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Multiemployer Plan Solvency: Crafting a Solution

The latest PBGC annual report indicates the multiemployer pension insurance program is projected to become insolvent by the end of 2025. That's only 7 years away. A PBGC insolvency would leave many pension plans and their participants without the financial backstop envisioned by ERISA. Combine this with the findings of a recent Society of Actuaries report that shows 107 plans becoming insolvent within the next 20 years – to the tune of over $7 billion in total annual benefit payments to more than 900,000 participants– and it's easy to see why the clock is ticking.[1] Both the Pension Protection Act of 2006 (PPA) and the Multiemployer Pension Reform Act of 2014 (MPRA) took major steps to stave off these insolvencies by creating a framework to measure a plan's financial health (zone status), giving sponsors of troubled plans new tools to help restore financial health (rehabilitation and funding improvement plans, employer surcharges), and permanent benefit reductions (adjustable benefits and benefit suspensions). Unfortunately, these tools are proving to be insufficient to help many of the most troubled plans, which has magnified the PBGC solvency concerns.

The Joint Select Committee

In February 2018, the Joint Select Committee on Solvency of the Multiemployer Pension System (JSC) was created as the latest Congressional initiative to address the financial troubles facing multiemployer plans. With equal representation from the House and Senate and both major parties (many of whom have been actively engaged in pension issues in the past), the JSC is tasked with issuing a report by November 30. With just nine months to reach a majority vote from each party (at least five Democrats and five Republicans), the JSC is hearing from a variety of stakeholders – plan sponsors, employers, participants, regulators, outside experts (including actuaries) and the public about how we got here, how plans operate, the rules that apply to funding and withdrawal liability, and ideas to fix the serious financial problems within the system.

Asking the Right Questions

The JSC's initial focus was on the impending insolvencies of plans and the PBGC. Based on the questions they are asking of the experts testifying before them it appears the JSC has expanded its scope to look at a wide range of issues affecting multiemployer plans. As the JSC proceeds with its deliberations, it's important they clearly articulate whether their goal is to:

- ***Keep the plans solvent***, which also addresses the PBGC's solvency problems, or
- ***Keep the PBGC solvent***, perhaps allowing plans to fail with an assurance that financial support is available

The recommendation from the JSC will be heavily influenced by which of these goals is selected. The JSC will have to weigh the cost of any proposed solution and the likelihood of its success. It's almost always true that cost and the likelihood of success are directly related.

[1] U.S. Multiemployer Plan Pending Insolvencies, Society of Actuaries, May 2018

Somethings Gotta Give

There are three basic options available to restore the most troubled plans to solvency:

- ***More money*** – This can take the form of increased contributions or funding from other sources to help pay benefits, which could go either directly to troubled plans or to the PBGC.
- ***Smaller benefits*** – Although an unpopular option, reducing benefits for at least some participants will help retain money in the plans to avoid or delay insolvency.
- ***Take more risk*** – If the money needed to cover benefit payments is not available from another source of funding, plan sponsors may be forced to invest plan assets in riskier investments hoping for a higher return.

In the end, finding a viable solution will likely involve some combination of these options.

What's on the Table?

The JSC has asked those testifying about issues ranging from whether plans might benefit from industry diversification to plan governance and fiduciary responsibilities. A wide range of potential solutions have been proposed for consideration, either as stand-alone solutions or as components of a packaged plan.

Loans to troubled plans

Plan loans are garnering the most discussion. There are many variations on how loans could be structured.

Loan Component	Variations and Considerations
Funding source	Alternatives include the government (effectively paid from tax revenues), the private sector, and other healthy pension plans in the private or public sector. Dedicated industry taxes or surcharges on employers, workers and/or retirees have also been proposed.
Structure	How much plans may borrow, combined with the interest and repayment terms, will largely define the cost of a loan program. Some proposals require periodic principal and interest payments, while others require only interest during the term of the loan with a balloon payment of the principal due at maturity. Interest rates are generally below market, as low as 1%.
Use of funds	Some proposals assume loan proceeds are invested in a diversified portfolio with a long-term rate of return sufficient to cover all future benefits payments plus interest and principal payments, while others require risk reduction measures such as immunization of plan assets or retiree liability settlements.
Collateral	Loans provided by the government may face significant risk of forfeiture without collateral to back the loans. Where funding is provided by the private sector, the government is likely to be the ultimate guarantor. Industry taxes and surcharges (described above) could also (or alternatively) be used to fund a risk pool that would back the loans.
Eligibility	The MPRA benefit suspension eligibility could be retained as the criteria for triggering loan eligibility. Broader or alternative criteria could be applied.

Benefit reductions

The main question is whether benefit cuts (beyond the reduction to the PBGC guaranteed level that occurs upon insolvency) should continue to be part of the solution, or be taken off the table altogether. Some proposals allow for smaller cuts than what may occur under MPRA, along with other changes such as a plan loan. Other alternatives include making accrued benefits adjustable, decreasing (or increasing) based on plan experience.

Modifications to the PBGC insurance program

Potential modifications to the PBGC program include:

- Increased per capita premiums,
- Introduction of a risk-based premium (tied to funding or based on other factors),
- Increased guarantees (to make insolvency less severe for participants),
- Decreased guarantees (to further reduce the payments PBGC make to insolvent plans), and
- Intervention authority to allow PBGC monitor plans and act earlier to facilitate plan merger or restructuring.

Modifications to funding requirements

The JSC has asked about the discount rate and mortality assumptions used for multiemployer funding calculations. Alternatives to the long-term rate of return basis include a solvency measure (using corporate or Treasury bonds), while mortality tables and shorter amortization periods could be mandated as with the PPA single employer rules.

Modifications to withdrawal liability rules

Encouraging employers to remain in the plan while strengthening the plan's ability to collect a greater portion of the employer's allocated unfunded liabilities would improve cash flow into the plan and provide additional funding to cover future benefit payments.

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