Multiemployer Pension Reform

Insights
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Too Little, Too Late?

Employers and unions locked into failing multiemployer pension plans received an 11th-hour reprieve in late December when Congress passed legislation revising laws that had hobbled these plans for years. Titled the "Multiemployer Pension Reform Act of 2014," the reforms give multiemployer trustees and the Pension Benefit Guaranty Corporation (PBGC) new tools to address plan underfunding, and seek to eliminate reasons employers abandon these plans prematurely.

But the new law is not without critics, and whether the reforms will work remains to be seen. Opponents point out that reform has been built on the backs of thousands of retired or soon-to-retire employees, who may see their pensions slashed in order to allow sick plans to survive. Supporters say that the reforms are the only way to prevent some large plans and PBGC's multiemployer pension guarantee system from going bankrupt, which could lead to even sharper pension losses.

The Nature Of The Problem

Multiemployer pension plans have been around since the 1950s. Sponsored jointly by unions and contributing employers, the plans allow employees to change jobs within an industry without losing pension coverage. Multiemployer plans flourished in industries such as construction, trucking, mining, food production, and manufacturing, but as unions declined and industries changed, the plans found themselves increasingly challenged.

Contributions made on behalf of fewer active employees supported more retirees. After ERISA was enacted in 1974, the plans were subject to strict vesting and break-in-service rules that had not been contemplated when they were established. And trucking deregulation and environmental laws drove many contributing employers out of business.

Recognizing that many multiemployer plans were in danger, Congress passed laws in 1980 creating "withdrawal liability," which required employers to pay their share of underfunding if they stopped contributing to a multiemployer plan. The theory was that this penalty would keep employers from leaving the plans, and better fund the plans if an employer withdrew. But after large market losses in the early 2000s and in 2008 created more underfunding, it became apparent that the threat of withdrawal liability actually caused employers to leave before their withdrawal liability became unmanageable. Moreover, many employers who stopped contributing did so because of bankruptcy, meaning that withdrawal liability was never paid.

As several large multiemployer plans spiraled toward insolvency, it became apparent that PBGC would not have sufficient assets in its multiemployer guarantee fund to finance its obligations to these plans. This could mean that even the minimal PBGC guaranteed pension would not be paid. Over the past few years, many in Congress acknowledged that action was needed, but no consensus arose as to what to do. Increased taxpayer funding of PBGC was opposed as a union bailout, but the alternative – cutting vested pensions of retired and soon-to-be retired employees – was equally distasteful and ran counter to longstanding requirements of ERISA.

Many observers believed that Congress would simply kick the can down the road until failure of a large multiemployer plan brought the issue to a head. Instead, Congress found political cover in the must-pass 2015 Spending Bill, adding multiemployer pension reforms to the stack of other laws tacked on to the legislation.

The Fix

While the new law makes a number of technical changes to multiemployer rules, the heart of the legislation is aimed at plans in "critical and declining" status. Simply put, these are multiemployer plans that are not only in "critical" or red-zone status under existing laws, but are projected to become insolvent in the next 20 years. These are the plans that pose the most danger to PBGC and could bring down the whole multiemployer guarantee system.

Under the new law, PBGC is authorized to promote mergers of critical and declining plans into more healthy plans by providing financial assistance, if a merger will reduce PBGC's potential liability. Similarly, the new law promotes plan "partition," which allows plans in critical and declining status to petition PBGC to spin off certain benefit obligations into a separate plan.

PBGC is obligated to fund benefits in the partitioned plan at the PBGC guaranteed rate, while the original plan pays the difference between the PBGC guarantee and scheduled benefits. This remedy is only available if all reasonable measures to avoid insolvency have been taken (including benefit suspensions discussed below), if partition would reduce PBGC's expected loss, and if the minimum possible amount of liability is spun off.

Congress also recognized that merger and partition would not be enough to save all plans, so the new law contains a process through which multiemployer plans in critical and declining status can apply to IRS to "suspend" benefits. This means that vested benefits for participants can be reduced by an amount necessary to avoid insolvency (taking into account any partition), as long as the reduction keeps benefits at no less than 110% of the PBGC guaranteed rate for multiemployer plans.

This suspension can be permanent, or for whatever period of time is necessary to avoid insolvency. Even retirees are not safe from suspensions unless they are receiving a disability pension or have reached age 80. Those who are age 75 but less than 80 are also subject to partial suspension reached age 80. Those who are age 75 but less than 80 are also subject to partial suspension.

The Hurdles

Because benefit suspension is a tool of last resort, a number of procedural requirements exist before a suspension can be implemented. For example, the plan's actuary must certify that after suspension, the plan is projected to avoid insolvency, and the trustees must determine that without the suspension, the plan will become insolvent even though all reasonable measures to avoid insolvency have been taken. The suspension must not materially exceed the suspension necessary to avoid insolvency, and IRS must consult with PBGC and the Department of Labor before approving a suspension.

Critically, if IRS approves a suspension, a majority of participants and retirees must vote to accept the suspension before it takes effect. However, in the case of "systemically important plans," a suspension takes place regardless of the outcome of the vote. A plan is "systemically important" when the present value of PBGC's projected financial assistance is more than $1 billion if the suspension does not go forward.

In such a case, IRS consults with PBGC and DOL, as well as with PBGC's "Participant and Plan Sponsor Advocate" to determine if the suspension should be effective as proposed, or if the suspension can be modified. A modified suspension can only be approved if the plan is projected to avoid insolvency as modified.

Will It Work?

Whether these reforms are enough to protect PBGC and save failing multiemployer plans is questionable. The partition and benefit-suspension processes are complex and politically charged. For example, the national Teamsters Union opposed the new legislation, while the Central States Teamsters Pension Fund – a multiemployer pension plan that was a poster-child for reforms – supported it. Will the union trustees opt to buck their national union to apply for benefit suspensions? Will trustees act to cut benefit promises to vulnerable retirees who are living on fixed incomes?

Similarly, what are the legal obligations of multiemployer trustees under ERISA when faced with benefit suspensions or the uncertain prospect of PBGC insolvency? The new law seems to say that trustees are not subject to fiduciary liability to participants or retirees for suspending benefits, but that is not entirely clear. Difficult and controversial decisions will have to be made when presented with merger and partition alternatives as well. The new reforms stop the bleeding but don't change the fundamental problems facing multiemployer plans, such as declining industries, declining unionization, and market volatility.

Finally, the new law does little to eliminate the increasing withdrawal liability obligation faced by employers. For the most part, plan partitions or benefit suspensions over the next 10 years are ignored when determining withdrawal liability, so any savings will not reduce employer exposure. Changes were made which eliminate certain contribution rate increases after 2014 from factoring into withdrawal-liability calculations, but employers in failing plans still likely face year-over-year multimillion dollar increases in underfunding.

While reforms do add some stability to the multiemployer system, employers must continue to report multiemployer participation on balance sheets and confront the limitation that potential withdrawal liability imposes on management decisions to close or consolidate facilities. Businesses fail, and the pool of employers contributing to multiemployer plans – especially the weak plans facing industry and demographic declines – continues to shrink.

Indeed, even if employers want to remain in multiemployer plans that are critical and declining, benefit suspensions will inevitably lead to bargaining unit pressure to get out. Why should bargaining units continue to divert amounts into pension plans that are not returning a pension commensurate with their contributions?

The bottom line is that reforms will likely provide some stability to the multiemployer plan system, but in the case of some of the most vulnerable plans, the patient may already be dead.

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