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PRIVATE PENSIONS

Multiemployer Plans and PBGC Face Urgent Challenges

Statement of Charles Jeszeck, Director
Education, Workforce, and Income Security Issues

GAO-13-428T

GAO
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Highlights

Highlights of GAO-13-428T, a testimony before the Subcommittee on Health, Employment, Labor and Pensions, Committee on Education and the Workforce, U.S. House of Representatives

Why GAO Did This Study

Multiemployer pension plans—created by collective bargaining agreements including more than one employer—cover more than 10 million workers and retirees, and are insured by the PBGC. As a result of investment market declines, employers withdrawing from plans and demographic challenges in recent years, many multiemployer plans have had large funding shortfalls and face an uncertain future. Also, both PBGC's single-employer and multiemployer insurance programs have been on GAO's list of high-risk federal programs for a number of years.

This testimony provides information on (1) recent actions that multiemployer plans in the worst financial condition have taken to improve their funding levels; and (2) the extent to which plans have relied on PBGC assistance since 2009, and the financial condition of PBGC's multiemployer plan insurance program.

GAO analyzed government and industry data, interviewed representatives of selected pension plans, and a wide range of industry experts and stakeholders and reviewed relevant federal laws, regulations, and documentation from plans.

GAO is not making recommendations in this testimony. GAO will soon release a separate report on multiemployer pension issues.

View GAO-13-428T. For more information, contact Charles Jeszeck at (202) 512-7215 or jeszeckc@gao.gov

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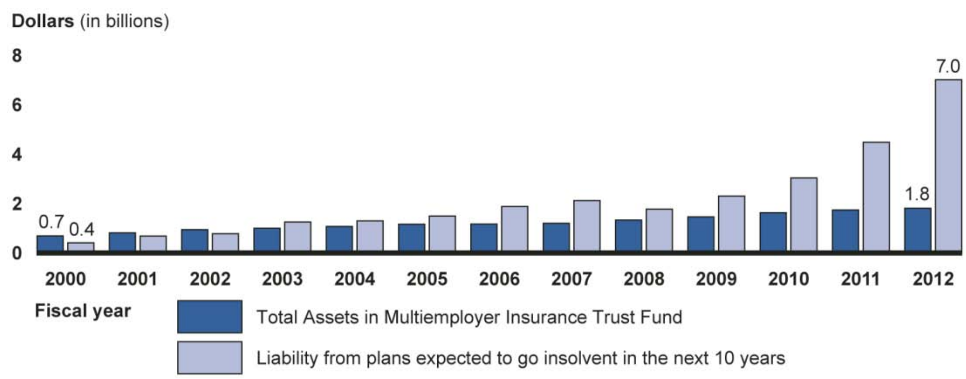
What GAO Found

The most severely distressed multiemployer plans have taken significant steps to address their funding problems and, while most plans expected improved financial health, some did not. A survey conducted by a large actuarial and consulting firm serving multiemployer plans suggests that the majority of the most severely underfunded plans—those designated as being in critical status—developed plans to increase employer contributions or reduce certain participant benefits. In some cases, these measures will have significant effects on employers and participants. For example, one plan representative stated that contribution increases had damaged some firms' competitive position in the industry. Similarly, reductions or limitations on certain benefits—such as disability benefits—may create hardships for some older workers, such as those with physically demanding jobs. Most of the 107 surveyed plans expected to emerge from critical status, but about 26 percent did not and instead seek to delay eventual insolvency.

The Pension Benefit Guaranty Corporation's (PBGC) financial assistance to multiemployer plans continues to increase, and plan insolvencies threaten PBGC's multiemployer insurance fund. As a result of current and anticipated financial assistance, the present value of PBGC's liability for plans that are insolvent or expected to become insolvent within 10 years increased from $1.8 to $7.0 billion between fiscal years 2008 and 2012. Yet PBGC's multiemployer insurance fund only had $1.8 billion in total assets in 2012. PBGC officials said that financial assistance to these plans would likely exhaust the fund in or about 2023. If the fund is exhausted, many retirees will see their pension benefits reduced to a small fraction of their original value because only a reduced stream of insurance premium payments will be available to pay benefits.

PBGC Assets and Liabilities from Current and Anticipated Plan Insolvencies, Fiscal Years 2000 through 2012



Source: GAO analysis of PBGC data.

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United States Government Accountability Office
Washington, DC 20548

Mr. Chairman and Members of the Committee:

I am pleased to be here today to discuss the challenges facing multiemployer plans and the Pension Benefit Guaranty Corporation's (PBGC) multiemployer insurance program. My testimony today is based on a draft GAO report that is due to be released later this month and, therefore, the findings should be regarded as preliminary. Multiemployer defined benefit (DB) plans are established through collective bargaining agreements including two or more employers and are generally operated under the joint trusteeship of labor and management. These plans are a vital source of retirement income for more than 10 million workers and retirees.

