortality tables that vary by "collar" and many multiemployer plans may use some variation of these "blue collar" tables, although those tables were not based on multiemployer experience. The SOA's RP-2014 blue collar mortality rates may result in slightly lower plan liabilities than the prescribed tables for single-employer plans. There are studies indicating that plans, and many industries in which multiemployer plans are prevalent, experience mortality rates that are significantly higher than the SOA blue collar table would indicate, so actuarial judgment is often used to modify the SOA tables.

<u>Asset Valuation Methods</u>

[10] The actual 25-year average is made using 24-month averages of the monthly segment interest rates, effectively extending the averaging period beyond 25 years.

Both single-employer and multiemployer funding rules allow for an AVA to be used for funding calculations. Generally, this is allowed to smooth out volatility in investment returns so that plan costs are less volatile than what would be calculated if the fair market value of assets was used in the calculations.

Single-Employer: The allowable AVA methods are narrowly defined in IRS Notice 2009-22. Actual investment returns differing from expected investment returns must be fully recognized in the AVA within 24 months. The expected rate of investment returns is limited by the third segment rate as of each valuation date, and the AVA must lie between 90 and 110 percent of fair market value.

Multiemployer: The range of allowable AVA methods is subject to ASOP No. 44 and pre-PPA regulatory guidance. Actual investment returns differing from expected investment returns are typically recognized over a period of five years or less. The expected rate of investment return is based on a best estimate of expected returns for the plan's investment portfolio. The AVA must lie between 80 and 120 percent of fair market value.

One of the PRA 2010 funding relief measures allowed for 10-year recognition of 2008–2009 investment losses in the AVA and longer amortization of those losses after they are recognized for multiemployer plans that elected the relief.

<u>Amortization of Unfunded Liabilities</u>

Single-Employer: The single-employer funding rules define the "Funding Shortfall" as the Funding Target minus AVA, where AVA is reduced by any PFB or COB. Each year, the Funding Shortfall in excess of the unamortized balance of prior Funding Shortfall amounts is amortized over seven years. A single annual amortization base is established, such that changes due to experience gains/losses, plan amendments, and assumption changes are not separately identified.

One of the PRA 2010 funding relief measures allowed for amortization of Funding Shortfall amounts for one or two of the plan years beginning in 2008, 2009, 2010, and 2011 to be amortized over 15 years or over "2 plus 7" years (where amortization was interest only for the first two years).

Multiemployer: Under the multiemployer funding rules, the unfunded actuarial liability (UAL) is defined as Actuarial Liability (AL) minus AVA. The PPA 2006 multiemployer funding rules allowed for the previously established amortizations of past plan amendments and assumption changes to be amortized over the remainder of their original 30-year amortization periods. Pre-PPA 2006 gains or losses continued to be amortized over the remainder of their 15-year amortization periods. All post-PPA 2006 changes in UAL due to experience gains or losses, plan amendments, or assumption changes are amortized over 15 years. Changes in UAL are separately identified and amortized by source, even though the amortization period is the same for each of these sources. Funding method changes are amortized over 10 years.

Another of the PRA 2010 funding relief measures allowed for amortization of 2008–2009 investment losses to be amortized over a 29-year period.

<u>Calculation of the MRC</u>

Single-Employer: Under the single-employer funding rules, the MRC is generally equal to Target Normal Cost plus Shortfall Amortization, where, as discussed earlier, Target Normal Cost (TNC) is calculated using prescribed discount rates based on corporate bond yields and a prescribed mortality table, Shortfall Amortization is over seven years, and the Funding Shortfall is calculated based on AVA reduced by PFB and COB. The TNC includes an estimate of the administrative expenses expected to be paid from plan assets during the year, and is reduced by any Excess Assets (defined as the AVA – COB – PFB – TL).

