INTERNATIONAL BROTHERHOOD OF TEAMSTERS

JAMES P. HOFFA
General President

25 Louisiana Avenue, NW
Washington, DC 20001

KEN HALL
General Secretary-Treasurer

202.624.6800
www.teamster.org

March 15, 2016

Filed electronically via http://www.regulations.gov

TREAS-DO-2015-0009

The Honorable Jacob J. Lew
Secretary of the Treasury
Department of the Treasury
MPRA Office
1500 Pennsylvania Ave., N.W.
Room 1224
Washington, DC 20220
Attn: Deva Kyle

Dear Mr. Secretary:

The International Brotherhood of Teamsters ("IBT") submitted comments on December 7, 2016, asking you to reject the Central States, Southeast and Southwest Areas Pension Plan's ("Central States" or "Fund") Application for Suspension of Benefits ("Application") under the Multiemployer Pension Reform Act of 2014 ("MPRA"). Our opposition to the Application was based on its unreasonable investment and contribution assumptions and the "all reasonable measures" standard required under MPRA. These flaws render Central States' determinations in the Application clearly erroneous. On March 1, 2016, Central States submitted a letter to you responding to the comments of the IBT and others. We respectfully submit this rebuttal to Central States' March 1, 2016 letter addressing a series of misrepresentations and smokescreens raised by Central States in a last ditch effort to defend their flawed Application.

Unreasonable Investment Assumptions – Central States' Asset Base Has Deteriorated Significantly Since June 30, 2015

What is most striking about the Central States' March 1, 2016 letter are the issues raised by the IBT which Central States neglected to address. When Central States filed its Application, it used June 30, 2015 assets for purposes of solvency projections, which was consistent with the Treasury temporary regulations, but inconsistent with reality. According to the Quarterly Reports of the Fund's Independent Special Counsel appointed by the U.S. District Court for the Northern District of Illinois (See Exhibit 1), Central States' assets declined from $17.330 billion on June 30, 2015 to $15.922 billion on September 30, 2015, a decrease of $1.408 billion or an 8.1% drop in plan assets due to negative cash flow and investment losses. In the nine months ending September 30, 2015 Central States assets dropped $1.941 billion or 10.8%. Our best estimate is that Central States' assets remained near $16 billion at the end of December 2015, with asset gains neutralized by negative cash flow. In the two months ending February 29, 2016, estimated investment performance was again negative with assets declining to an estimated $15.5 billion, if not lower.

Treasury should demand current asset information from Central States, and require Central States to rerun their stochastic solvency projections based on updated assets. This is not a burden on Central States or their actuary in light of modern actuarial software technology, and could be prepared quickly for Treasury's review. Treasury cannot ignore the fact that Central States' assets have deteriorated significantly during the pendency of the Application without making a mockery of Treasury's approval process. What has happened to Central States' assets in the past eight months is highly consistent with the IBT's original comments and concerns that the Application's investment assumptions of either 7.5% in each and every year, or a decade of lower returns followed by higher returns which come out to 7.5% long term, are clearly erroneous.

Unreasonable Investment Assumptions – Using a Single Long Term Investment Assumption for a 50 Year Time Horizon for Expected Return Assumption While Ignoring the Current Low Interest Rate Environment and Central States' Severe Negative Cash Flow is Clearly Erroneous

Central States' March 1, 2016 letter mischaracterizes the IBT's criticism of the Fund's use of a 7.5% investment assumption. The IBT did not state in its public comments that earning 7.5% over the long term is unattainable. In fact, the IBT's comments were much more nuanced and focused on Central States' unique financial, actuarial, and demographic characteristics and history.[1] Central States is currently bleeding $2.2 billion in benefit payments and administration expenses each year after employer contributions and withdrawal liability payments. This negative cash flow represented 14% of plan assets. Even if the proposed cuts are made, the negative cash flows starts at 9% of assets and grows steadily thereafter. A normal pension plan may be in a position to rely on a 7.5% investment assumption long term. But Central States' situation is far from normal. That is why the IBT finds it ludicrous for

---

[1] Significantly, the only pension plan at issue in the Application is Central States. The assumptions used by other multiemployer pension plans are totally irrelevant to the merits of this Application. Nevertheless, Central States' gratuitous, misguided attack on Cheiron, the IBT's actuarial consultant, is not only beside the point but blatantly inaccurate. Cheiron, a preeminent actuarial firm in the multiemployer pension plan universe, never asserted that Central States cannot earn 7.5%. Their analysis was based on the fact that there will be significant variability in the return from year to year, that in the short-term 7.5% is an unlikely outcome especially considering the experience over the last six months of 2015, and that the Plan's negative cash flow makes it extremely vulnerable to investment volatility.

