March 7, 2016

To: Senate Finance Committee; Senate Health, Education, Labor and Pensions Committee
House Ways and Means Committee; House Education and Workforce Committee

Subject: Imperative need to modernize the Nation's private sector multiemployer defined benefit pension plan system

On behalf of the United Association of Plumbers and Pipefitters International Union (UA), and the national Mechanical Contractors Association of America (MCAA), we urge Congress to act and the Administration to support the adoption of badly needed options for plan trustees to consider modernizing the Nation's fragile multiemployer plan structure. The UA and the MCAA jointly sponsor some 148 Taft-Hartley defined benefit pension plans covering approximately 434,494 participants. These plans have $31.35 Billion in assets.

A broad national labor/management expert panel, the Retirement Security Review Commission, administered by the National Coordinating Committee for Multiemployer Plans (NCCMP), proposed a comprehensive, coordinated, and long-overdue reform of the multiemployer system providing options for plan trustees. Two of the three major recommendations in the Commission's proposal, ***Solutions Not Bailouts,*** were enacted in the Kline/Miller Multiemployer Reform Act of 2014 (MPRA).

We are writing to urge your active and timely support for the most fundamental and least controversial part of that proposal – the third recommendation that would provide plan trustees with new options to consider. The Commission recommended creating a new type of plan, called a "composite plan", that is safer and more sustainable for both workers and their contributing employers than defined benefit plans, which provides a significantly more efficient use of pension contributions for pension benefits than is available under the 401(k) model.

While defined benefit plans are the primary form of benefit for participants in multiemployer plans, a number of factors have changed the environment for many contributing employers making continued participation in these plans an unacceptable risk.

These factors include increased market volatility that has produced both real and perceived threats of unfunded liabilities resulting in the re-emergence of withdrawal liability for contributing employers. In addition, new financial disclosures for employers imposed by the accounting profession have negatively affected the ability of employers to access credit markets. This is a critical problem in credit dependent industries including such as construction.

Under the current tax laws, for employers who are not willing to participate in a multiemployer defined benefit plan, the only available alternative to provide any retirement benefits is a defined contribution plan. These plans have their own broadly recognized shortcomings including transferring longevity and investment risk to plan participants, greater fees, lack of professional asset management, reduced opportunities to invest in a full range of investment classes and account degradation through various forms of "leakage" (loans, hardship withdrawals, early distributions, etc…). In addition, many participants receive their benefits in the form of lump sum distributions (instead of annuity income). The result is an inefficient system that leaves workers to manage account balances that are insufficient to meet their lifetime retirement income needs.

Composite plans are designed as a way of preserving the best of both the defined benefit and defined contribution structures. A composite plan is neither a defined benefit nor a defined contribution plan, but is a new plan design that draws from the best of both of the existing structures.

For existing defined benefit "legacy" plans that desire to convert to a composite plan structure, the retirement plan would be comprised of two pieces – the "legacy" defined benefit plan, which would be required to be fully funded as part of the transition to the new composite structure, but which would cease granting future accruals; and the new composite benefit plan for future accruals. The legacy plan portion of the combined plan remains subject to all of the existing ERISA / PPA funding rules, PBGC protections and premium payments, and withdrawal liability requirements. One of the transition requirements in going from the legacy defined benefit plan to the new composite plan would be a required minimum transition contribution that is sufficient to amortize the existing legacy plan liabilities over no more than thirty years. There is no question but that the transition rules must ensure that the legacy plan liabilities are fully funded.

The new composite plan design would resemble that of the current defined benefit plan (typically $X per month per year of service), but would be self-adjusting (as are all defined contribution plans) based on market performance. As a composite plan is not a defined benefit plan it is not subject to the ERISA funding requirements, PBGC coverage or premiums and contributing employers are not subject to withdrawal liability on benefits earned under the composite plan. The attraction of the composite design, however, is that it is much more efficient and addresses the recognized shortcomings of the current defined contribution system, allowing more of the contribution and investment returns to be paid out to the participants in their retirement benefit. In addition, it will provide <u>lifetime retirement income</u> (in the form of annuity payments) and require funding targets designed to moderate market volatility. Most importantly, however, the composite plan will increase long-term retirement security by eliminating the obstacles to new employer participation in the plan. By limiting their obligations to the negotiated contribution amount new employers will no longer fear the emergence of liabilities over which they have no control.

The major features of composite plans are as follows:

- **Requires full funding of the legacy defined benefit plan.** The legacy defined benefit plan remains subject to all of the ERISA / PPA funding requirements to which any defined benefit plan is subject. In addition, at the time of the transition to the composite design, a plan may elect a one-time "fresh start" that would provide a re-set to a single 30 year amortization of all of the existing amortization bases. As an additional funding protection, a plan must meet an additional "minimum transition contribution" under which the remaining liabilities of the legacy defined benefit plan must be funded over thirty years.