Multiemployer: Under the multiemployer funding rules, the MRC is generally equal to Normal Cost plus amortization of UAL, where, as discussed earlier, Normal Cost is calculated using a discount rate equal to the expected rate of return on plan assets and a best-estimate mortality table, and UAL is amortized generally over 15 years. The expense load for expected plan administration expenses may be defined explicitly by inclusion in the normal cost (as with single-employer plans) or implicitly through a reduction in the discount rate.

<u>Credit Balances Available to Offset MRC</u>

Both the single-employer and multiemployer funding rules allow plan sponsors to offset the MRC by past contributions made in excess of past MRC amounts.

Single-Employer: The use of COB or PFB is restricted in a number of ways under the PPA 2006 single-employer funding rules, to reduce the ability of a plan sponsor with a seriously underfunded plan to rely on a large credit balance to meet minimum funding requirements. PPA 2006 does not allow a plan less than 80 percent funded to use these balances to satisfy minimum funding requirements. PPA 2006 requires the funding shortfall to be calculated deducting PFB and COB from AVA, so maintaining these balances actually increases a plan sponsor's calculated MRC amounts by increasing the shortfall amortization amounts. A plan sponsor may also waive these balances to increase the funded percentage, for example to avoid benefit restrictions or restrictions on plan amendments under IRC Section 436 or reporting to the PBGC under ERISA Section 4010.

The COB and PFB are credited annually with interest at the actual rate of return on plan assets, to the extent not used to offset the MRC or reduced to improve the funded percentage. This mark-to-market approach precludes a plan sponsor from incurring large losses while still increasing its future funding credits with an assumed rate of return. Plan sponsors must actively elect to use the balances to satisfy the MRC, and must specify the exact amount to be used each year.

Multiemployer: The PPA funding rules for multiemployer plans retained the credit balance concept from the pre-PPA funding rules. Any prior years' contributions in excess of prior MRC amounts are accumulated at the valuation interest rate (i.e., an expected return on assets) and are automatically used to satisfy current minimum funding requirements to the extent not otherwise satisfied with cash contributions. If the credit balance ever becomes negative, this amount is called a "funding deficiency." If a funding deficiency occurs or is projected to occur in the next four or five years, the plan will be considered to be in critical status (in the Red Zone) and must adopt a rehabilitation plan, which reduces plan benefits and/or increases employer contributions to correct the funding problem, if possible. If a funding deficiency is projected to occur within seven years, a plan is considered to be endangered (in the

Yellow Zone) and must adopt a Funding Improvement Plan, reducing the rate of future benefit accruals and/or increasing employer contributions to correct the funding problem.

Consequences of Lower Funding Levels

Single-Employer: Plans less than 80 percent funded are subject to restrictions on (a) payment of accelerated benefit distributions (such as lump sums and other amounts paid more rapidly than in equal installments over a participant's lifetime), (b) amendments increasing plan benefits, and (c) unpredictable contingent event benefits. Special "At-Risk" funding measures accelerate the minimum funding requirements for certain plans that are less than 80 percent funded on the regular funding assumptions and less than 70 percent funded using special "At-Risk" assumptions.[11] Plans less than 60 percent funded must freeze benefit accruals. Additional contributions in excess of the minimum funding requirements may be made to remove these restrictions, and cannot be added to the plan's PFB. A plan sponsor in bankruptcy will be subject to the accelerated benefit restrictions unless the plan's actuary has certified the funded percentage for the current year to be in excess of 100 percent. The only remedial actions available for underfunded single-employer plan sponsors are to reduce or eliminate future benefit accruals, waive PFB and COB, or contribute their way out of underfunding.

Multiemployer: Plans not certified as Green by the Enrolled Actuary must take actions to reduce benefits and/or increase employer contributions to improve plan funding. Within 30 days of certification as endangered or critical, the plan must notify all participants and beneficiaries, the bargaining parties, the PBGC, and the Secretary of Labor. Certain improvements are to be made over a funding improvement period or rehabilitation period of about 10 years. Annual certification of "scheduled progress" under the funding improvement plan or rehabilitation plan must be certified by the Enrolled Actuary or further corrective action is required. The guidelines and applicable timelines for establishing the funding remedies were designed to work under the collective bargaining process.

