

ADMINISTRATION VIEWS ON COMPOSITE PLAN DISCUSSION DRAFT

The Administration is committed to working with Congress on a solution to the looming crisis in the multiemployer pension plan system. Today, many people earn valuable benefits under multiemployer plans, but the system is still failing over a million people who are in plans headed toward insolvency, and are therefore faced with the prospect of suffering significant benefit cuts either in the near future or when their plans run out of money.

Legislation authorizing a new type of pension plan could make sense if existing defined benefit plans were not undermined and if the new plan were well-designed. However, the discussion draft of the Multiemployer Pension Modernization Act of 2016 does not meet this standard. Accordingly, the Administration strongly opposes the discussion draft.

The Administration is fundamentally concerned that the discussion draft would put workers' and retirees' existing pension benefits at greater risk and that the new type of pension it would create would unacceptably shift the risk to workers without adequate safeguards or transparency. The discussion draft neither provides for appropriate governance for composite plans nor does it include an appropriate regulatory and enforcement structure for either legacy or composite plans. It also weakens protections for plan participants by depriving them of insurance in case their plan fails.

Specifically, the discussion draft:

- Puts participants' existing pension benefits at greater risk by increasing the likelihood that their plans will run out of money or will implement benefit cuts under the Multiemployer Pension Reform Act (MPRA).
- Deepens the insolvency crisis of the PBGC's multiemployer program, putting more retirees at risk of being left with only a tiny fraction of the benefits they have earned if their plan runs out of money.
- Creates a new type of pension plan that
 - perpetuates the problems of the current multiemployer system with regard to underfunding and lack of sustainability;
 - will likely impose inequitable adjustments to contributions, accruals, and benefits when funding surpluses or shortfalls emerge, especially judged across cohorts; and
 - is insufficiently transparent to adequately warn participants of the risk of significant benefit reductions or to provide information they can rely on.

We urge Congress not to include any composite plan legislation in an end-of-year package without appropriate bicameral hearings and time for analysis and debate. The problems facing multiemployer pensions are complex and deserve adequate time for full consideration and an open process involving all interested stakeholders.

Policy Concerns with Discussion Draft

- The multiemployer system has served many participants well, but more than one million participants (10% to 15% of ALL participants) are being failed by the system because their plans are headed toward insolvency or benefit cuts.
 - Even if the PBGC guarantee system is funded, there will be many unkept promises relating to benefits in excess of the PBGC-guaranteed amounts.
- Any acceptable proposal should avoid increasing the number of plans at risk of insolvency; it should instead better protect participants left behind in the existing multiemployer defined benefit (legacy) system and lead to fewer benefit losses than under the status quo.
- The discussion draft would allow employers with existing multiemployer plans to avoid their share of plan obligations to participants without any additional money going into the plan.
 - Existing employers participating in multiemployer plans will likely divert disproportionate amounts of funding to composite plans.
 - Employers could withdraw after a decade with significantly reduced withdrawal liability.
 - Under current law, an employer that withdraws from an existing multiemployer plan and sets up a defined contribution plan must fund both the cost of the new plan and the withdrawal liability that pays its share of the defined benefit plan underfunding.
- The composite design in the discussion draft perpetuates the problems of the current multiemployer system.
 - Plan sponsors make commitments based on optimistic “reasonable” assumptions and then defer necessary adjustments over a 15-year period.
- Composite plans are less dependable and transparent than either a defined benefit or a defined contribution plan.
 - Composite plan participants cannot count on an account balance, nor on rules that describe their benefit. Instead they must rely on the decisions of future generations of boards of trustees, long after the benefit was earned. The discussion draft gives the trustees almost complete discretion in choosing how to adjust the plan benefits in the case of underfunding, and plan documents need not specify the remedies the plan would use to address underfunding.
 - While the discussion draft would require composite plans to inform participants that benefit cuts might be necessary, it would not require disclosure of the extent of possible cuts, and benefits would not be insured to a guaranteed minimum level. Since the composite plan is intended to “feel” much like a defined benefit plan (including an accrued benefit stated as a lifetime annuity), and since trustees are likely to postpone benefit cuts for as long as possible, participants may well underestimate the risk of cuts.
 - By contrast, existing risk sharing plans (e.g. adjustable benefit plans) provide mechanisms for reducing the risk that employers will bear the burden of changes in investment performance. They reduce risk to sponsors in a more transparent manner that preserves valuable protections for workers and retirees.

- Adjustments to contributions, accruals, and benefits in the composite system are likely to be inequitable, especially across cohorts. Any reaction to surpluses is entirely at the trustees' discretion. Retirees have little ability to influence negative or positive adjustments.

