

PENSION RIGHTS CENTER

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STATEMENT OF NORMAN P. STEIN

ON BEHALF OF

THE PENSION RIGHTS CENTER

ON

“BUILDING A SECURE FUTURE FOR MULTIEMPLOYER

PENSION PLANS”

BEFORE THE

COMMITTEE ON HEALTH, EDUCATION, LABOR AND PENSIONS

UNITED STATES SENATE

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Mr. Chairman and members of the committee, I am Norman Stein, and I teach tax and employee benefits law at the University of Alabama School of Law. Starting next week, I will be teaching at the Earle Mack School at Drexel University in Philadelphia. I am testifying today on behalf of the Pension Rights Center. The Center is a nonprofit consumer organization that has been working since 1976 to promote and protect the retirement security of American workers and their families. It is the only consumer organization devoted exclusively to this purpose.

Thank you for inviting me here to speak to you this morning on the critically important subject of multiemployer pension plans, which have provided millions of American working people with the opportunity to enjoy an adequate income in retirement. As I will explain, the subject should be of interest not only to the hardworking men and women who continue to rely on these plans for their retirement, but also to policymakers who believe that as a society we should, can, and must do better to help Americans prepare for retirement than give each of them a savings account and tell them you are on your own. For such a do-it-yourself system to work, workers must combine Spartan discipline, a Harvard investment degree, and a Cassandra-like ability to predict not only the direction of different investment markets but also the precise date of their own death.

Such a system would not work well in an ideal world, and the world that most of us inhabit is far from ideal. As I said, we should, can, and must do better. And an important step in doing better is to build a secure future for multiemployer pension plans.

I will divide my testimony into four parts.

The first part will explain why defined benefit plans are worth preserving, not only to provide a secure retirement for American workers, but also because such plans are the most fiscally responsible means of preparing Americans for retirement.

The second part will provide some observations on multiemployer pension plans that are germane to today's topic. Here I will show that the problems of such plans are not quite as severe as some claim and that those problems that do exist are not the fault of participants or mismanagement, but of structural changes in the economy and the financial meltdown caused by Wall Street.

The third part will explain why the legislation proposed by Senator Casey on partition—especially if it were modestly amended—is both equitable and economically responsible.

The fourth part will detail some other legal changes for multiemployer plans that we believe will contribute positively to retirement policy.

I. Defined Benefit Plans Are Worth Preserving

Almost all pension experts agree that from a worker's perspective, defined benefit pension plans are the best type of retirement vehicle. They do not require workers to figure out how much to contribute to a plan or how to invest their contributions. They do not require workers to monitor investment performance, to periodically rebalance, or to pay high fees. They do not tempt workers to dip into their retirement savings before retirement. And they do not require retired workers to devise strategies to make their retirement savings last until they die. In addition, defined benefit plans save workers time and anxiety—they are a true automatic pilot mechanism for employees to prepare for retirement. They worked well for our parents and they can work well for our grandchildren.

Some commentators, however, have claimed that our employment markets have spoken and that the verdict is clear: employers and employees no longer want defined benefit plans. But that is simply not the case. It is true that some employers have frozen or terminated their plans because of concerns about funding volatility. But it is also true that some of the nation's most prominent corporations continue to sponsor them because they know they have tremendous value. And more important, working people value defined benefit plans greatly in segments of the economy where they still exist. Unions continue to bargain for them and public-sector workers advocate for their continuation. And this is especially true today, when investment markets and high fees have devastated so many 401(k) accounts. In short, workers know that defined benefit plans work.

But are they too expensive? In fact, they are in many ways less expensive than defined contribution plans. Investment and administrative fees are lower and rates of return are higher in defined benefit plans, and economists such as Jeff Brown have demonstrated that annuitization of retirement wealth—which defined benefit plans provide—is generally welfare maximizing.

Moreover, defined contribution plans also have a potentially steep future economic cost to society. It was hardly costless when the market meltdowns of the last decade destroyed hundreds of billions of dollars in 401(k) accounts. Many millions of older workers will have to delay retirement if they are physically able to keep working, depriving younger workers of jobs and job advancement opportunities. And when workers do retire with lower savings than needed, there will be costs as government is called upon to widen the safety net for older Americans and as younger generations are asked to take up the slack. Moreover, defined benefit plans tend to provide a more patient source of capital than do 401(k) plans, which is good for the economy generally.

Sound retirement policy requires that we determine ways to preserve the defined benefit plans we have and expand them if possible. Multi-employer plans figure prominently in the current defined benefit plan universe. And many believe that multi-employer plans can furnish a template for new defined benefit vehicles outside the collective bargaining arena. For these reasons, I applaud this Committee's concern with preserving multiemployer plans.