Investment market declines, employers withdrawing from plans, and an aging workforce leave many multiemployer plans facing challenges that threaten their long-term financial outlook. As we reported in 2010, these challenges contributed to large funding shortfalls for most plans.[1] We noted that some plans would likely be able to improve their funded status with improvements to the economy, but plans in the worst financial condition would likely be unable to fully address these challenges through increasing employer contributions or reducing certain benefits. We found that, without additional options to address plan underfunding or to attract new contributing employers, plans may be more likely to require financial assistance—further straining the PBGC multiemployer pension insurance program.[2] More recently, three federal agencies also noted the grave condition of some plans and the insurance program.[3]

We prepared this statement at the request of this committee addressing challenges facing both multiemployer plans and PBGC. Today, my testimony will focus on (1) recent actions that the weakest multiemployer plans have taken to improve their long-term financial position, and (2) the

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[1] GAO, *Private Pensions: Changes Needed to Better Protect Multiemployer Pension Benefits*, GAO-11-79, (Washington, D.C.: October 2010).

[2] PBGC is on GAO's High Risk List. For more information, see GAO, *High-Risk Series: An Update*, GAO-11-278 (Washington, D.C.: February 2011).

[3] *Multiemployer Pension Plans: Report to Congress Required by the Pension Protection Act of 2006*, U.S. Department of Labor, U.S. Department of the Treasury, Pension Benefit Guaranty Corporation, January 2013.

extent to which plans have relied on PBGC assistance since 2009, and the current financial condition of the PBGC multiemployer insurance program.

To answer these questions, we analyzed government and industry data; reviewed relevant federal laws, regulations, and documentation from plans; and interviewed a wide range of industry experts and stakeholders. In particular, to identify actions that multiemployer plans in the weakest financial condition have taken to improve their long-term financial position, we reviewed the survey methodology and analyzed plan survey data from the Segal Company, a large actuarial and consulting firm with a client base representing about 25 percent of multiemployer plans. This was a unique, one-time survey Segal conducted to supplement its routine surveys of client plans and provide more in depth information on specific steps that multiemployer plans are taking to address their funding shortfalls. To supplement the survey data, we conducted structured interviews with 13 multiemployer plans across the country. We selected these plans based on key characteristics, including industry, region, funded status, and number of participants. To determine the extent to which plans have taken advantage of PBGC assistance and to assess the financial condition of PBGC's insurance program, we obtained data on various types of assistance to plans and data regarding plans that are insolvent or expected to become so in the next 20 years. We conducted our work from April 2012 through March 2013 in accordance with generally accepted government auditing standards.

To summarize, we found that while the most distressed multiemployer plans have taken significant steps to address their funding problems, a substantial percentage of these plans have determined that they will not be able to return to a healthier funding status, and instead seek to forestall insolvency. Further, existing and anticipated plan insolvencies threaten to drive the PBGC's multiemployer insurance fund into insolvency in about 2023. If this occurs, retirees depending on the PBGC multiemployer insurance fund would see their pension payments reduced to a small fraction of their original value—or nothing at all.

Background

To address the need for improved funding, the Pension Protection Act of 2006 (PPA) included new provisions designed to compel multiemployer plans in poor financial shape to take action to improve their long-term financial condition.[4] The law established two categories of troubled plans—endangered status (commonly referred to as “yellow zone”, which includes an additional subcategory of “seriously endangered”) and a more serious critical status (commonly referred to as “red zone”).[5] PPA further requires plans in both categories to develop strategies that include contribution increases, benefit reductions, or both, designed to improve their financial condition. These strategies must generally be adopted through the collective bargaining process, and plans are required to periodically report on progress made in implementing them.[6]

Because of the greater severity of critical status plans’ funding condition, such plans have an exception to ERISA’s anti-cutback rule[7] in that they may reduce or eliminate certain so-called “adjustable benefits” such as early retirement benefits, post-retirement death benefits, and disability benefits for participants not yet retired. For example, if an approved rehabilitation plan eliminated an early retirement benefit, appropriate notice was provided, and the reduction is agreed to in collective bargaining, then participants not yet retired would no longer be able to receive early retirement benefits.[8]

PPA funding requirements took effect in 2008, just as the nation was entering a severe economic crisis. The dramatic decline in the value of stocks and other financial assets in 2008 and the accompanying recession broadly weakened multiemployer plans’ financial health.[9] In response, Congress enacted the Worker, Retiree, and Employer

[4] Pub. L. No. 109-280, 120 Stat. 780.

[5] Our review of 13 plans included 8 that were in critical status, 2 in endangered status and 3 that were neither critical nor endangered.

[6] Endangered plans are required to develop funding improvement plans, and critical plans are required to develop rehabilitation plans. All such plans are required to report annually on whether scheduled progress has been made under the plan in the Form 5500 filings.

[7] This rule provides that, subject to certain exceptions, once an individual’s benefit is vested (or earned), the vested benefit cannot be cut back through a plan amendment. 26 U.S.C. § 411(d)(6).

[8] See 26 U.S.C. § 432(e)(8). Certain specific conditions apply to the ability to “adjust” these benefits.

[9] Because employer contributions to multiemployer plans are generally based on hours worked, the high unemployment rates that accompany an economic recession also reduce plan revenue and negatively affect plan funding levels.

