Curing Troubled Multiemployer Pension Plans

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Summary

The PBGC estimates that there are 100 multiemployer pension plans (MEPP's) in critical and declining status who will become insolvent if MPRA benefit reductions are not approved and would require the PBGC to loan these plans amounts necessary to pay the PBGC guaranteed benefits. These plans have $100 billion in promised benefits to approximately 1 million participants, but only $40 billion in assets. The PBGC projects that it will become insolvent in 2026 and will be unable to pay such guarantees. Further, on a fair-value basis, the Congressional Budget Office projects that the value of claims for PBGC financial assistance, net of premiums received over the 2017-2036 period totals $101 billion.

The potential impact of the MEPP failures and PBGC insolvency would be extraordinary to the affected participants (promised pensions of several thousand dollars per month reduced to almost zero), the U.S. economy (billions of dollars not spent by participants), and the federal government (reputation risk of allowing a federal corporation to fail and increased demands for welfare relief).

The following "shared sacrifice approach" provides a potential solution that provides MEPP's with financial assistance that is not a bail-out. In short, troubled plans would receive a low interest, long term loan to cover its cash flow shortage for 5 years. Benefits would be reduced up to 20%. This allows plans to have a realistic chance to earn their way out of the funding shortfall. Loan repayments would begin after 5 years (interest only for first 5 years). A plan may receive up to three loans. A Risk Reserve Pool would be established with funds from non-government sources to ensure loan repayment.

According to the Government Accountability Office, at the end of FY 2014, the federal government had over $1.1 trillion in outstanding federal direct loans[1]. Based upon 2015 Form 5500's for critical and declining status MEPP's, it is estimated that these plans would need a range of approximately $22-30 billion in loans.

Loans and Benefit Modifications

Eligible Plans may submit an application to the Treasury. A plan is eligible if its actuary certifies that it is in critical and declining status as defined in MPRA. The plan's actuary must also certify at that time that the loan will correct the funding issue and can be repaid[2].

[1] A direct loan is "a disbursement of funds by the government to a nonfederal borrower under a contract that requires the repayment of such funds with or without interest." (as defined in Section 502(1) of the Federal Credit Reform Act of 1990).

[2] Plan actuaries are required to conform to applicable Actuarial Standards of Practice (primarily numbers 27 and 35 in this context) and Code of Professional Conduct or face discipline by the American Academy of Actuaries.

Assumed rate of return for loan calculations to be set forth in the statute (e.g., that expressed in the most recently published Horizon Survey of investment forecasts).

Approval must be made within 30 days of filing application and is deemed approved if no action is taken. Approval is automatic unless the plan uses a different rate of return assumption or its investment strategy/policy falls outside generally accepted principles for appropriate risk management. There is no participant voting process.

Initial loans to be provided within 60 days of application approval. The remaining portions of the loan are made on a monthly basis as cash flow to pay benefits to eliminate investment risk.

Loans to be in the amount calculated by the plan's actuary to pay the "shortfall" for the next 5 years. The shortfall is equal to 5 times the projected income from contributions and earnings minus the projected benefit payments (not reduced) and reasonable plan administrative expenses. The earnings are based on the projected asset value as of the first day of the next plan year times the statutory rate of return assumption. The contributions and benefit payments are those of the immediately preceding plan year.

Loans shall be made at a 1% interest rate and amortized over 30 years. Loan repayment commences immediately but interest payments only for the first 5 years (or 10 years if two loans and 15 years if three loans).

Benefit payments to be reduced up to 20% for all participants effective as of 60 days following application approval. Such reductions may reduce a participant's benefit below the PBGC guarantee (there could be a floor for reductions in plans with relatively small benefits). Upon an application's approval, the plan shall send each affected participant a notice informing them of the amount of their benefit reduction. Benefit accruals for active participants in the plan will also be reduced by the same percentage as those in pay status. Nothing about PPA rehabilitation or funding improvement plans will be affected.

Because the amount of the reduced benefit payments are not included when calculating the shortfall, the fund has the opportunity to improve its funded status through investment performance. The amount of the benefit reductions will stay in the general asset pool so the fund has the opportunity to grow the asset base which in turn increases future investment earnings.

At the end of the 5 years following the loan initiation, the plan's actuary must certify whether the plan remains in critical and declining status. If it is, the shortfall is recalculated (without including the benefit reductions) and a new 5 year loan amount is calculated and provided in monthly payments. If the plan is no longer in critical and declining status, then the loan principle begins to be repaid.

Benefit reductions remain in place until the plan is projected to become a green zone plan with the benefits restored (could even occur while the loan is being repaid). Plans would be required to assess the ability to restore all or a portion of the benefit reductions annually. Troubled plans may only apply for 3 consecutive loans. At the end of the third loan cycle, the principle and interest on the loan begin to be repaid no matter what the financial condition of the plan is at that time.

