Guiding Principles to Protect the Members of the Central States, Southeast and Southwest Areas Pension Fund

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Current leaders of the Central States, Southeast and Southwest Areas Pension Fund (hereafter called "Central States") apparently believe that Central States is in such a financial crisis that drastic benefits reductions must be imposed immediately, regardless of the hardship that Central States' members would suffer. Leaders of Central States have proposed a "rescue plan" to slash pension benefits by up to 60% at once. They argue that there are no viable alternatives to this rescue plan.

In truth, the only urgent matter is the dire threat of this rescue plan to Central States' members. The financial condition of Central States does not require immediate action. Furthermore, there certainly are preferable alternatives to the rescue plan itself; and if significant cuts to the pension benefits of Central States' members prove necessary, the cuts should be made only after measures are put in place to offset the financial impacts on members and their families. Thus, the U.S. Department of Treasury should reject Central States' rescue plan to allow time for responsible parties to develop a comprehensive set of solutions to protect the members of Central States and other multi-employer pension funds, as well.

This document suggests "Guiding Principles" to protect Central States' members. Individually and collectively, the guiding principles are "works-in-progress," subject to criticism and improvement by one and all. This document, then, is merely intended to contribute to a thoughtful and constructive dialogue about the complex challenges facing Central States and federal agencies so that consensus on positive solutions can be achieved.

Guiding Principles

1. The goal should be a "grand bargain." Karen Friedman of the Pension Rights Center called for a "grand bargain" on Central States and other multi-employer pension funds. That all parties should reach for a "grand bargain"— one that is comprehensive in scope and encompassing in buy-in – is the first guiding principle. A "grand bargain" would include commitments among pension funds, employers, unions, active employees, and retirees that are durable and mutually beneficial; and a "grand bargain" must include a substantial re-commitment by the federal government to protecting the retirement incomes of more than 10 million members of multi-employer pension funds.

2. Striking a "grand bargain" need not be rushed; Central States has ample time. Central States' management says that, without any pension benefit cuts, pension obligations could be fully paid for ten more years. This is uncertain. It could be more or less than ten years depending on multiple factors, including investment performance, employer participation and retirements. Given this uncertainty, and the number and complexity of issues, it seems that a timeframe of two years to strike and implement a "grand bargain" would be reasonable. It is more likely than not that in 2018, Central States will still have sufficient assets and time for financial restructuring.

3. The Multiemployer Pension Reform Act of 2014 is contrary to a "grand bargain"; it should be repealed or substantially amended. The Multiemployer Pension Reform Act (MPRA) invites pension funds in "critical or declining" condition to slash pension benefits already earned by their members (subject to approval by the U.S. Department of Treasury, but not approval by the pension funds' membership). MPRA was Congress's response to reports that numerous multi-employer pension funds were at risk of future insolvency – instead of honoring its historical commitment to workers and retirees, Congress eliminated a crucial protection that had existed under federal law since 1974. The premise of MPRA is simplistic and harsh -- *if a pension fund has a large unfunded liability, its leaders should be able to cut earned pension benefits without the consent of the membership.* By passing this law, Congress essentially told members of multi-employer pension funds, "No, you don't get a 'grand bargain'; instead your pension funds get permission to break their trust with you."

Apparently, the author of MPRA, Representative John Kline (R-MN), deems it insufficient. On March 15, 2016, as Chairman of the House Education and Workforce Committee, he implored the Secretary of Labor to commit to additional reforms to modernize the multi-employer pension system. Additional reforms certainly are a good idea – repeal or substantial amendment of MPRA should be among those reforms. Presently, MPRA dictates a process that is cumbersome, undemocratic and hostile; and the outcome of this process cannot be positive for the long-term financial health of a pension fund.

4. Central States' members need a "grand bargain," not the proposed "rescue plan." Central States was the first multi-employer pension fund to submit an application to the U.S. Department of Treasury under MPRA. Ironically, Central States' leaders call their proposal "the rescue plan." It is nothing like a rescue plan. First, dropping financial bombs on innocent people is no way to rescue them. (Sudden pension income losses of up to 60% most certainly would be "financial bombs" hitting Central States' members.) Second, Central States' leaders have little confidence that this plan would actually rescue their pension fund even after causing devastating harm to its members. With approval of their massive cuts in member payments, Central States' leaders think that the pension fund would have only a fifty-fifty chance of solvency in ten years.