Recovery Act of 2008 (WRERA) and, later, the Preservation of Access to Care for Medicare Beneficiaries and Pension Relief Act of 2010 (PRA) to provide funding relief to help plans navigate the difficult economic environment.[10] For example, WRERA relief measures allowed multiemployer plans to temporarily freeze their funding status, and extended the timeframe for plans' funding improvement or rehabilitation plans from 10 to 13 years.[11] Generally, PRA allows a plan that meets certain solvency requirements to amortize investment losses from the 2008 market collapse over 29 years rather than 15 years, and to recognize such losses in the actuarial value of assets over 10 years instead of 5, so the negative effects of the market decline would be spread out over a longer period.[12]

Overall, since 2009, the funding status of multiemployer plans has improved, but a sizeable number of plans are still critical or endangered. According to plan-reported data, while the funding status of plans has not returned to 2008 levels, the percentage of plans in critical status declined from 34 percent in 2009 to 24 percent in 2011.[13] The percentage of plans in endangered status declined to a greater extent, from 34 percent in 2009 to 16 percent in 2011. However, despite these improvements, 40 percent of plans have not emerged from critical or endangered status.

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[10] Pub. L. No. 110-458, 122 Stat. 5092 and Pub. L. No. 111-192, 124 Stat. 1280.

[11] WRERA relief measures extended seriously endangered plans' funding improvement period from 15 to 18 years.

[12] To meet PRA's solvency requirements, a plan must demonstrate that it has sufficient assets to timely pay expected benefits and anticipated expenditures over the period of time when PRA relief measures would take effect. The recognition of a single year's investment results over multiple years is an example of "asset smoothing", an actuarial technique used to focus decision making on the long term, and avoid disruptive reactions to short term fluctuations in asset values. Just as this technique prevents assets from being fully marked down after a severe market decline, it prevents assets from being fully marked up following a rally in asset values, though only if the technique is followed consistently.

[13] WRERA funding relief measures allowed plans to temporarily freeze their funding status at the prior year's level, for plan years beginning during the period October 1, 2008 to September 30, 2009. Data for 2009 and 2010 reflect some plans that chose to freeze their funding status at the prior year's level. WRERA also extended the timeframe for plans' funding improvement or rehabilitation periods from 10 to 13 years. For plans in seriously endangered status, the plan's funding improvement period shall be 18 years rather than 15 years. According to the recent report on multiemployer plans issued by three federal agencies, the IRS received a total of 764 WRERA elections.

In addition to the difficulties many multiemployer plans face, the challenges that PBGC faces have led us to designate its insurance programs as a "high-risk" federal program. As we noted earlier this year, because of long term challenges related to PBGC's funding structure, the agency's financial future is uncertain.[14] We noted that weaknesses in its revenue streams continue to undermine the agency's long-term financial stability.

Plans in Poor Funded Status Have Taken Steps to Cut Benefits to Current Employees and Increased Employer Contributions, and the Financial Outlook for Some Plans Remains Bleak

According to a 2011 survey of 107 critical status plans conducted by the Segal Company, the large majority of critical status plans have developed rehabilitation plans that both increase required employer contributions and reduce participant benefits in an effort to improve plans' financial positions. Plan officials explained that these changes can have a range of effects and, in some cases, may severely affect employers and participants. While most critical status plans expect to recover from their current funding difficulties, about 25 percent do not and instead seek to delay eventual insolvency.

[14] GAO, *High Risk Series: An Update,* GAO-13-283 (Washington, D.C.: February 2013).

Critical Status Multiemployer Plans Have Developed Rehabilitation Plans Imposing a Range of Contribution Increases and Benefit Reductions

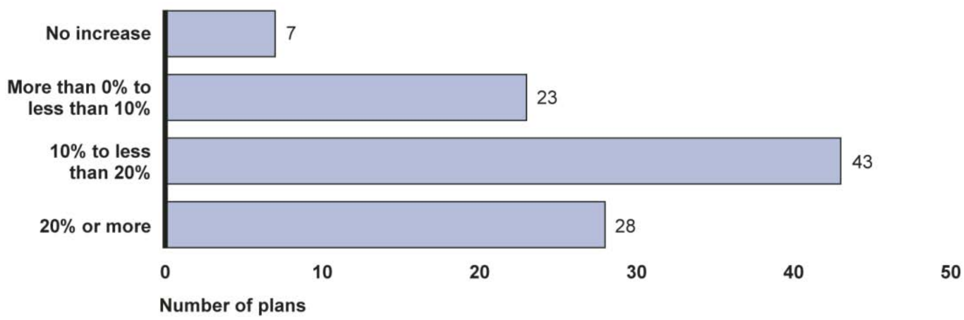
The 2011 survey showed the large majority of critical status plans surveyed developed rehabilitation plans that included a combination of both contribution increases and benefit reductions to be implemented in the coming years.[15] Of plans surveyed, 81 proposed increases in employer contributions and reductions to participant benefits, while 14 proposed contribution increases only and 7 proposed benefit reductions only.[16]

The magnitude of contribution increases and benefit reductions varied widely among plans. As Figure 1 illustrates, the rehabilitation plans of 7 critical status plans proposed no contribution increases, while those of 28 plans proposed first year increases of 20 percent or more. It is important to note that these data tell only a part of the story because some rehabilitation plans call for additional contribution increases in subsequent years.