Generally, endangered plans may reduce future benefit accruals and increase employer contributions. Critical plans may reduce optional forms of benefit subsidies, amounts payable at early retirement ages and disability benefits payable prior to normal retirement age, in addition to reducing future benefit accruals. Some severely underfunded critical plans may not be able to restore funding within the rehabilitation period and in that case may conclude that all "reasonable measures" to restore plan funding have been taken.

MPRA allows critical and declining plans to apply for benefit suspensions to reduce all benefits, but not below 110 percent of the PBGC guaranteed level, if this is projected to restore solvency after all reasonable measures have been taken to attempt to restore funding without benefit suspensions. Another MPRA measure allows the PBGC to consider applicants for a "partition," in which the agency provides immediate resources to pay for the benefits of a segment of the participants, in combination with a maximum suspension for all participants, enabling long-term solvency to be projected for the non-partitioned segment.

[11] The special "At-Risk" assumptions reflect accelerated retirement timing and an election of the most valuable form of benefit payment at the assumed retirement date.

Quarterly Contributions

Single-Employer: Plans less than 100 percent funded must make quarterly payments toward the MRC to accelerate the payment of minimum required contributions to the plan. Plan sponsors may elect to use PFB or COB to cover the quarterly requirements, in certain circumstances. Failure to make a quarterly contribution or a timely election to use PFB or COB to cover the quarterly requirement is a PBGC-reportable event, and requires participant notification (unless promptly corrected).

Multiemployer: There is no quarterly contribution requirement for multiemployer plans. Employer contributions are generally made throughout the year based on hours or other units worked for which employer contributions are due under the applicable collective bargaining agreements.

Failure to Contribute MRC

Single-Employer: There are several consequences of failure to satisfy the minimum funding requirements.

- Additional interest penalties apply when quarterly contributions are paid late. When the full MRC is not paid by the final contribution due date (8½ months after the end of the year), interest on the late amount continues to accrue until paid. For late quarterly payments, an additional 5 percent interest penalty applies in addition to the regular interest accrued.
- An excise tax equal to 10 percent of the unpaid MRC is due for failure to pay the full amount by the final contribution due date. Amounts remaining unpaid continue to accrue additional 10 percent penalties as of each final contribution due date for subsequent years, until corrected. Amounts that remain uncorrected after several years may become subject to a 100 percent excise tax.
- The PBGC must be notified of the failure to pay the MRC in a timely fashion. Special reporting applies when the aggregate unpaid amount of any quarterly and final installments (with interest) exceeds $1 million.
- When aggregate unpaid contributions (with interest) exceed $1 million, the PBGC may place a lien against the plan sponsor’s assets.

Plan sponsors experiencing temporary financial hardship may apply for a minimum funding waiver, allowing them to defer and amortize the waived contribution over a period of five years, if they can demonstrate an ability to make the amortization payments in addition to their projected funding requirements in future years.

Multiemployer: Excise taxes and other penalties apply. However, plans in the Red Zone operating under a Rehabilitation Plan generally qualify for a waiver of the excise tax.

Representative Scott, Question #2

In the PBGC’s multiemployer program, the “insurable event” is plan insolvency. What does that mean in practice? Please describe in detail the corrective action specified under the Pension Protection Act (PPA) and the Multiemployer Pension Reform Act (MPRA) requiring plans to identify and take steps to remedy funding challenges before insolvency is reached.

Plan Insolvency and PBGC

A multiemployer pension plan is insolvent when it will have insufficient liquid assets and revenue to pay next year's benefit payments to retirees and beneficiaries in pay status. When a multiemployer pension plan becomes insolvent, triggering PBGC's insurable event, PBGC will provide the plan with financial assistance to enable the plan to make benefit payments, but only up to the PBGC-guaranteed levels. The amount of the financial assistance considers the plan's available resources—any liquid plan assets and cash inflow such as employer contributions and withdrawal liability payments—that can be used to pay at least a portion of guaranteed benefits.