Central States to use a single long term assumption for a 50 year time horizon for its asset class capital assumptions.

First, as Central States points out in its own March 1st comments, "*It is true that most investment experts believe that asset returns will be lower over the short run than they will over the longer time frames…*" Second, the IBT's public comments highlighted the current low return environment that experts believe could trend for another 5-10 years, and the adverse effect this could have on Central States' Application. IBT supplied several examples of Wall Street research support for the low return environment theory. In a recent client conference call on February 25, 2016, Bridgewater shared a table (See Exhibit 3) which projects expected 10 year returns for a 60/40 asset allocation (U.S. equity and bonds) of only 3.0%.

Third and lastly, the Horizon Actuarial Services Survey of Capital Market Assumptions 2015 Edition (see Exhibit 2) supports the IBT's position. Page 3 of the Horizon Survey states:

> When evaluating the expected return assumption for an active, ongoing multiemployer pension plan, the plan actuary will usually consider investment returns over a long-term horizon of 20 years or more. **A shorter time horizon, 10 years or shorter, may be more appropriate when evaluating the return assumption for a very mature plan that has unusually high negative cash flows relative to its asset value.** (emphasis added)

The IBT believes Central States is especially vulnerable to sequence of returns risk. The actual investment performance of Central States since 2014 supports the IBT's argument. As we noted in our public comments, return underperformance in early years will undermine Central States' ability to maintain solvency under the Application. Contrary to Central States' accusation that "it is absurd for the IBT to claim with certainty that the Fund's projected investment returns will not be realized," the IBT is merely stating financial reality. As stated in the IBT's December 7, 2015 comments at page 4:

> One thing that can be said with certainty is that neither Central States nor any other pension plan will ever earn the same return **year in and year out**. Future returns, especially for a pension plan with as an aggressive earnings assumption as Central States (7.5%) in nearly a zero inflation environment, will be extremely volatile. This is especially true for Central States with its substantial negative cash flow (contributions minus benefits). Once a few poor returns happen, and the assets have been depleted by those poor returns combined with negative cash flows, there is not enough principal left to restore assets to their prior level, even with very high future returns.

Cheiron, the IBT's actuary, has estimated that with lower returns in the short run of 6% for 5-6 years, Central States would have to earn in excess of 10% for the balance of the 50 year projection period. Furthermore, to earn 10% per year long term, Central Sates would have to invest in significantly riskier assets, and this while liquidity needs steadily increase to the point that the negative cash flow will be exceeding 20% of available assets.

Finally on this point, Central States on page 4 of its March 1, 2016 letter acknowledges that an actuarial method called "select and ultimate" allows plans to use different assumptions for expected investment returns over various periods. However, Central States made the choice not to utilize the select and ultimate method, even though it may have been most appropriate, because as they state "actuaries rarely use different assumptions for expected investment returns over various periods ('select and ultimate' returns)" Central States failed to note that actuaries must always use such select and

ultimate returns as promulgated by the Pension Benefit Guaranty Corporation for terminated pension plans. This is because it was widely recognized that terminating pension plans were typically poorly funded and faced severe negative cash flows, and therefore different assumption were used for the short and more predictable term, than for the long term.

Unreasonable Investment Assumptions - Central States' Explanation of Historic Returns is Misleading and Inaccurate

Central States' March 1, 2016 letter informs us for the first time that the expected return assumptions for stochastic projections in their Application at Item 7.1.24 (see Exhibit 4) were arithmetic returns, not geometric returns, and thus not comparable to the assumptions in the Horizon Survey of Capital Market Assumptions (2015 edition). It is unfortunate that Central States failed to disclose this fact in their Application. However, this new information does not in any way weaken the IBT's argument about unreasonable investment assumptions. It is noteworthy that Central States does not take issue with the Horizon Survey analysis testing the probability of earning the 7.5% assumption. The IBT's public comments document Horizon's findings for a hypothetical multiemployer plan which shows on average a 45.7% probability of meeting or exceeding 7.5% over a 20 year horizon and a 37.8% probability over a 10 year horizon. In both examples, the Treasury standard of at least a 50% probability of maintaining solvency required under the temporary regulations fails, indicating the challenges facing pension plans that have to earn 7.5% annually into the future.