[15] Unless otherwise noted, data pertaining to actions that critical status plans have taken to emerge from critical status are based on a 2011 survey conducted by the Segal Co., a large actuarial firm that provides consulting services to multiemployer plans that account for about 25 percent of multiemployer plans and about 30 percent of multiemployer plan participants. The same data was the basis of a 2011 report, *Multiemployer Plans Respond to the Financial Crisis*, Judith F. Mazo and Eli Greenblum, Pension Research Council Working Paper PRC WP2011-15, September 2011.

[16] The data refer to the “preferred schedule” developed by plans, which the survey defined as the schedule of contribution increases and benefits reductions that plan trustees intend to be most desirable or which has become the dominant schedule through collective bargaining. According to PPA, the default schedule is the schedule to be imposed on bargaining parties if they fail to agree on the preferred schedule or another provided by plan trustees.

Figure 1: Percentage Contribution Increases in Rehabilitation Plans in First Year



Source: GAO representation of data compiled by Segal Company.

Note: Of the 107 critical status plans surveyed, these figures exclude the 4 “do nothing” plans that proposed neither increased contributions nor reduced benefits, and 2 other plans for which preferred schedule data were not available. The contribution increases reflect those to be made in the first year of the subsequent collective bargaining agreement.

The vast majority of multiemployer plans surveyed developed rehabilitation plans that reduced benefit accruals and/or adjustable benefits in an effort to improve the financial condition of the plan. Thirty-two of the 107 multiemployer plans surveyed proposed, in their rehabilitation plans, to reduce accrual rates, and of these, the large majority proposed to cut accruals by more than 20 percent. Fifteen plans proposed to cut accruals by 40 percent or more. This doesn’t reflect all the changes plans made, because some plans reduced accrual rates prior to development of the rehabilitation plans. Furthermore, a majority of plans—88 out of 107—proposed to reduce one or more adjustable benefits.[17] Typically, these reductions will apply to both active and vested inactive participants, but some plans applied them to only one participant group.

[17] This data is roughly comparable to data reported in the 2013 report by Labor, Treasury, and PBGC. That report found that of 378 plans certifying as critical status in 2010, 96 reduced only adjustable benefits, 42 reduced only future benefits, and 53 did both. About half of these critical status plans reported no action, possibly because rehabilitation plans were still being developed. *Multiemployer Pension Plans: Report to the Congress Required by the Pension Protection Act of 2006*.

Funding Improvement Efforts Sometimes Require Significant Sacrifices by Employers and Participants

While the data are informative, they do not get to the heart of the issue—what impact will these changes have on employers, participants, and plans themselves? As might be expected, the impacts on employers and participants will vary among plans. In some cases, employers and participants will be able to bear these changes without undue hardship. In other cases, the impacts were expected to be significant. For example, plan officials said employers outside the plan generally do not offer comparable pension or health insurance benefits, and increases in contributions puts contributing employers at a significant competitive disadvantage. Similarly, an official of a long-distance trucking firm said high contribution rates have greatly affected the firm's cost structure and damaged its competitive position. In other cases, plans may have been unable to increase employer contribution rates as much as needed. For example, our review of one rehabilitation plan revealed that a 15 percent contribution increase resulted from a difficult balance between, among other factors, adequately funding the plan and avoiding excessive strain on contributing employers. According to the plan administrator, plan trustees determined many employers were in financial distress and a significant increase in contributions would likely lead to business failures or numerous withdrawals. Subsequently, five employers withdrew from the plan after the rehabilitation plan was adopted.

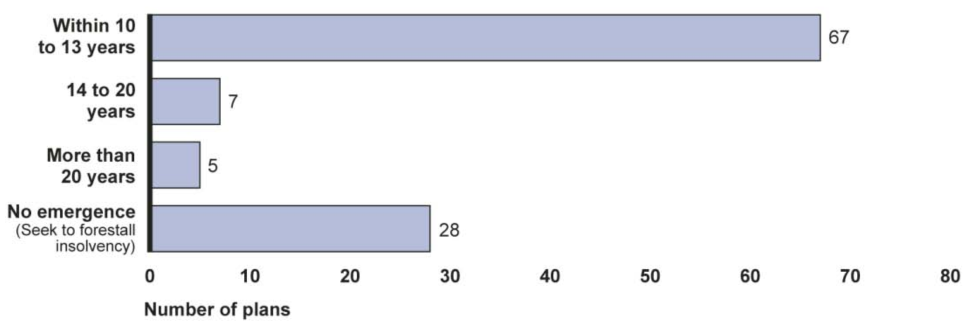
Similarly, the reduction or elimination of adjustable benefits were significant and controversial for participants in some cases. Officials of several plans stated the reduction or elimination of early retirement benefits for participants working in physically demanding occupations would be particularly difficult for some workers. At the same time, some plans also eliminated or imposed limitations on disability retirement so workers who have developed physical limitations will have to either continue to work or retire on substantially reduced benefits.[18]

Importantly, while most plans expected to emerge from critical status eventually, a significant number did not and instead project eventual insolvency. According to the Segal survey, of 107 critical status plans, 67

[18] Two plans reduced or eliminated disability retirement benefits for workers who are not disabled according to the criteria used by the Social Security Administration. As a result, instead of being disabled only for his or her current occupation, in order to qualify for a disability retirement, the worker will have to obtain certification of disability under the Social Security program, which further requires a determination that a worker cannot adjust to other work due to his or her medical condition.

expect to emerge from critical status within the statutory timeframes of 10 to 13 years, and 12 others in an extended rehabilitation period (See figure 2).[19] However, 28 of the plans had determined that no realistic combination of contribution increases and benefit reductions would enable them to emerge from critical status, and their best approach is to forestall insolvency for as long as possible. Among these plans, the average number of years to expected insolvency was 12, with some expecting insolvency in less than 5 years and others not for more than 30 years. The majority of these plans expected insolvency in 15 or fewer years.

