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RESEARCH REPORT

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ERISA GUARANTEE OF MULTIEMPLOYER PENSION BENEFITS

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Ed. Note: This is the first of a series of occasional reports on some questions often raised by trade unionists--but not answered very simply. It is our hope to provide more basic information, so that our readers will be better able to provide their own answers. But sometimes a viewpoint or a recommendation will be included. That should be identified as the viewpoint or the recommendation of the author of that particular Research Report, and not necessarily of the Labor Center or the Institute of Industrial Relations or the University of California.

One of the most significant provisions of the Pension Reform Law of 1974 (ERISA) was the establishment of the Pension Benefit Guarantee Corporation. PBGC (or, the Corporation) is a federally chartered, non-profit government insurance agency, designed to protect the basic pension rights of workers when their pension plans are discontinued or terminated without enough assets to provide promised benefits.

PBGC is required by law to insure the basic pension benefits of about 33 million workers and retirees (30% of the U.S. labor force) in more than 80,000 private pension plans. About 8 million of these workers and retirees are participants in approximately 2,000 multiemployer pension plans in existence in the U.S. today.

A multiemployer plan (or, ME plan) is defined by PBGC as a collectively bargained plan, receiving contributions from a number of employers, and administered by a joint board of trustees representing both employers and unions. Compared to other states, California has a very high percentage of union employees covered by ME plans.

The funds required by PBGC to guarantee worker pensions come from a special tax on all pension plans, which was originally set and still continues at the rate of 50¢ per employee per year, in the case of ME plans. In the case of single employer plans (or, SE plans), the original rate of $1.00 per employee per year has since been raised to $2.50. The law establishes four separate revolving funds, covering guarantees of "basic retirement benefits" of (1) SE plans and (2) ME plans, and covering guarantees of "non-basic benefits" of (3) SE plans and (4) ME plans. The law requires the resources of each of these four funds to be kept and used separately from each of the other funds.

The legislated PBGC guarantees became effective for employees covered by SE plans as of September 1974, but ERISA originally postponed the effective date for employees covered by ME plans until January 1, 1978. This three year and four month delay was occasioned primarily by uncertainty about the amount of liability that PBGC might be assuming in the case of the ME plans. The uncertainty led to a PBGC study of ME plans, completed and reported in September of 1977. PBGC found that plans covering 15% of all employees in ME bargaining units were experiencing significant financial problems serious enough to raise the possibility that these plans would become insolvent within a decade. The potential ME plan terminations posed enormous liabilities for PBGC--far more than the Corporation could meet with its revenues of 50¢ per covered employee per year.

Because of the conclusions of PBGC's study reported in September 1977, Congress passed a law in December of that year, deferring the effective date of insurance coverage of ME plans from January 1, 1978 to July 1, 1979. This law also required PBGC to make a more detailed study of ME plans and to make a full report to Congress on the guarantee problem by July 1, 1978.

The PBGC report to Congress is now available. It is entitled "Multiemployer Study Required by P.L. 95-214: July 1, 1978." Copies can be obtained from the Superintendent of Documents, GPO, Washington, D.C. 20402. Additional information about the report can be obtained from PBGC's Office of Communications, 2020 K Street, N.W., Washington, D.C. 20006 (202/254-4817).

The two delays in coverage of ME plan employees now total four years and ten-months--but there may still be more delay. The PBGC report of July 1978 contains a number of proposals (outlined below), but the Corporation has yet to make its recommendations to the Administration or to Congress. The proposals were intended to suggest the range of alternatives or options available to PBGC and Congress. The Corporation wanted more discussion and analysis of the options, before its Board of Directors comes up with firm recommendations (expected late in November). The final PBGC recommendations will undoubtedly play a large role in the development of the legislation which Congress must pass before the ME plans can be insured with PBGC guarantees by July 1, 1979.