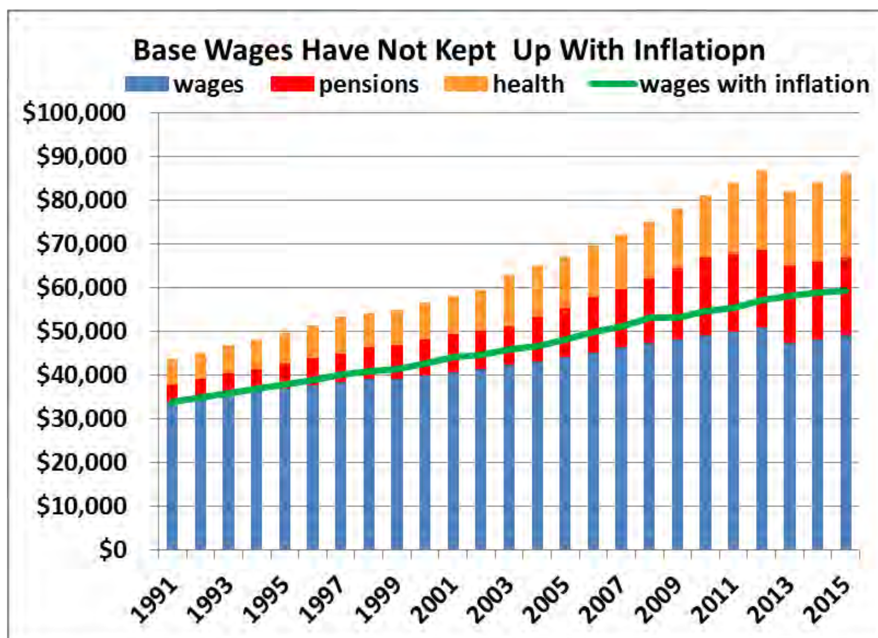
Central States' arithmetic versus geometric return exercise raises another, more important technical question regarding Central States' assertions -- its use of expected time weighted returns versus expected dollar weighted returns. This is a hugely important issue for Central States because of its uniquely high negative cash flows. Central States has to earn 7.5% on a dollar weighted basis over the 50 year solvency period to avoid insolvency. All actuarial projections are based on dollar weighted returns. Almost universally, reported pension plan returns are based on a time weighted basis, which are always based on geometric returns and which are always lower than arithmetic returns, as Central States has pointed out. Yet, Central States has repeatedly commented on its historical returns using arithmetic average returns by claiming, for example, that it has exceeded 7.5% over 20 years between 1996 and 2015. Central States' assertion that it has outperformed the 7.5% assumption by nearly 1.0% annually seems counterintuitive with its severe underfunding and projected insolvency. This is because using arithmetic average rates of return is grossly misleading and not representative of the actual return a pension fund has earned. Even reporting geometric returns on a time weighted basis will overstate dollar weighted returns. Dollar weighted returns are the only returns that matter.

A simple example may be helpful. Suppose a fund has $100 in assets and loses 50% in year one, and then earns 50% in year two. The average return will be reported as zero (-50% + 50%)/2 = 0%. If the fund earned zero over the two years, then it should have the $100 still invested. But in fact, the fund lost 50% and had $50 at the end of year one, and in year two earning 50% only brought the fund assets up to $75. The geometric return will be negative 13.4% ((1 – 50%) x (1 + 50%) – 1). But even that does not tell the whole story. That is because the calculations ignore cash flows. Suppose the fund pays out $5 at the end of year one. The $50 becomes $45 and the fund grows in year two to $67.50. On a dollar weighted basis, the fund earned a negative 15.3%. You must weight the average of the returns based on how large the assets were when each return was earned. Knowing with certainty that no plan can earn 7.5% each and every year, and assuming conservatively that Central States has earned 0% since June 30, 2015, it is the IBT's best estimate that Central States would have to earn more than 9.0% on a dollar weighted basis long term to avoid solvency.

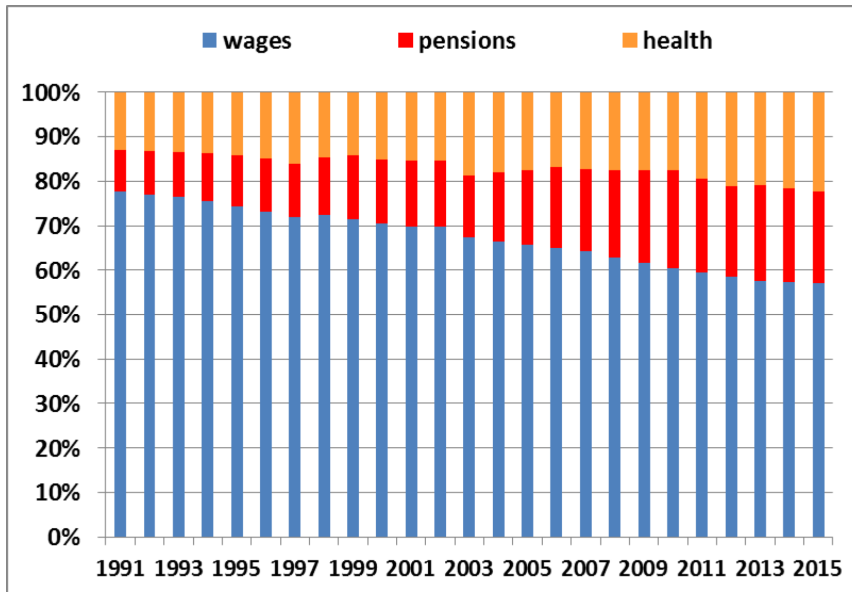
Unreasonable Contribution Increase Industry Decrease Assumptions