Figure 2: Plans' Expectations about Emergence from Critical Status



Source: GAO representation of data compiled by Segal Company.

Our contacts with individual plans provide insight into the stark choices faced by these plans. Four of the eight critical status plans we contacted expected to eventually become insolvent, and officials explained that their analyses concluded that no feasible combination of contribution increases or benefit reductions could lead them back to a healthy level of funding. Several indicated that efforts to do so would likely accelerate the demise of the plan. For example, plan documents noted that the actuary of one plan determined the plan would be able to emerge from critical status if contribution rates were increased by 24 percent annually for each of the

[19] Under the PPA, critical status plans are to develop rehabilitation plans that will lead to emergence from critical status within 10 years from the date of rehabilitation plan. WRERA allowed plans the option of adding 3 years to this recovery period, so that plans wishing to do so could aim to emerge from critical status in 13 years. According to the Segal survey, 12 plans, even after exhausting all reasonable measures, could not emerge from critical status within the time allotted by the statute. To avoid undue harm to employers and employees participating in the plan, these plans have set a longer range goal for their rehabilitation.

next 10 years—a total increase of more than 850 percent. The trustees of this plan determined such a proposal would be rejected by both employers and workers, and would likely lead to negotiated withdrawals by employers. This, in turn, could result in insolvency of the plan, possibly as early as 2019. Instead, this plan opted for measures that officials believed are most likely to result in continued participation in the plan, which nonetheless are projected to forestall insolvency until about 2029. Similarly, according to officials of another plan, plan trustees concluded that the contribution increases necessary to avoid insolvency were more than employers in that geographic area could bear. In addition, the plan considered the impact of funding the necessary contribution increases through reductions to base pay. The plan found this infeasible because of the rising cost of living facing employees and their families. Consequently, the plan trustees adopted a rehabilitation plan forestalling insolvency until about 2025.

Total Financial Assistance Increased More Rapidly in Recent Years, and Current and Projected Insolvencies Will Exhaust Multiemployer Insurance Fund

Total PBGC Financial Assistance to Plans Increased More Rapidly in Recent Years, and Current and Projected Plan Insolvencies Will Exhaust Insurance Fund

Increases in PBGC Loans and Other Financial Assistance

In recent years, the total amount of financial assistance PBGC has provided to insolvent plans has increased markedly. From fiscal years 2006 to 2012, the number of plans needing PBGC's help has increased significantly, from 33 plans to 49 plans. For fiscal year 2012 alone, PBGC provided $95 million in total financial assistance to help 49 insolvent plans provide benefits to about 51,000 retirees.

Loans comprise the majority of financial assistance that PBGC has provided to insolvent multiemployer plans.[20] Based on available data from

[20] Under Title IV of ERISA, a plan may be considered insolvent if it does not have enough assets to pay the PBGC-guaranteed benefits for a full plan year. An insolvent plan continues operations, and PBGC provides necessary financial assistance for payment of benefits at statutorily guaranteed levels and for reasonable administrative expenses. The amounts of financial assistance for plan partitions and mergers and closeouts fluctuate from year to year, so the total amount of assistance for one fiscal year is not an indication of trends or amounts of assistance in prior years.

fiscal year 2011, loans totaled $85.5 million and accounted for nearly 75 percent of total financial assistance.[21] However, the loans are not likely to be repaid because most plans never return to solvency. To date, only one plan has ever repaid a loan.

Potential Future Liabilities for PBGC

PBGC monitors the financial condition of multiemployer plans to identify plans that are at risk of becoming insolvent—possibly requiring financial assistance. Based on this monitoring, PBGC maintains a contingency list of plans likely to make an insolvency claim, and classifies plans according to the plans' risk of insolvency.[22] PBGC also assesses the potential effect on the multiemployer insurance fund that insolvencies among the plans on the contingency list would have. Table 1 outlines the various classifications and definitions based on risk and shows the liability associated with such plans.

[21] In addition to providing loans for insolvent plans, PBGC provided $13.7 million in fiscal year 2011 to help support two plan partitions, which enabled those plans to carve out the benefit liabilities attributable to "orphaned" employees whose employers filed for bankruptcy, while keeping the remainder of the plans in operation. PBGC also provided $15.1 million in fiscal year 2011 to help plan sponsors close out five plans, which occurs when plans either merge with other multiemployer plans or purchase annuities from private-sector insurers for their beneficiaries.

[22] To determine which multiemployer plans belong in each of the contingency categories, PBGC uses an automated screening process that measures the financial health of plans based on a number of variables, which include: (1) the ratio of active participants (those for whom employers are continuing to make contributions) to other participants (those for whom plans are making benefit payments) and (2) the ratio of assets to the present value of vested benefits accrued.