Technically, the financial assistance provided by PBGC is structured as a loan, but it is highly unlikely the insolvent plan will be able to repay that loan. (To date, only one insolvent plan has repaid the financial assistance provided to it by PBGC.)

Corrective Actions under PPA

PPA provided multiemployer pension plans a framework and new tools to address their underfunding that did not previously exist under ERISA. Most notably:

- *Required remedial action plans in endangered or critical status:* PPA requires annual actuarial status certifications for multiemployer pension plans. Certifications are based on current and projected funded levels. The sponsor of a plan certified to be in "endangered" status must adopt a "funding improvement plan," and the sponsor of a plan in "critical" status must adopt a "rehabilitation plan."

- *Required contribution increases*: A critical status rehabilitation plan or endangered status funding improvement plan may include schedules of required increases in contribution rates, which must be adopted by the bargaining parties. Prior to PPA, multiemployer plan sponsors could encourage bargaining parties to adopt increases in contribution rates, but there was no specific statutory authority providing for this.

- *Reductions in adjustable benefits*: A rehabilitation plan (but not a funding improvement plan) may include reductions to "adjustable benefits," which include early retirement benefits, ancillary benefits, and other subsidies. These reductions may apply to benefits that have already been accrued, but generally may not apply to participants in payment status. Prior to PPA, accrued benefits were protected under the anti-cutback rule first established under ERISA.[12] With very limited exceptions, accrued normal retirement benefits and benefits already in payment status when a plan enters critical status remain protected under PPA.

[12] Internal Revenue Code Section 411(d)(6) prohibits the reduction or elimination of any accrued benefit, early retirement benefit and retirement-type subsidies, and optional forms of benefit.

- *Exhaustion of all reasonable measures*: Under PPA, the primary goal of a rehabilitation plan is to enable the plan to emerge from critical status by the end of a 10-year rehabilitation period. If, however, a plan sponsor determines that it has exhausted all reasonable measures, it can instead adopt a rehabilitation plan that takes reasonable measure to enable the plan to emerge from critical status at a later date, or to forestall the projected insolvency.

The financial market collapse of 2008 and the Great Recession put significant strain on multiemployer pension plans, but most were able to work within the framework provided by PPA to restore funding levels. Some plan sponsors, however, found their plans were too severely distressed to develop a remedial plan that enabled the plan to emerge in a timely way from critical status or avoid projected insolvency.

For these severely distressed plans, even after significant benefit reductions, the contribution rate increases needed to emerge from critical status within the required statutory timeframe were so immense that they would cripple or bankrupt the participating employers. Therefore, these plan sponsors relied on the “exhaustion of reasonable measures” clause under PPA and adopted rehabilitation plans that focused instead on emerging from critical status at a later date, or perhaps delaying insolvency for as long as possible. Those plan sponsors acknowledged the reality that unreasonable required contribution increases and unreasonable benefit reductions would be counterproductive. In other words, overly burdensome contribution increases could actually reduce plan revenue by triggering employer withdrawals or the rejection of plan participation by active employees.

<u>Corrective Actions under MPRA</u>

When MPRA was passed in late 2014, it targeted those plans in critical status that had exhausted all reasonable measures and were still on the path toward insolvency. MPRA intended to provide these severely distressed plans with additional tools to enable them to remain solvent. Specifically:

- *Critical and declining status*: MPRA established a new status for severely distressed plans: critical and declining status. In general, a multiemployer pension plan is in critical and declining status if it is in critical status and also projected to become insolvent (in other words, run out of money) in the next 20 years.