Principles for Any New Plan Design

The discussion draft fails to adhere to the following principles imperative for any new plan design.

Specifically, the draft fails to:

1. Protect the benefits of those left behind in the existing defined benefit system
2. Allocate risks and rewards in composite plans as fairly and symmetrically as possible
3. Provide for appropriate governance for composite plans
4. Provide for an appropriate regulatory and enforcement structure for defined benefit plans and composite plans

Should Congress ultimately opt to pursue legislation creating a new plan design, any reform should adhere to these principles. However, composite plan legislation should not be included in an end-of-year package as such complex legislation deserves, at minimum, appropriate bicameral hearings and time for analysis and debate.

Principle #1 – Protect the benefits of those left behind in the existing defined benefit system

Key elements

- Tighten funding requirements:
 - The discussion draft periodically resets the supplementary funding requirements for a bargaining unit to reflect changes in legacy plan funding status of the plan over time and to incorporate funding improvement/rehabilitation plan requirements. Also, supplementary contributions are not scheduled to end until the plan is well enough funded to be able to immunize the investment risk or annuitize. However, because unfunded liabilities may be amortized over 25-30 years under the discussion draft, more participants in legacy plans would lose benefits than under current law.
 - Contributions to legacy plans must not be disproportionately decreased. There are different ways to accomplish this principle, including:
 - Supplementary funding amount could be determined as suggested in the draft, but accelerated to a 7-year period (as in single-employer plans) rather than decelerated.
 - The transition contribution could be based on existing minimum funding requirements for multiemployer plans, without use of credit balances.
- Do not weaken withdrawal liability payments through back door mechanisms
 - The discussion draft provides that withdrawal liability from a legacy plan will continue to apply until the plans are sufficiently funded to hedge investment risk or annuitize. We support the use of mass withdrawal liability for this determination.

- But the discussion draft would provide for substantially reduced withdrawal liability payment requirements after 10 years. This is because, while unfunded obligations are theoretically allocated to employers using a plan-specified method to determine a reasonable share of the underfunding (“withdrawal liability”), employers are only obligated to pay it off in defined installment amounts
 - The installment amounts are based on multiplying the highest recent (last 10 years) contribution rates by the highest recent average contribution base units.
 - E.g. the highest recent hourly contribution rate multiplied by the highest recent 3-year average of hours worked.
 - The discussion draft does not count contributions to the composite plan in the rate and the treatment of contribution base units generated by new workers is unclear.
 - There are alternate ways to fix this problem, either by extending the number of years that are counted as recent, or by putting a floor on the potential payment amount.
- Enact the Administration’s proposal for PBGC premium reform.
 - The Administration’s proposal would delegate premium-setting authority to the PBGC Board, which we anticipate would use it to create a variable rate premium and an exit premium for the multiemployer program that allows for the careful targeting of premium increases so as not to exacerbate the risk of insolvency of the most troubled plans.
 - Higher premiums are necessary to ensure the solvency of PBGC’s multiemployer system and its continued ability to pay guaranteed benefits.

Additional elements

- Restrict adoption of composite plans to green zone plans. (Note, we understand that the discussion draft intends to restrict the ability to adopt a composite plan when the legacy plan is in or approaching critical status, but technical changes are needed to fully accomplish that goal.)
- Forbid MPRA benefit suspensions for legacy plans.
- We believe further changes to the discussion draft may be necessary to clarify that conversion/transfer of accrued benefits from any plan (other than a composite plan) to a composite plan is not allowed.
- We understand that the discussion draft will be revised to eliminate any additional incentives for bargaining units to move to composite plans on a “fast track” to cease benefit accruals under the legacy plan, such as additional changes to minimum funding rules (apart from the basic structure of the plans).
- Once the plan is fully funded, and withdrawal liability and supplemental contributions are no longer required, restrictions on unfunded benefit promises or potential hedging requirements should be considered.

- The 25 percent floor on composite plan contributions when a legacy plan becomes endangered or critical can jeopardize the funding of the legacy liabilities. This provision effectively *caps* the contribution to the legacy plan at 75%, during the period when the legacy plan enters a heightened state of risk.