Table 1: Classifications of Plans on PBGC Contingency List

Dollars in billions

Classification	Definition	FY 2012 Liability[a]
Probable (Current)	A plan that is known to be insolvent and has received or will begin receiving financial assistance.	$1.4
Probable (Terminated Future)	A plan that may still have assets, but current assets and future collectible payments are projected to be insufficient to cover plan benefits plus expenses.	$1.7
Probable (Ongoing Future)	An ongoing plan with a projected date of insolvency generally within 10 years.	$3.9
Reasonably Possible	An ongoing plan with a projected date of insolvency generally between 10 and 20 years in the future.	$27.0

Source: PBGC.

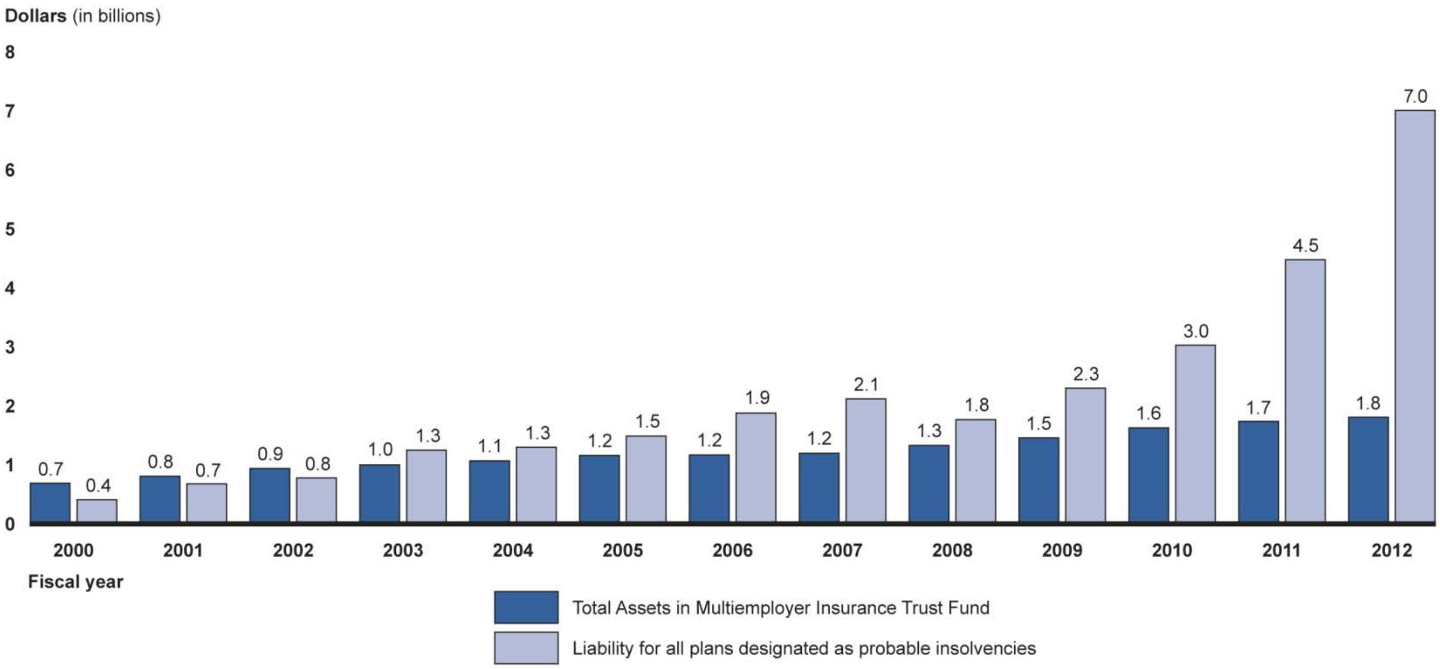
[a]Liability represents the present value of PBGC's potential liability to these plans.

Both the number of plans placed on the contingency list and the amount of potential financial assistance have increased steadily over time, with the greatest increases recorded in recent years. According to PBGC data, the number of plans where insolvency is classified as "probable"—plans that are already insolvent or are projected to become insolvent generally within 10 years—increased from 90 plans in fiscal year 2008 to 148 plans in fiscal year 2012. Similarly, the number of plans where insolvency is classified as "reasonably possible"—plans that are projected to become insolvent generally between 10 and 20 years in the future—increased from 1 in fiscal year 2008 to 13 in fiscal year 2012.

Although the increase in the number of multiemployer plans on the contingency list has risen sharply, the present value of PBGC's potential liability to those plans has increased by an even greater factor.[23] For example, the present value of PBGC's liability associated with "probable" plans increased from $1.8 billion in fiscal year 2008 to $7.0 billion in fiscal year 2012 (see fig. 3). By contrast, for fiscal year 2012, PBGC's multiemployer insurance fund only had $1.8 billion in total assets, resulting in net liability of $5.2 billion, as reported in PBGC's 2012 annual report.

[23] PBGC determines the present value by using certain assumptions about interest rates, among other things, to adjust the amount of future benefit payments to reflect the time value of money (by discounting) and the probability of payment (by means of decrements, such as for death).

Figure 3: PBGC Assets and Liabilities from Probable Insolvencies on PBGC's Contingency List, Fiscal Years 2000 through 2012



Source: GAO analysis of PBGC data.