A real rescue plan would be like the "grand bargain" – sufficient, durable, equitable and humane. Its goals would be absolutely positive; delaying negative outcomes would not be good enough. A real rescue plan would fix not only Central States, but it would fix the federal apparatus that is supposed to safeguard the pensions of Central States' members. A real rescue plan is achievable.

5. First, the confidence of employers and members in the leadership of Central States must be restored. The Board of Trustees and managers of Central States have lost the trust and confidence of their employers and members. The success of any rescue plan will depend largely on the support of employers and active workers that are the source of pension contributions. Their support will be delivered only if they believe that their leaders can and will effectively direct Central States to long-term viability; and they must also believe that their Trustees and managers are committed to honest communication and participatory deliberations about critical issues. It is unlikely that these conditions can be achieved with the current roster of Trustees and managers. Temporary receivership and contracted managers might be needed.

6. Central States should engage the "best and brightest" independent experts to develop and implement a turn-around plan. There may be valuable improvements that can be made in the areas of internal operations and costs, performance of investment managers, terms of employer participation, strategies to stabilize and increase the number of participating employers and members, and more. The stakes are too high to not bring in the fresh perspectives and insights of experts who have successfully turned around other troubled pension funds. And their charge must be more ambitious than finding reasonable measures to reduce the potential for insolvency. Their charge must be to find and implement improvements that cause employers and employees to be optimistic about their futures with Central States.

7. Central States should empanel pension fund experts, members and employers to design a new contribution and benefits structure that is prudent, flexible, equitable and humane. The proposed rescue plan has none of these positive characteristics. Independent pension fund experts should lead a redesign project that encompasses all aspects of the financial participation of employers and members. The involvement of current retirees, active workers, and employers in this redesign project is crucial, for they are best qualified to reach a durable consensus on the trade-offs related to flexibility, equity and humaneness. This redesign project is likely to result in benefit reductions, but the process and outcomes would be more broadly accepted than the proposed rescue plan.

8. Central States and its federal overseers should reconsider their faith in large financial institutions to act as managers of Central States' assets. Personnel assigned by large financial institutions are not necessarily competent or trustworthy. Even when they are, conventional wisdom, institutional prejudices, and over-confidence lead to sub-optimal results. Central States cannot afford to be without a deep and talented team whose only job is to oversee asset management, and whose only allegiance is to Central States.

Central States' asset management team should be bold and progressive. The team should look for opportunities to make investments that support and grow the companies that employ Central States' members. Some may say, "Not again!" Everybody should say that. It must be mandatory that any such investments are subjected to an extraordinary process of rigorous third-party due diligence. Only those investments that are found to have risk/reward profiles that are at least as good as alternative investments should be approved.

It has been shown in recent years that Wall Street financial institutions often put their own self-interest ahead of their institutional clients' interest. Would it not be better for Central States to make prudent investments that generate competitive yields and also support Central States' employers?

9. Congress and federal agencies should reaffirm their commitment to defined-benefit pension funds (or abandon that commitment honestly and finally). Americans are not confident in the future of Social Security. Americans do not trust Wall Street financial institutions or personal financial advisors, and they generally do not save and invest enough for retirement on their own. Defined-benefit pension funds could become important again as a "leg" of the three-legged retirement stool (along with individual savings and Social Security); and pension funds could again become effective vehicles to promote mutual loyalty among employers, employees and unions.

The federal government's apparent ambivalence impedes a resurgence of defined-benefit pension funds. With respect to Central States, the federal government's performance undermines the prospects for a successful financial recovery because Central States' members and their employers lack confidence in the apparatus of the 1982 Consent Decree and the Pension Benefit Guaranty Corporation. This would be a good time for the federal government to demonstrate its commitment to effectively oversee Central States and safeguard members' pensions.

10. Congress, the General Accountability Office and other federal agencies should continue to conduct investigations and hearings until they figure out how to correct mistakes made in federal oversight of Central States. In 1982, the federal government persuaded Central States to accept a consent decree which put Central States under the oversight of the U.S. Department of Labor and a Special Independent Counsel. Asset management responsibilities were given to "named fiduciaries" and investment managers selected or approved by federal officials. The Central States Board of Trustees retained some authority and responsibilities; how these evolved in practice over 34 years might be hard to trace.