The employer contributions will remain as they would under the plan's red-zone rehabilitation plan provisions.

Withdrawal liability calculations during the period of any outstanding loans will be made as if the loan and benefit reductions had not been made. This proposal does not reduce withdrawal liability because of the loan.

In the event that a MEPP had submitted an application to reduce benefits under MPRA and it was approved prior to this proposal becoming effective, the plan could still apply for the loan(s) and instead of reducing benefits like other plans, it could restore benefits to the level that they would have been reduced if the MPRA application had not been approved.

<u>Risk Reserve Pool</u>

It is estimated that there may be a need for a total of $30 billion in loans to support the critical and declining status plans over the next 15 years. Interest only will be paid by the plans receiving loans until the plan is no longer in critical and declining status or it has received three loans. For most plans, this will be 15 years after the first loan is initiated. At this time, the plans will begin paying principle and interest amortized over the next 30 years. While the plan has certified that it can repay the loans in full prior to receiving the loan approval, to ensure that the loans do not default, there would be established a new back-up fund called the MEPP Risk Reserve Pool (MRRP).

In the event of significant poor investment performance during the loan repayment period, the MRRP is designed to provide relief to a fund during its loan repayment period. The objective is to ensure that the loan is repaid in full. If a MEPP determines that loan repayment is projected to make it insolvent during the loan repayment period, the MRRP would provide enough cash in that year so that the MEPP continues making loan repayments and is projected to remain solvent while repaying the loan. For example, 25 years after receiving its first loan, a MEPP has been paying $130 million each year to repay the principle and interest. However, market losses in the prior year mean that the plan can only pay $100 million that year in order to remain solvent while repaying the loan. The plan would apply to the MRRP for $30 million in relief. The MEPP then pays the full $130 million loan payment for that year. The process repeats each year as necessary until the loan is fully repaid.

The funding of the MRRP would begin upon the passing of the legislation establishing the loan program and would be projected to have approximately $16 billion in 25 years when any deficiencies may possibly occur. This represents approximately 50 percent of the total amount loaned.

The PBGC would collect the money and conservatively invest it in a separate trust solely for this purpose. It is expected that the MRRP would earn a conservative 4% return. The proposal is to collect the MRRP funds from the following sources:

- Increased MEPP PBGC premiums of $7 per participant – approximately $70 million annually
- Employer surcharges on active employees of $2 per month – approximately $80 million annually
- Employee membership fees of $2/month per participant – approximately $160 million annually
- Union surcharges of $2/month per active participant - approximately $80 million annually

This totals $390 million each year.

When a MEPP has fully repaid its loans, the MRRP is no longer available to that plan.

__Example:__

XYZ Multiemployer Plan (the "plan") is certified by the plan's actuary to be in critical and declining status as of January 1, 2017. The plan is anticipated to become insolvent in 2026.

The plan applies to the government for the first loan on April 1, 2017.

The first loan amount is calculated as follows:

Loan #1:		
Estimated earnings on 1/1/2018 assets at the rate defined by the statute (6.5%)	6.5% times $7,573M	$492M
2017 contributions		$350M
2017 benefit payments		$1,500M
Shortfall	Benefit payments less contributions less estimated earnings	$658M
Loan amount	5 times shortfall	$3,290M paid in 60 equal installments of $55M per month starting in 2017

During the 5 year period that the loan is being paid, benefits are reduced by 20% and the plan is required to pay 1% interest on the outstanding balance.

During the period from 2017 through 2021, the plan's asset returns are as expected and no significant employers withdraw from the plan.

As of January 1, 2022, the plan's actuary certifies that the plan is still in critical and declining status, but the projected insolvency date has now been extended to 2039.

The plan applies to the government for the second loan on April 1, 2022.

The second loan amount is calculated as follows:

Loan #2:		
Estimated earnings on 1/1/2023 assets at the rate defined by the statute (6.5%)	6.5% times $9,860M	$641M
2022 contributions		$290M
2022 benefit payments		$1,530
Shortfall	Benefit payments less contributions less estimated earnings	$599M
Loan amount	5 times shortfall	$2,995 paid in 60 equal installments of $50M per month starting in 2022

During the 5 year period that the 2nd loan is being paid, benefits are reduced by 20% and the plan is required to pay 1% interest on the 1st and 2nd outstanding loan amounts.

During the period from 2022 to 2026, the plan's asset returns are as expected and no significant employers withdraw from the plan.

Beginning 2027, the plan begins to repay both loan amounts. The repayment of both loans at a rate of 1% is approximately $241M annually.

As of January 1, 2027, the plan's actuary certifies that the plan is no longer in critical and declining status. The plan is projected to remain solvent for the next 38 years. However, the plan is still not in the green zone, so benefits are not restored. The 20% reduction in benefits and accruals remain in effect.