Although PBGC's cash flow is currently positive—because premiums and investment returns on the multiemployer insurance fund assets exceed benefit payments and other assistance—PBGC expects plan insolvencies to more than double by 2017, placing greater demands on the insurance fund and further weakening PBGC's overall financial position.

Potential Exhaustion of Multiemployer Insurance Fund

PBGC expects the liabilities associated with current and future plan insolvencies that are likely to occur in the next 10 years to exhaust the insurance fund by about 2023.[24] Further, insolvency may be hastened by

[24] In addition to the report by Labor, Treasury, and PBGC, two PBGC reports on the financial condition of the multiemployer insurance program were released in January 2013: *FY 2012 PBGC Exposure Report* and *PBGC Insurance of Multiemployer Pension Plans: Report to Congress required by the Employee Retirement Income Security Act of 1974, as amended*. The PBGC reports confirm that escalating liabilities are expected to exhaust PBGC's multiemployer insurance fund. In particular, the scenarios described by PBGC's Exposure Report may be even worse than reported when key assumptions used for modeling the program's future financial position are adjusted to better reflect recent experience of multiemployer plans.

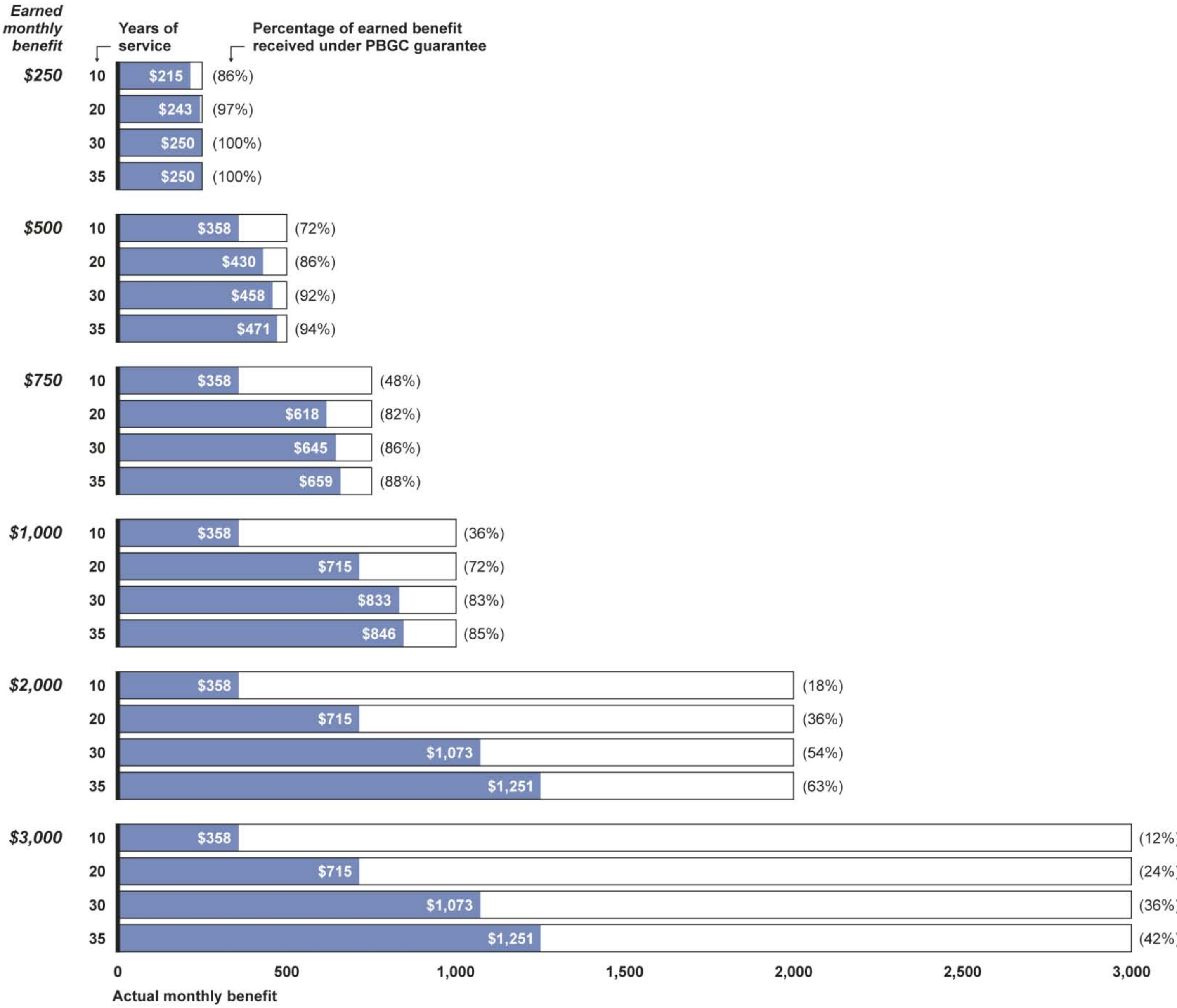
the projected insolvencies of two very large multiemployer plans whose financial condition has greatly deteriorated in recent years. According to PBGC officials, the two large plans for which insolvency is “reasonably possible” have projected insolvency between 10 to 20 years in the future. Importantly, the PBGC’s projection of program insolvency by 2023 does not account for the impact of these two plans because their projected insolvency is more than 10 years in the future. PBGC estimates that, for fiscal year 2012, the liability from these plans accounted for about $26 billion of the $27 billion in liability of plans in the “Reasonably Possible” category. Taken in combination, the number of retirees and beneficiaries of these two plans would represent about a six-fold increase in the number of people receiving guarantee payments in 2012. PBGC estimates that the insolvency of either of these two large plans would exhaust the insurance fund in 2 to 3 years.