Obviously, mistakes were made in designing this complicated, fractured arrangement, and the performance of Central States has suffered as a result. Now, however, the focus should not be on placing blame. Instead, ample time and resources should be dedicated to redesigning the entire apparatus put in place with the 1982 Consent Decree to achieve more effective authority, execution, oversight and accountability. This effort has the potential to significantly improve the financial performance and long-term viability of Central States.

11. Given the federal government's extraordinary role since 1982, the federal government should accept extraordinary obligations to the members of Central States. With the 1982 Consent Decree, the federal government promised to safeguard the pensions of Central States' members by ensuring financial and administrative integrity and by providing expert asset management in the best interest of the membership. This promise has not been kept, and some form of compensatory financial support is justified.

Yes, such financial support could be a straight "bail-out" of Central States. Alternatively, it could be tax credits, additional Social Security benefits or supplemental monthly payment from the Pension Benefit Guaranty Corporation to members that take voluntary or forced pension benefit reductions. The financial support could also be directed to participating employers in the form of tax benefits, loans, loan guaranties, or risk-pooling mechanisms to help employers make their pension contributions and remain as employers in good standing.

12. The Pension Benefit Guaranty Corporation is an essential federal commitment to pension fund members. The Pension Benefit Guaranty Corporation (PBGC) is a federal agency that was created by Congress in 1974. Its purpose is to encourage continuation of private-sector defined-benefit pension funds by guarantying pension benefits to their members. The PBGC has two programs – one for single-employer pension funds, and one for multi-employer pension funds. Functioning somewhat like an insurance company, the PBGC charges premiums to "guaranty" retirement income for pension fund members. (Oddly, premiums are set by Congress rather than by executive officers or the Board of Directors.) In the event that a pension fund goes bankrupt, the PBGC pays monthly benefits to the retired members of the bankrupt pension fund.

The demands on the PBGC program for multi-employer pension funds could increase significantly. The Pension Rights Center reports that 52 multi-employer pension funds have filed "critical and declining" status notices with the U.S. Department of Labor (as of February 10, 2016). Some of these multi-employer pension funds are likely to fail in the next ten to twenty years. Their members will suffer greatly if there is not a viable PBGC program to replace their lost retirement income.

13. The PBGC program for multi-employer pension funds must be redesigned to fulfill its purposes. The PBGC program for multi-employer pension funds has been neglected and underfunded. It is supposed to provide substantial replacement income to members of bankrupt pension funds, but it presently offers only up to $12,870/year to these unfortunate retirees. Furthermore, even that replacement income is not secure – some financial projections apparently indicate that the PBGC multi-employer program itself would go bankrupt if Central States fails. (To date, Central States has paid premiums to the PBGC for 42 years, and Central States is paying premiums still for what may be a false promise to its members.)

There is agreement across the political spectrum that something needs to be done. The PBGC Director suggests that the multi-employer program needs alternative premium structures to simultaneously increase revenues and encourage employers to remain in underfunded multi-employer pension funds. The conservative Heritage Foundation concluded in an article that "Congress should swiftly enact reforms that bolster the solvency of multiemployer pension plans and maximize the PBGC's ability to make good on its insured benefits."

The PBGC multi-employer program had an estimated unfunded liability of $52.3 billion at the end of FY 2015. Fixing this may require entirely new revenue sources. There are options, such as: revenues from a financial transaction tax (which, at a rate of 0.01%, would raise $185 billion over ten years); a small split of corporate income taxes as tax rates are reduced in stages; and a new tax on corporate sales or assets of companies completing inversions.

It certainly makes sense to increase revenue from premiums to reduce the unfunded liability of the PBGC multi-employer program, but only companies that still participate in multi-employer pension funds would bear additional costs (to the extent that pension funds are able to pass through PBGC premium increases to employers). It might be a good idea to also raise revenues from companies that have abandoned defined-benefit pension funds. The options mentioned above would expand the revenue base in this manner imperfectly. There surely are more options worth considering.

14. Central States and other multi-employer pension funds need attention now, but they don't need drastic action now. The challenges are complex and multi-faceted. If the only tool Congress provides to address these challenges is the sharp hatchet of the Multiemployer Pension Reform Act, then the outcomes will be devastating hardship to tens of millions of retirees, their families, and their communities; unabated financial insecurity for America's working class; and a weakened national economy. Before that hatchet is used even once, time and resources should be devoted to developing a set of tools that can achieve humane and productive outcomes.

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