- **Allow participants to maximize their payout by pooling longevity risk.** One of the most appealing aspects of traditional defined benefit plans is that the benefit is paid as a life annuity using the group mortality to determine the payout periods and amounts. Conversely, one of the greatest unknowns for anyone who must decide how much to withdraw from their IRA or 401(k) is how long they will live. There is a significant risk that an individual will outlive his or her individual account. The composite plan addresses this problem by eliminating individual accounts and pooling longevity risk, requiring the benefit to be paid out in a life annuity as it would in a defined benefit plan. This will enable higher benefits to be paid than if the participant and spouse had to assume the most conservative mortality as benefits are drawn down and will insure that that participant and spouse do not outlive their retirement assets.

- **Reduce costs by professionally managing investments and negotiating fees.** Defined benefit plan assets are typically large enough to permit plan fiduciaries to retain professional investment managers and consultants, access asset classes that are unavailable to the average individual investor, and to negotiate fees that are only a fraction of those charged to the average mutual fund investor. Over one's career, these savings could increase benefits paid out by as much as 25%. The new composite model will provide such savings to both the legacy defined benefit and composite portions of the participant's benefit.

- **Preserve assets for retirement income.** It is often said that participation rates in 401(k) and other defined contribution plans would be significantly lower if workers felt they would be unable to access their funds for other purposes. Nevertheless, one of the factors frequently cited as contributing to low account balances in the current defined contribution system is the problem of "leakage." Leakage occurs when the plan includes features such as loans, hardship or other early and lump-sum distributions that diminish the assets in a retirement account, defeating the objective of providing lifetime income. Composite plans cover all employees pursuant to the applicable bargaining or other written agreement making individual elections unnecessary and prohibit these other forms of leakage that threaten a participant's standard of living in retirement.

- **Eliminate barriers to both existing and new employer participation.** As these are not defined benefit but modified defined contribution plans, employers make their negotiated contributions as they would under a 401(k) plan, but have no further funding obligations as they would under a defined benefit plan. As these plans mature, the legacy defined benefit plan liabilities are phased out and no unfunded liabilities are attached to any future service under the composite plan. Therefore, no withdrawal liability would have to be reported on employer financial statements.

- **Requires funding at rates sufficient to protect participants against market volatility.** Recognizing that this approach shifts the entire investment risk to the participants as is the case with any defined contribution plan, the rules governing composite plans seek to mitigate market volatility by requiring target contributions at 120% of the projected actuarial cost to fund the benefit. This funding buffer is evaluated annually using a fifteen year projection of assets at market value and the plan's assumed rate of return to determine whether intervention is required.

- **Requires adjustments when annual funding projections drop below 120% to further minimize benefit fluctuations due to market volatility.** Defined contribution plan benefits automatically adjust immediately when markets fluctuate. Composite plans moderate adjustments by imposing annual reviews and when projections fall below the 120% target, by imposing a hierarchy of modifications to restore funding to the 120% target. Such modifications would begin with the traditional approach of negotiating contribution increases and/or adjusting future benefit accrual rates. More substantial modifications which resemble changes to adjustable benefits under the Pension Protection Act and Multiemployer Pension Reform Act are available to return the plan to fiscal health if substantial market corrections occur. Under this hierarchy of benefit reductions, the normal retirement benefit paid at normal retirement age would only be at risk in the event of a catastrophic market event such as the recession of 2008 – 09 and then, only in the event the plan were projected to become insolvent.

In sum, the proposal would allow (not require) joint labor and management trustees to consider converting their defined benefit plans to a composite plan design that combines the best features of the defined benefit and defined contribution models for workers, and rebalanced plan funding risk for employers contributing to the plans – keeping employers in the system and attracting new ones. By ensuring greater employer participation in secure retirement plans our industry can also address the related problem of growing workforce deficits. Absent these essential reforms ongoing economic and asset value volatility and mounting adverse demographic challenges will continue to erode the stability of the system at an increasing pace. Furthermore, competitive pressures will press employers to leave the system and the active workers who have borne the brunt of the cost increases to fund past generations at the expense of their own retirement security will feel no choice but to consider conversion to a less secure defined contribution plan.

In fact, making proposed composite plan design available can help plan sponsors avoid the fate that currently faces critical and declining plans. The trustees of critical and declining plans have determined that the only option to preserve benefits for all participants above those they would receive if the plans were allowed to become insolvent is to judiciously cut benefits now to preserve plan assets for the greater number of participants and avoid becoming insolvent which would require even more drastic benefits cuts for all.

We are all aware of the devastating impact those remedies will have for affected retirees, and we are truly empathetic that this "least-worst" option had to be adopted in MPRA to avert an overall system meltdown. We believe that the enactment of legislation permitting composite plans will help to preserve existing multiemployer defined benefit plans by keeping employers and employees in the system and committed to funding legacy defined benefit plans. The composite design will insure lifetime retirement income for retirees in place of the current defined contribution alternative to defined benefit plans.

So, in the interest of sound and modern pension policy for the Nation's 1400 multiemployer plans covering some 10.5 million participants and their families, please support enactment of the new composite plan design option as proposed in the ***Solutions Not Bailouts*** legislative proposal and help us move our multiemployer retirement security benefit system to much safer ground.

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