Retiree Benefits are Reduced under Guarantees, and May Be Further Reduced if Multiemployer Insurance Program Becomes Insolvent

Generally, retirees who are participants in insolvent plans receive reduced benefits under PBGC’s statutory guarantee. When a multiemployer plan becomes insolvent and relies on PBGC loans to make benefit payments to plan retirees, retirees will most likely see a reduction in their monthly benefits.[25] PBGC calculates the maximum benefit guarantee based on the amount of a participant’s benefit accrual rate and years of credit service earned (see figure 4). For example, if a retiree has earned 30 years of credit service, the maximum coverage under the guarantee is about $1,073 per month, yielding an annual benefit of $12,870.

[25] The guaranteed benefit amount is a function of the participant’s accrual rate, which is calculated as the participant’s monthly benefit amount divided by his or her years of service. PBGC guarantees 100 percent of the first $11 per month per year of service plus 75 percent of the next $33, or $35.75 maximum, per month per year of service. 29 U.S.C. § 1322a(c).

Figure 4: Illustration of PBGC Guaranteed Benefit Levels



Source: GAO analysis of PBGC data.

Note: Although the maximum monthly benefit based on a 30-year working career is about $1,073, as this chart shows, a greater benefit can be earned if a worker retires after a longer career.

Generally, retirees receiving the highest benefits experience the steepest cuts when their plans become insolvent and their benefits are limited by the pension guarantees. According to PBGC, the average monthly benefit received in all multiemployer plans in 2009 was $821.[26] However, according to a PBGC analysis of benefit distributions among retirees of an undisclosed large plan, the range of benefits varies widely across retirees. About half of this plan's retirees will experience 15 percent or greater reductions in their benefits under the guarantee. Additionally, according to PBGC, one out of five retirees of this plan will experience 50 percent or greater reductions in their benefits under the guarantee. Ultimately, regardless of how long a retiree has worked and the amount of monthly benefits earned, any reduction in benefits—no matter the amount—may have significant effects on retirees' living standards.

In the event that the multiemployer insurance fund is exhausted, participants relying on the guarantee would receive a small fraction of their already-reduced benefit. Because PBGC does not have statutory authority to raise revenue from any other source, officials said that, once the fund is depleted, the agency would have to rely solely on annual insurance premium receipts from multiemployer plans (which totaled $92 million for fiscal year 2012). The precise effect that the insolvency of the insurance fund would have on retirees receiving the guaranteed benefit depends on a number of factors—primarily the number of guaranteed benefit recipients and PBGC's annual premium income at that time. However, the impact would likely be severe. For example, if the fund were to be drained by the insolvency of a very large and troubled plan, we estimate the benefits paid by PBGC would be reduced to less than 10 percent of the guarantee level. In this scenario, a retiree who once received monthly benefit of $2,000 and whose benefit was reduced to $1,251 under the guarantee would see monthly income further reduced to less than $125, or less than $1,500 per year. Additional plan insolvencies would further depress already drastically reduced income levels.

[26] The average monthly benefit was determined by dividing benefits paid under all plans by the number of retired participants under all plans. However, the average is somewhat inflated because benefits paid during the year include lump-sum payments (mostly $5,000 or less). Additionally, the average monthly benefit received in 2009 is slightly higher for plans in the transportation industry ($1,120), where an annual benefit can reach $30,000 or more for a plan participant with 30 years of service. On the other hand, average monthly benefit is lower ($642) for plans in retail trade and service industry.

Concluding Observations

Despite unfavorable economic conditions, most multiemployer plans are currently in adequate financial condition and may remain so for many years. However, a substantial number of plans, including some very large plans, are facing very severe financial difficulties. Many of these plans reported that no realistic combination of contribution increases or allowable benefit reductions—options available under current law to address their financial condition—will enable them to emerge from critical status. While the multiemployer system was designed to have employers serve as principal guarantors against plan insolvency, PBGC remains the guarantor of last resort. However, given their current financial challenges, neither the troubled multiemployer plans nor PBGC currently have the flexibility or financial resources to mitigate the effects of anticipated insolvencies. Should a critical mass of plan insolvencies drain the multiemployer insurance fund, PBGC will not be able to pay current and future retirees more than a very small fraction of the benefit they were promised. Consequently, a substantial loss of income in old age looms as a real possibility for the hundreds of thousands of workers and retirees depending on these plans.

In a matter of weeks, we will be releasing a report that goes into greater detail about the issues I have discussed in this testimony, and includes possible actions Congress can take to prevent a catastrophic loss of retirement income for hundreds of thousands of retirees who have spent years often in dangerous occupations and in some of the nation’s most vital industries.

This concludes my prepared statement. I would be happy to answer any questions the committee may have.

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