In the cost analysis sections of PBGC's "Multiemployer Study of July 1978" (or, the ME Study), a sample of 279 ME plans was used to develop estimates of the potential incidence of plan termination, and the potential insurance costs that might accure to PBGC, over the next ten years. Certain plan characteristics were considered to be indicative of potential termination because of financial hardship--including a high ratio of retired and inactive vested participants to total participants; a low ratio of assets to annual benefit obligations; and a slightly increasing or a decreasing level of assets.

Projecting such characteristics, the study found that about 160 ME plans (10% of all such plans) have financial and participant characteristics that raise the possibility of their termination within the next ten years because of financial hardship. These plans cover approximately 1.3 million participants. Under the current program, if all of these plans were to terminate, the estimated present value of the gross unfunded liability for guaranteed benefits would be $8.3 billion. The estimated present value of net liability to PBGC would be $4.8 billion (gross unfunded liability less employer liability payments under the current statutory rules). In order to finance these liabilities, an annual premium of $80 per participant would be required--representing approximately 14% of annual plan contributions.

Although it is not likely that all of the 160 sample plans will terminate during the next ten years, or even thereafter, PBGC nonetheless concluded that "the magnitude of the potential liabilities indicates that the premium required to maintain the current program on a self-financing basis may not be affordable by multiemployer plans." What legislative changes might make it more affordable? The rest of the ME Study explores many possible answers to this question, and the following outline summarizes the most important of them:

1. Changes in minimum funding standards:

a. Require ME plans to amortize unfunded past service liabilities created by future benefit increases over 30 years, rather than over 40 years as allowed at present; and require amortization of experience losses over 15 years, rather than 20 years, as currently permitted.

b. Require that contributions to a plan be sufficient to pay benefit obligations as they become due. This would be accomplished through a new minimum contribution requirement (MCR), specifying that total contributions, including both normal cost and past service cost, must be adequate to meet a plan's benefit payment commitments. The MCR would be based on a percentage of unfunded vested benefits. The percentage would vary, depending on a plan's interest rate assumptions.

c. Establish stricter funding guidelines to be applied when "shortfall losses" create large funding deficiencies. "Shortfall losses" occur when hours actually worked in the bargaining unit turn out to be less than the hours projected when the pension plan contribution rate was fixed at the beginning of a collective bargaining contract term. Under present law, shortfall losses are amortized over 15 years, and there is no limit to the number or amount of such losses that can be funded in this manner. One proposed new guideline would prohibit benefit increases while an excessive shortfall funding deficiency exists. Another approach would require an actuarial certification that the excess funding deficiency would be corrected in a specified time period, such as five years.

2. Changes in the design of ME plan insurance:

The basic philosophy underlying this group of proposals is that plan continuation provides the greatest security against potential loss of pension benefits.

Proposals for restructuring the ME insurance program originally legislated in ERISA revolve around the following four areas:

a. Carry out plan reorganizations: A voluntary, two-tier system of reorganization would be established to help plans in difficulty to correct their financial problems. Level I reorganization would include plans facing long-term financial deterioration (e.g., they would exhaust their assets in 15 years, based on projected benefit payments, the current contribution rate, and continuation of recent trends in the size of the contribution base). Corrective measures could include increasing contributions or limiting future benefit increases. Level II reorganization would apply to plans in imminent danger of insolvency (e.g., they would exhaust their assets in seven years). Corrective measures could include reducing benefits.

b. Provide PBGC financial assistance to ongoing plans: Loans could be provided to those plans which still face involvency in spite of corrective measures taken during reorganization. Such financial assistance could become the primary PBGC vehicle. Under this approach there could be lower guarantees--or no guarantees--for plans that terminate--and particularly for plans that terminate without first attempting to reorganize or without taking all required corrective measures during reorganization. Thus, PBGC program funds would be restricted to those plans most in need of help that have first complied with all reorganization requirements.