Principle #2 – Allocation of risks and rewards in composite plans should be as fair and symmetrical as is possible

Key elements

- Composite plans should pre-specify automatic adjustments that will take effect when current funding gets too far off target to ensure the plan’s sustainability and the credibility of its promised benefits. These triggers should be symmetric so participants enjoy the potential for increased benefits in addition to bearing downside risk.
 - Participants’ benefits are earned while they are employed. Participants should be able to have reliable expectations as to how benefits will change that do not vary based on the changing opinions of different generations of the boards of trustees.
 - These adjustment procedures should be written into plan documents.
 - Maintaining and following an automatic adjustment plan must be a condition of qualification.
 - Failure to implement and follow a realignment plan when a composite plan fails either prong of the projected funding test should trigger an excise tax.
 - In addition to the projected funding test in the discussion draft, there should be a test based on current funding that (when failed) requires automatic adjustments projected to be sufficient to restore funding to the allowable range by the end of the second year after the failure.
 - The bounds for this test would be symmetric and in a range around the bounds for the projected funding test.
 - E.g., the funding thresholds for this test could be set at 100 percent (lower) and 140 percent (higher).
- The projected funding test in the discussion draft should likewise be symmetric: adjustments should be required if projected funding is unexpectedly high as well as unexpectedly low.
 - Composite plans must have an annual contribution requirement. Plans that have current or projected funding above the thresholds should be required to increase benefits rather than use the overfunded status to eliminate contributions under a new CBA.
 - The discussion draft requires that contributions are at least 120 percent of the normal cost in the first year of the plan and in any year in which it is amended to increase benefits. To preserve equity across cohorts and symmetry of outcomes, it is important to apply such a minimum contribution requirement to each year’s accruals (although it may be acceptable in some circumstances to have a lower contribution requirement than 120 percent in certain years).

Additional elements

- CBAs may provide for contribution holidays in accordance with an automatic adjustment plan triggered by the current funding test above.

- Expenses should be included in the cost of annual accruals.
- A modest benefit should be guaranteed by PBGC and paid for by new premiums that are sufficient to cover the risk.
 - By highlighting the distinction between benefits in the plan that are guaranteed and those that are not, a partial PBGC guarantee might help reduce the risk that participants would develop expectations that someone will or should back up a perceived implicit pension promise covering all of their vested benefits under the plan.
 - In lieu of a PBGC guarantee, an alternative approach would be an annuitization requirement -- whereby composite plans would purchase annuities to provide for a similar portion of benefit accruals.

Principle #3 – Appropriate governance for composite plans

Key elements

- Composite plan boards must include effective representation of retiree/inactive interests.
 - It is important to spell out a means for choosing a retiree representative on the board that can represent views of retirees, beneficiaries, and terminated employees with a vested right.
 - Merely appointing a retired former trustee is not sufficient.
 - This could be accomplished through the selection mechanism, fiduciary responsibilities, or both.
 - Provide regulatory authority to ensure adequate representation of retiree/inactive interests, including regulation of:
 - Voting procedures (e.g. bloc voting, supermajority voting);
 - Qualifications for reps (e.g. experience, expertise, plan participation, communication skills, not otherwise a plan fiduciary);
 - When the retiree/inactive representation requirement is triggered (e.g. when composite is adopted, when realignment plan is developed);
 - Board makeup (e.g. number of retiree/inactive representatives);
 - Legal liability of retiree/inactive representatives;
 - Degree/nature of retiree input into the selection process (e.g. proxies); and
 - Effectiveness of representation.
- Provide regulatory authority allowing or requiring removal of plan trustees, closing the plan, and/or transferring control to a third party if guarantee is triggered/violated.
- Provide regulatory authority to allocate powers and responsibilities in any cases where the board of trustees for a composite plan and for a related legacy plan is the same or substantially similar given its duty to divergent populations of participants. A composite plan's board of trustees should be separate from the legacy plan's board of trustees. Absent a clear separation, conflicts of interest may arise, particularly with regard to the division of the employers' contribution rate between the two plans.

Principle #4 – Appropriate regulatory and enforcement structure for defined benefit plans and composite plans

Key elements

- Provide regulatory authority allowing or requiring removal of plan trustees, closing the plan, and/or transferring control to a third party if guarantee is triggered/violated or if a legacy plan enters critical status.
- There are few to no regulatory enforcement mechanisms for the composite plans or legacy plans. While the discussion draft does add a civil enforcement provision for failures to comply with a realignment program, many provisions need strong enforcement mechanisms.
 - For example, an enforcement mechanism would be needed to ensure compliance with the specification that the trustees may not accept a CBA which does not satisfy the various statutory rules (such as not accepting a contract with an exclusion of younger or newly hired employees).
 - Maintaining and following a realignment plan should be a condition of tax qualification.
 - Failure to implement or follow a realignment plan should trigger an excise tax or be a condition of tax qualification.