Central States has very little to say about the IBT's criticism of the Application's contribution increase assumptions, other than a gratuitous comment about the IBT's ability to negotiate increases in salaries and pension contributions that keep pace with inflation. Again, we face a reality check with Central States, which seems incapable of grasping the fact that it's existing and growing outsized contributions are crowding out the Union's ability to negotiate wage increases and maintain health insurance coverage for active workers. It is clearly erroneous to expect a group of contributing employers to decline from 65,000 active members in the Fund to 20,000, while at the same time assume contributions will increase fivefold and base wages become a smaller and smaller portion of the entire wage package. At some point, well before 50 years, active workers will have no reason to support this dying plan from which they are not likely to ever collect a benefit from.

Historically, Central States' active membership fell from 243,000 in 1991 to 65,000 in 2015, a decline of 73%. During that period, contributions increased from $4,108 per member per year to $17,784. At the same time, health and welfare contributions increased from $5,647 to $19,120 per member per year. The current combined annual per member pension and health contributions for Central States participants now totals nearly $37,000. In contrast, wages have only grown from $34,000 to $49,000 annually in the same 1991-2015 period. The following graphs, based on the Master Freight contracts, demonstrate the economic effect of the growing share of pension and health contributions in relation to total compensation which has accounted for much of the exodus of employers from Central States. Wages are not currently keeping up with inflation, and pension and health contributions are trending to 50% of the total compensation package. Annual pension contribution increases of 2.5% - 4.0% are simply not sustainable when it becomes a zero sum game for workers and employers in a plan that is proposing severe benefit reductions for over 200,000 participants.



The next graph demonstrates how base wages have steadily decreased as a percent of the total wage package. To assume that this trend can continue for the next 50 years, and that the remaining active workers will accept declining real wages while at the same time increasingly contribute to a "zombie plan" from which they will not except to ever collect a benefit is clearly erroneous.



Central States Failed to Satisfy MPRA's All Reasonable Measures Standard by Rejecting the IBT/Kroger Agreement

Central States' March 1, 2016 letter is internally inconsistent in its comments regarding the IBT's assertion that the Plan failed to satisfy MPRA's all reasonable measures standard by its outright rejection of the IBT/Kroger April 2015 collective bargaining agreement. This agreement offered to spin-off Kroger liabilities and the liabilities of Kroger subcontractors into a new jointly trusteed pension plan without requiring any assets to follow those liabilities in the spin-off. Kroger further agreed as a starting position to pay a minimum 22 years of withdrawal liability payments. First, Central States argues why it did not agree to accept Kroger's offer because of the unsubstantiated necessity of keeping Kroger in the Fund to preserve its ongoing contribution base. Then in contrast to the first claim, Central States' Application assumes Kroger's withdrawal effective July 1, 2016. In response, the IBT poses the following question – if Central States assumed Kroger was going to withdraw anyway, why did it refuse to negotiate a transaction that nets more money for the Fund and at the same time avails more benefit protection for the thousands of affected participants? Did Central States actually analyze the Kroger proposal before it sent a rejection letter to the bargaining parties five days after it was received? The IBT believes that Treasury should be asking Central States these same questions.

Conclusion

Central States' application has a series of fatal flaws that have been enumerated in the IBT's December 7, 2015 public comments and in this letter. Central States' letter of March 1, 2016 represents a continuation of the Fund's blind rejection of financial realities in terms of the economic choices it is presenting to its participants and contributing employers. The investment assumptions and contribution assumptions in the Application are a reflection of Central States' failure to get a grip on these financial realities. The IBT has focused on the Application's key economic assumptions and finds that they are

clearly erroneous based on Central States' unique and tragic history. Central States' rejection of the IBT/Kroger pension agreement demonstrates a clear failure to satisfy the all reasonable measures standard of MPRA, and is possibly a breach of fiduciary duty to negotiate the best withdrawal liability terms in the best interests of the Fund and its participants. The IBT believes with great certainty that if the Application is approved, Central States will fail its first annual certification a year from now and will be forced to suspend additional benefits or fail the MPRA tests. For all these reason, we implore the Treasury Department to reject the Application.

Sincerely,

John F. Murphy
International Vice President

cc: Special Master Kenneth Feinberg