c. Revise the guarantees and/or the employer liability provisions for terminated plans: The purpose of this approach would be to gain greater control over terminations by making plan continuation more attractive than termination. Plan reorganizations would be a part of this approach, but PBGC financial assistance would not be provided to ongoing plans. The current statutory limit on employer liability--30% of net worth--would be eliminated in this approach (i.e., employers would retain full liability after termination). To provide employer incentives for reorganization, the study proposes five different programs of reduced employer liability (i.e., reduced from 100% of net worth, instead of the present 30%), combined with reduced levels of benefits (". . . if that is necessary to control program costs.").

d. Change the phase-in of guarantees of benefit increases: Under present ERISA provisions, guarantees of benefit increases are phased-in quickly, at the annual rate of 20% of the monthly benefit increase or $20 per month, whichever is greater. The proposed phase-in rules eliminate the $20 rule and retain the 20% phase-in rule for guaranteed benefit increases--and also include the option of delaying the start of the initial five year phase-in for three years. These rules would be applicable both to financial assistance guarantees and to termination guarantees. Other possibilities under consideration would make the rate at which a benefit increase becomes guaranteed contingent on the plan's funding status at the time of the increase.

3. Changes in employer withdrawal provisions:

An employer withdrawing from an ME plan would be required to complete the funding of his share of the unfunded vested liabilities arising while the employer was in the plan, thus reducing the burden to those employers remaining in the plan. The proposed rules contain a method of allocating liability to a withdrawn employer based on his relative contributions to the plan, thus reflecting the share of the funding burden the withdrawn employer was carrying. The proposed rules would also hold new employer entrants liable only for underfunding occurring after their entry. (Under present law new entrants may be liable upon plan termination for underfunding arising before they entered a plan.)

4. Changes affecting plan mergers and transfers of assets:

New rules would replace existing statutory rules with more specific tests to determine whether a merger or transfer of assets would place a plan in financial danger.

5. Premiums:

The report contains three options for computing premiums, in addition to the current uniform charge per plan participant. One is based on risk and exposure, the second an exposure only, and the third on a variation of the alternative premium permitted under current law (a percentage of total insured benefits, whether funded or not). The three alternatives to the current method could produce a more equitable allocation of program financing by shifting the burden toward large, more poorly funded, high-benefit plans.

<u>Conclusions and Comments</u>

1. The difficulties and delays encountered in arranging for PBGC insurance for ME plans have given rise to such hasty generalizations as "another example of big government not knowing what it's doing," or, "they're going to increase the participant tax rate so much that a lot more plans will fail." But the following conclusions, with entirely different implications, can be drawn from the Multiemployer Study of July 1978: First, the delays and difficulties were due primarily to the fact that we have had very little detailed and reliable information about what has been happening to pensions negotiated in multiemployer collective bargaining units. Second, because of the potential extent of liabilities, PBGC was obliged to probe carefully to find out what is going on, and in the process produced some first class research about negotiated pensions. Third, the primary difficulty confronting the government in carrying out ERISA's requirement to insure ME plans is poor funding and poor management of some of these plans--enough of them to affect as many as 1.3 million workers.

Poor funding and poor management are not problems created by government--they are problems created by some of the private parties who established some of the ME plans, and then failed to set aside enough resources to pay covered employees the benefits they were promised. As often happens, government has been asked to redeem the broken promises, but so far has not been given enough resources to permit it to do so. In the meantime, the employees are expected to bear the financial burden--which also happens all too often.

2. The cost analysis sections of the Multiemployer Study do not make it appear likely that ME plan participants can be guaranteed the level of protection now made available to participants in SE plans. The study concludes that the level annual premium required to finance a program consisting only of assistance to reorganized multi-employer plans would be $2.47 per participant (close to the present $2.50 annual premium required for each single employer plan participant). If reorganization assistance is provided in combination with a 50% reduction in the present (ERISA) level of guaranteed benefits, a level annual premium in the $2.50 range would be possible only by including these additional requirements: (a) elimination of the current 30% net worth limitation on employer liability; (b) addition of the minimum funding requirements summarized above; (c) a three year delay on the phase-in of guarantees of benefit

increases, and the elimination of the $20 rule on benefit increases; (d) a guarantee of only those benefits which accrued after the passage of ERISA. Of course the study considers many other possibilities--all requiring higher premium rates (up to $80 per participant per year)--which in turn would increase the projected rate of potential plan terminations.