- *Suspension of benefits:* MPRA permits sponsors of plans in critical and declining status to elect to suspend benefits if doing so would enable the plan to be reasonably expected to avoid projected insolvency. For this purpose, a suspension of benefits is a temporary or permanent reduction in benefits that would otherwise be protected under ERISA, including benefits that have already been accrued and benefits already in payment status. Certain classes of participants—for example, those over a certain age or those who are or will be receiving disability benefits under the plan—are fully or partially protected from suspensions. Additionally, suspensions must not reduce benefits below 110 percent of PBGC guarantee levels. Plan sponsors that decide to suspend benefits must submit an application to the Department of Treasury for review and approval.

- *Partitions and facilitated mergers*: MPRA also permits sponsors of plans in critical and declining status to apply to PBGC for special assistance in the form of a partition or a facilitated merger. Under a partition, PBGC would provide financial assistance to cover a portion of plan benefits, but only up to PBGC-guaranteed levels. A precondition of a partition is that the plan must suspend benefits to the maximum extent permitted under law. Under a facilitated merger, PBGC may provide financial assistance to enable a merger between two plans, with the goal of extending plan solvency and reducing PBGC's overall anticipated losses related to the plans involved. PBGC may only approve a partition or facilitated merger if the transaction would not impair PBGC's ability to provide financial assistance to other insolvent plans. Given the financial condition of PBGC's multiemployer program, the impairment requirement significantly limits the level of available financial assistance from PBGC.

Representative Scott, Question #3

In any case where all but one employer withdraws from a multiemployer pension plan, is that one remaining employer's withdrawal liability equal to the entire unfunded liability of the plan? Please describe in detail the "last man standing" rule.

Many refer to the "last man standing" rule as meaning that the final remaining employer in a multiemployer pension plan is responsible for the entire unfunded liability of the plan. When a multiemployer plan is suffering from a declining employer base, the remaining employers tend to bear a larger proportional share of the plan's underfunding. However, it is also important to understand that there are provisions in the statute that significantly limit the actual exposure to the last remaining employers. Most notably:

- Under ERISA, as amended by PPA, the sponsor of a plan in critical status may determine that it has exhausted all reasonable corrective measures to emerge from critical status within the required number of years. In that case, the plan sponsor may develop a rehabilitation plan that includes reasonable measures that target emergence from critical status at a later date, or forestall possible plan insolvency. This provision provides relief to plans with only a few remaining participating employers, in that it does not force them to provide unreasonable contribution increases to rectify underfunding that may be associated with employers that have previously withdrawn.

- Under ERISA, an employer's withdrawal liability assessment is not required to be paid as a lump sum. Instead, the statute establishes a withdrawal liability payment schedule based on historical contribution rates and contribution base units. Furthermore, under ERISA, withdrawal liability payments are generally subject to the "20-year cap," meaning that they stop after 20 years if the statutory payments have not paid down the employer's withdrawal liability assessment, with accumulated interest. In a mass withdrawal situation, however, the 20-year cap no longer applies, meaning that the statutory payments could continue indefinitely. Even if statutory withdrawal liability payments continue forever, however, an employer's withdrawal liability assessment may not be fully satisfied. In other words, the statute does not require an employer to pay its withdrawal liability assessment, even in a mass withdrawal situation.

- Finally, under ERISA, a mass withdrawal may be triggered if "substantially all" employers have withdrawn from a multiemployer pension plan. Furthermore, mass withdrawal rules may "claw back" certain employers that have withdrawn in the three years prior to a mass withdrawal. These provisions may help mitigate the unfunded liability exposure to the final few employers participating in a multiemployer plan.

Representative Scott, Question #4

Please explain why the risk to employers participating in multiemployer pension plans could occur sooner than plan insolvency dates if accounting rules eventually require such employers to record their contingent withdrawal liability on their balance sheets.

Under current accounting rules, there are required disclosures for employers that participate in multiemployer pension plans, including information regarding the employer's total contributions to all multiemployer plans in which they participate. Withdrawal liability is not a balance sheet liability, nor is it a required financial disclosure. That said, some employers voluntarily disclose contingent withdrawal liability in their financial reporting footnotes.