II. Some Observations on Multi-Employer Plans

- (i) Approximately ten million Americans, who live in every state, rely on multi-employer plans. The continuation of these plans is vital to their retirement security and the spending power the plans provide to retirees is vital to our economy.
- (ii) The PBGC's estimated multiemployer plan liability is considerably smaller than that of the single-employer plan program. Multiemployer pension plans cover approximately 25% of all Americans participating in PBGC-covered pension plans, but multiemployer plans comprise less than 3% of the PBGC's current deficit. And this is true despite multiemployer plans being almost alone among private-sector pension plans in occasionally providing post-retirement cost-of-living adjustments to benefits.
- (iii) The funding problems currently being experienced by multiemployer plans are attributable primarily to two causes: the Wall Street-created financial meltdown and structural changes in the economy, which have devastated certain industries. The problems are not attributable to so-called overreaching unions or poor management by plan trustees. Indeed, at the start of this decade, most multiemployer plans were overfunded. And unlike businesses sponsoring single-employer plans, which sometimes enter bankruptcy to strategically shift unfunded liabilities to the PBGC, employers who contribute to multiemployer plans must pay steep withdrawal liability if they leave a plan.
- (iv) The heavy legacy costs that have resulted from structural changes in certain industries—such as the trucking and coal extraction industries—are being paid for by today's surviving businesses and their workers. Employees in the Central States Pension Fund currently have \$16,000 of their wages contributed to the Fund each year. And the resulting financial stress of such contribution obligations on surviving firms in these troubled industries—industries that are critical to our nation's economy and security--threaten their economic viability.
- (v) Some observers incorrectly claim that multiemployer plans imprudently increased benefits during the 1990s. But this claim misses two key points. First, tax laws virtually dictated that overfunded multiemployer plans use surplus assets to provide improved benefits. Second, unlike most single-employer plans which are based on final pay and thus automatically adjust to reflect inflation, benefits in multiemployer plans are typically stated in nominal terms. Often, benefit improvements in multiemployer plans do nothing more than adjust benefit formulas to reflect inflation, which as I just noted occurs without amendment in most single-employer plans.
- (vi) Unlike the PBGC guarantees for benefits in single employer plans, the guarantees for benefits in multiemployer plans are not adjusted to reflect inflation. The multiemployer guarantees are today approximately 1/5 of the guarantees for single employer plans.

III. Partition Proposals

Firms and employees in multiemployer plans are responsible to provide benefits for employees of firms that have gone out of business and have not contributed their share of funding for their former employees. This is an ordinary structural feature of multiemployer plans and plans are ordinarily protected from severe financial loss by the ERISA's withdrawal liability provisions. But in a few troubled industries, too many firms became insolvent while in contribution arrears

and without paying their withdrawal liability. The remaining employers and employees are now paying the liabilities left over from these dead firms. Compounding the problem is that these industries have low ratios of active workers to retirees and are thus unable to contribute their way to plan solvency. If we do nothing, these plans—and perhaps the employers who are now forced to cover liabilities of their former competitors—will ultimately fail and responsibility for the plans’ benefit liabilities will be shifted to the PBGC.

The legislation proposed by Senator Casey would deal with this legacy-cost problem in a few vital but financially stressed industries by allowing—under very limited conditions—a plan to partition off liabilities attributable to bankrupt firms (and other firms that went out of business without paying withdrawal liability). The plan would transfer the liability for these benefits—and certain assets paid to the plan by those defunct firms—to the PBGC.

Senator Casey’s proposal is a classic “stitch in time saves nine” approach, for it will make it probable that the plan itself will be financially viable for the long term. By taking on some liability now, the PBGC will avoid taking on much larger liabilities later and will improve the future viability of troubled but critically important industries, such as trucking and mining.

I would, however, suggest a change to the legislative proposal: partitioned retirees should be treated identically to the participants in the parent plan—both before and after partition. This should mean that the benefits for which partitioned retirees are eligible immediately after partition are determined under the parent plan’s then-current provisions, and that if the parent plan ultimately fails, their benefits will be subject to the same guarantees that are applicable to the participants in the parent plan. In other words, the participants in the partitioned portion of the plan should fare no worse or better than the participants in the parent plan.

This is not only a matter of fair treatment of all participants in the pre-partitioned plan, but also provides important protections for the PBGC.

IV. Other Multiemployer Changes

- (i) PBGC guarantees for multiemployer plans should be improved and in the future automatically increased to reflect increases in the cost of living.
- (ii) The red zone provisions that allow plans to reduce already earned benefits are harsh and penalize employees and retirees, who played by the rules. These cutbacks in benefits should be automatically restored when a plan becomes adequately funded.
- (iii) The PPA changes to the funding rules should be revisited for ongoing plans, to allow for greater actuarial smoothing and longer amortization periods for experience gain and loss. Indeed, we think similar changes are desirable for non-frozen single-employer plans.