3. In the range of options analyzed in the study, two categories appear to be the most dramatic in their impact on insurance costs accruing to PBGC. The first involves reducing the guaranteed benefits--an approach that will be strongly opposed by organized labor. Under the reduced guarantee options considered in the study, guaranteed benefits would range from 43% to 79%. The study observes that "these proportions are much lower than under the current program, where participants in the same group of plans would be guaranteed approximately 94% of their vested benefits." (It may be worth another reminder at this point that most participants in ME plans are still guaranteed <u>nothing</u>--except that PBGC has had discretionary authority to guarantee benefits for ME plans that terminated before January 1, 1978.)

The second caregory of options with significant cost impact involves removal of the current 30% limitation on employer liability--i.e., increasing employer liability after termination of a pension plan to 100% of the employer's net worth--a possibility that will undoubtedly evoke potent employer opposition.

Probably in recognition of the organized pressure that can be brought against legislators by unions and by employers, the study goes on to develop an important range of new options involving the reorganization of plans, and the use of financial assistance to encourage early reorganization efforts. The study suggests that the primary thrust of the PBGC program, at least as it affects ME plans, could be changed from the guarantee of benefits at plan termination, to the reorganization of weak plans. Financial assistance could also be provided to ongoing, reorganized plans. Under this approach, financial assistance could also be provided in combination with reduced termination guarantees (for plans that terminate without reorganizing). Such a program, according to the study, would have substantially lower costs than the current program. But the study concludes that this approach "would provide participants in reorganized plans with virtually the same benefit security as under the current program."

4. Because of the high cost estimates of the alternative approaches, both PBGC and Congress appear likely to advance the reorganization and financial assistance approach. However, any legislation based on this approach would have to incorporate a substantial increase in the government's regulation and supervision of some private pension plans--and could also lead to direct government control of some private plans. In the present political climate, such legislation would be subject to enough criticism to make it very difficult to enact.

From the worker's point of view, increased government regulation and even control of some private pension plans should be encouraged. The present alternative is simply to leave those who work under ME plans unprotected, and to let them absorb by themselves all the losses of mismanaged plans that have promised too much and have been funded too little. Most workers would consider that alternative worse than more government regulations and control.

5. The PBGC's "Multiemployer Study" of July 1978 suggests--but cannot prove--that many ME plans may be confronted with serious funding and management problems in the next decade. Those who manage ME plans can be expected to raise indignant protests. However, there is sufficient evidence in the PBGC's study to justify a continuing governmental program of monitoring and surveying the financial problems of negotiated ME plans.

If other recent studies are also taken into account (see, for example, J. Rifkin and R. Barber, The North Will Rise Again: Pensions, Politics and Power in the 1980s, Beacon Press, Boston 1978), there may now be sufficient evidence to justify a program of continuing governmental monitoring and surveillance of all negotiated pension plans. In addition to providing new information on financing and funding problems in private plans, a program of this kind might also be able to develop more definitive guidelines than now exist for (a) the use and the reporting of actuarial assumptions affecting funding, and (b) the risks affecting investment of private pension funds in an economy characterized by high unemployment, a serious and possibly a chronic inflation problem, and increasing overseas investment.

Perhaps it is not too much to suggest that such a continuing program could also develop important and needed new insight into the continually changing relationships between the private pension system, as it is tied both to national and to international capital investment structures, and the Social Security system, as it is tied to the national tax structure. These basic systems affect how workers and their dependents live many years of their lives. The PBGC study of financial problems in ME plans has just scratched the surface of a much broader need for more information and insight about the financial security of all retired and disabled workers and their survivors.