If employers were required to record contingent withdrawal liability on their balance sheet, it would likely result in lowered valuations for publically traded companies. Many employers, both public and private may experience increased difficulty in securing financing. In some cases, these factors could add additional financial pressures to companies already facing challenging economic conditions.

Representative Scott, Question #5

In your written testimony, you concluded by saying "[o]ne of three actions must be taken: Either benefits are reduced (this is the current course if there are no interventions), or contributions to the plans have to increase, or as a third option, more risk can be taken by plans to achieve prospective investment gains. Each option presents pros and cons with very different outcomes to different stakeholders." Please describe in detail the key considerations of each option.

All available solutions to avoid the insolvency of plans in critical and declining status, which have not found a means to resolve their funding distress, will involve one or more of three actions, broadly defined. In each of these approaches, equity and fairness to participants, employers, and taxpayers—and the ability to accept and withstand risk—all need to be considered.

<u>Option 1: Benefits can be reduced</u>

There are many ways this could be accomplished on a targeted basis. It would be necessary to decide whose benefit is reduced (e.g., everyone, future retirees, or current retirees, or even current retirees under a specified age), and by how much to reduce benefits. The reductions could vary by group or even by individual. If no action is taken, benefit reductions to the PBGC guarantee limit are the default, upon insolvency. However, if the PBGC is unable to honor its guarantee, then further drastic reductions will take place.

This option relies on sacrifices from plan participants in order to resolve the funding crisis.

<u>Option 2: Provide financial assistance</u>

Financial assistance provided to troubled plans could be in the form of more contributions—from employers, existing participants, or even retirees—or from other sources. There are practical limits on how much employer contributions can be increased and still be affordable (i.e., not contribute to bankruptcy or withdrawal), and limits on how much can be paid from participants; in general, critical and declining plans have determined that they have already reached that limit—they have no recourse in the absence of other sources of assistance.

The PBGC offers financial assistance that, per the statute, is a loan (that is realistically not anticipated to be repaid); however, the PBGC's multiemployer program is itself currently projected to become insolvent by the end of 2025 if another solution is not found to stave off several pending insolvencies from systemically significant plans. An alternative is for financial assistance to come from outside the current multiemployer system. To the extent that this option draws on taxpayer money, it represents a sacrifice from the associated taxpayers.

<u>Option 3: Take on more risk</u>

The option of taking on more risk could reduce the amount of benefit reduction or additional financial support needed to avoid projected insolvency. It is important to note, however, that taking on additional risk could still result in plan insolvency. It should also be noted that taking on additional risk must be done in combination with other measures. In other words, plans currently in critical and declining status cannot reasonably expect to alleviate their projected insolvency solely by taking on more investment risk in hopes of achieving higher returns.

An example of taking on additional risk would be to use funds from a government-backed loan at a lower interest rate but then investing the borrowed amount in return-seeking assets (including stocks) with the potential to earn a better return than the fixed rate of the loan, which would shift the risk to whatever entity provides or underwrites the loan.

This option will likely involve a taxpayer cost that is expected to be less than would be required under Option 2, but that cost will not be known in advance, and could be higher than expected or could result in unanticipated benefit losses if future experience is poor.

Representative Scott, Question #6

Is present law sufficient to address the looming failure of several systemically important multiemployer pension plans and the insolvency of the PBGC's multiemployer program? Or are additional legislative tools necessary?

As described above, the provisions under PPA and MPRA are not sufficient to avoid the looming insolvency for roughly 100 to 120 multiemployer plans. For some plans in critical and declining status, Treasury and PBGC may be able to provide a means of survival via approval of plan applications for benefit suspensions and partitions. For other plans the existing tools are insufficient and additional legislative measures will be needed to avoid the insolvency and to prevent the failure of the PBGC guarantee program. However, it is important to not jeopardize the survival of the 90 percent of plans that are doing well, or are far along the path to recovery from the financial crisis.

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