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Multiemployer Plans – A Tale of Two Countries…

A cause of, or solution to, your pension problems depending on where you hail from—a look at U.S. and Dutch multiemployer plans.

By Elizabeth Mack

Multiemployer plans are a fascinating idea—pool together the pensions of employees in a certain industry into one plan. Employers then buy into this plan by paying a set contribution for a future pension benefit for their employees. Once this contribution is paid, their obligation is satisfied and no liability exists on the balance sheet the way a typical defined benefit (DB) plan is accounted for. In fact, according to US GAAP and IAS19, multiemployer plans are accounted for as defined contribution (DC) plans. This is a convenient way for employers to offer a defined benefit program with a defined contribution risk. Or is it?

This article explores multiemployer plans in both the United States and the Netherlands and discusses factors that have made them thrive or flounder.

A U.S. VIEW

Multiemployer plans in the United States are generally for blue collar workers in industries like trucking, maritime, entertainment, manufacturing, retail, mining, etc. There are over 1,500 active multiemployer defined benefit pension plans (10 percent of the total defined benefit plans in the United States) covering over 10 million participants (25 percent of DB plan participants in the United States). When a company joins a multiemployer plan, they have little control over the plan, such as administration, which is handled by a board of trustees composed equally of labor and management. It is this board which determines the contribution levels which actuaries then translate into a benefit. Certain industries negotiate the benefit levels during their collective bargaining. When employees leave their company but remain in the same industry, their pension is generally unaffected by their move, incorporating a valuable portability feature into the plan.

This description sounds simple and beneficial for both employers and employees, however, in the United States, the majority of multiemployer plans are dangerously underfunded. This is due to a number of reasons. More than half the firms that led their industries in 1955 remained industry leaders in 1990, but since then more than two thirds of the 1990s market leaders no longer existed in 2004. Multiemployer member firms that go out of business "orphan" their pension obligations with the fund—as this happens over and over, the situation becomes dire. In the 1990s the majority of multiemployer plans reported assets exceeding 90 percent of liabilities, but statistics as of late show that the portion of multiemployer plans less than 80 percent funded rose from 23 percent of plans in 2008 to 68 percent of plans in 2009.

We only have to look at the market to see why underfunding is becoming so prevalent. In addition to companies going out of business, there is a decline of unionized workers in many sectors and an ageing population. The financial crisis has only added to the unfortunate circumstances and plans are slow or unable to make changes as complex negotiations often must first take place.

That's the situation in the United States—generally multiemployer plans are considered doomed. So, from a U.S. perspective how could multiemployer plans work? Is it unthinkable they could even flourish? If this was a movie, we'd cue the dramatic music and view the dark storm clouds over the United States. Then we'd zoom partway around the world to the Netherlands where the sky is blue and birds are singing and people are cheerily praising the benefits and lauding multiemployer plans while consultants advise that your company join one.

"Why are companies in the Netherlands considering joining industry wide funds, while American firms are trying to extricate themselves from theirs?"

A DUTCH VIEW

In the Netherlands, DB plans are also in decline, but at a slower rate than the United States and the rest of the world. Plans in the Netherlands are also, on average, always funded well over 100 percent of the liabilites. The financial crisis has been felt in Europe and the Netherlands, but the funding standards are different. Plans in the Netherlands must, in general, be funded at a minimum level of 105 percent of liabilities. Not only is 105 percent a minimum funding level, the required funding level is much higher, often around 120 percent or more depending on their benefits (such as indexation) and investment risk (percentage invested in equities). There are two types of multiemployer plans in the Netherlands – compulsory and non-compulsory industry wide pension funds. For the sake of completeness, I'll mention that there is a third type of "multiemployer plan"—a company fund may also have other participating employers in the fund if the firms work closely together, but this area is not the topic of this discussion.

In the Netherlands, around 80 compulsory industry wide funds currently exist which have around 11 million participants or over 80 percent of Dutch employees who participate in a pension fund.

Because employees who fall into certain employment categories must mandatorily participate, there is no shortage of employees in these funds. If a firm would like to opt out of a mandatory fund, they must prove that the fund is doing poorly which provides extra incentive for funds to do well. This is the opposite situation from the United States, where the fund doing poorly makes it extremely expensive for a firm to exit.

In the Netherlands, if a firm is found to not participate in a multiemployer fund which it should have joined it can face steep penalties. These penalties can include retroactive contributions of five years minimum and 20 years maximum.

Contributions of the employer and employee are set conservatively, often over 20 percent of pay, so the funds don't lack incoming cash flow. As soon as funding levels begin to look threatening, the Board immediately takes action with recovery plans or if funding hits below 105 percent, more drastic measures such as cuts in benefits are considered and quickly implemented. This is another key difference in Dutch pensions—the pension fund functions as a company and has separate advisors and an independent board.

Currently in the Netherlands, many firms are deciding if they should merge their private pension plan into a multiemployer plan. The advantages are certainly there—joining a fund eliminates both assets and liabilities from the balance sheet and leads to very stable contributions. All risk is transferred from the company to the industry-wide plan, which then buffers the risk and volatility for the firm. Lastly, administrative burden is nearly eliminated.

The considerations of joining a multiemployer fund include losing out on upside potential, giving up control over benefit design and loss of some employee/firm identity. If a company plan is already in place, the transition can be time consuming and complex. If other companies were to be unable to fulfill their obligations, then that risk must be shared among the remaining companies, the same as in the United States.

Why are companies in the Netherlands considering joining industry wide funds, while American firms are trying to extricate themselves from theirs? There are the three main things that make multiemployer plans a success in the Netherlands, underfunding isn't

tolerated and plans are both mandatory and commonly used so the concept that young subsidizes the old does not (currently) pose a problem. The third factor is that the Dutch are a conservative bunch—they see far fewer firms going out of business (and subsequently orphaning their pensions) than their less risk averse U.S. counterparts.

WHAT'S NEXT IN THE UNITED STATES?

In the United States, the pension situation continues to decline. Many companies in multiemployer plans face rapidly increasing contributions which will mainly be paid toward the legacy liabilities rather than current employees. As companies withdraw, the pools get smaller. If enough sponsoring employers decide to withdraw, a mass withdrawal will occur which can be very expensive for all firms involved.

At this stage, it doesn't seem possible to have a healthy multiemployer system in the United States. Before the system could recover a few things would have to change: 1) more regulation—requiring companies to join and broadening the workforce to ensure steady participation 2) change the stigma that multi-employer plans have. If we could accomplish #1, then #2 would likely follow, but in a country where there are frequent debates about the right level of government intervention, adding more regulation could take years and maybe never even happen.

What can be taken from this article is that there are different approaches to pensions around the world. Perhaps by learning more about different systems, we can come up with an innovative solution to the U.S. pension situation. ☐

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