Comparing Union-Sponsored and Private Pension Plans: How Safe Are Workers' Retirements?

DIANA FURCHTGOTT-ROTH
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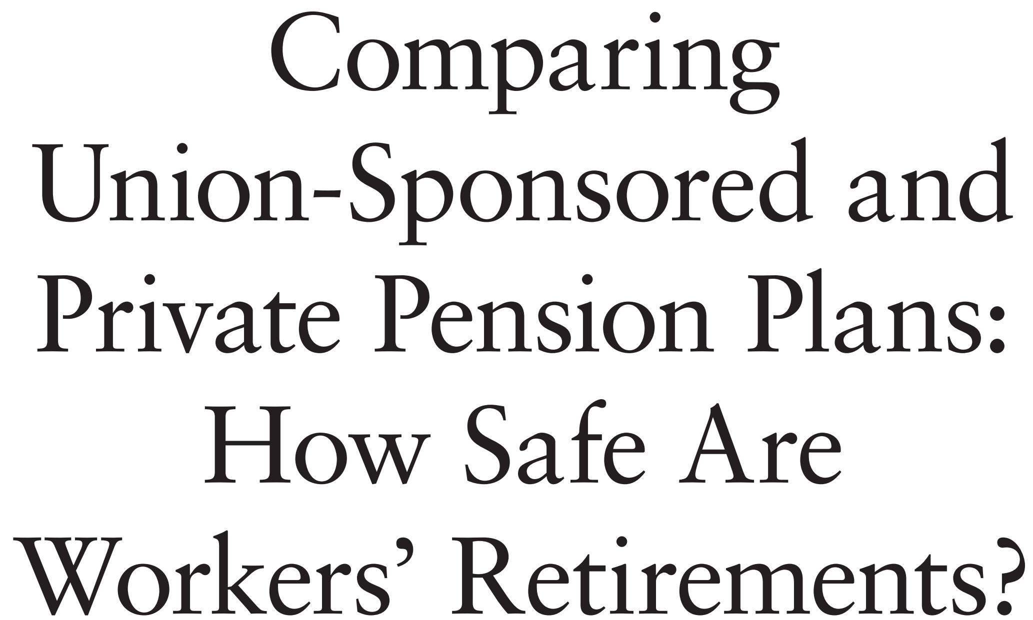

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The authors are grateful for the research assistance of Astha Shrestha. The views expressed in the paper are those of the authors alone, and do not necessarily reflect those of any other party. The authors take responsibility for all errors.

Table of Contents

I. Introduction 1

II. Executive Summary 1

III. What are Pensions? 4

IV. Trends in Pension Coverage 7

V. Sources of Information on Pension Plans 10

VI. General Health of Pension Plans in the United States 11

VII. Why Union Plans Tend to Perform More Poorly 16

VIII. Small Plans 19

IX. Rank-and-File Versus Officer Pension Plans 21

X. Underfunded Pensions and the Employee Free Choice Act 23

XI. Political Spending 25

XII. Eight Case Histories 28

Service Employees International Union *28*

E.I. DuPont *29*

International Brotherhood of Teamsters *30*

Plumbers and Pipefitters *32*

Southern California, Arizona, Colorado and Nevada Glaziers *33*

United Auto Workers *34*

Sheet Metal Workers *35*

UNITE Here Fund Administrators, Inc. *37*

XIII. Conclusions 39

Appendix I: How Do Pensions Work? 42

Appendix II: The Pension Protection Act 45

Appendix III: Data 46

Bibliography 47

Endnotes 50

List of Tables and Charts

Chart 1 – Number of Pension Plans over Time 7

Chart 2 – Number of Pension Plans Sponsored by Single Employers over Time 8

Chart 3 – Number of Multiemployer Pension Plans over Time 9

Chart 4 – Average Ratio of Assets to Liabilities for Large Defined Benefit Plans 11

Chart 5 – Percent of Large Defined Benefit Plans That Are Fully Funded 12

Chart 6 – Percent of Large Defined Benefit Plans In Endangered Condition 13

Chart 7 – Percent of Large Defined Benefit Plans in Critical Condition 13

Chart 8 – Percent of Underfunded Plans Paying At Least Minimum Annual Charges 14

Chart 9 – Percent of Plans in Critical Condition Paying At Least Minimum Annual Charges 15

Chart 10 – Percent of Large Defined Benefit Pensions Making Additional Contributions Because of Funding Deficiency 15

Chart 11 – Average Annual Payment To Correct Funding Deficiency 16

Chart 12 – Percent of Large Single Employer Defined Benefit Plans That Are Fully Funded 17

Chart 13 – Percent of Small Defined Benefit Plans That Are Collectively Bargained 20

Chart 14 – Percent of Large Defined Benefit Plans That Are Collectively Bargained 20

Chart 15 – Average Number of Participants in Small Defined Benefit Pension Plans 21

I. Introduction

With union membership down to only 8 percent of private sector workers—or 12 percent of employed wage and salary workers—unions are doing their best to recruit new members. The advertised benefits of joining a union sound appealing: unions claim time and time again that their members are more likely to have health insurance, defined benefit pension plans, and higher wages.

What unions do not tell prospective recruits is that there is a widespread pattern of poor performance among collectively-bargained defined benefit pension plans. They perform poorly when compared to plans sponsored unilaterally by single employers for non-union employees. And pensions sponsored by unions that cover many employers (multiemployer plans) fare worse than pensions offered by a single employer under a collective bargaining agreement with a union. This disparity raises an important question: is the promise of a union-run pension plan a valuable one? To put it another way, do union pension plans have provisions to ensure that they remain sufficiently funded to pay the generous retirement benefits that unions advertise as part of the union benefits package?

This paper offers explanatory background information on pensions, including sources of information, reporting and disclosure requirements of Congress and the U.S. Department of Labor, and data and analysis that illuminate the causes of the underlying problem of underfunding. The study goes on to analyze the general health of pension plans in the United States and, in particular, documents eight case histories that illustrate issues in pension funding. It also examines the role political interests may play in union membership and pension funding, and it analyzes the link between legislation now pending in Congress, the Employee Free Choice Act, and underfunding of pensions. The paper will present evidence of the disparity between union and non-union pension plans, and call on union members to recognize their leaders' responsibility to close that gap.

II. Executive Summary

Unions recruit new members by claiming that their members are more likely to have health insurance, defined benefit pension plans, and higher wages. However, an analysis of the financial status of individual pension plans shows that collectively bargained pension plans perform poorly when compared to plans sponsored unilaterally by single employers for non-union employees.

Pensions are regular payments made to retired workers from money that they and their employers put aside during their working years. Pensions come in two broad categories: defined benefit pensions, and defined contribution pensions. A defined benefit pen-

sion promises a specific monthly stipend for a retiree's lifetime, calculated using the number of years worked and some measure of workers' earnings over that time. A defined contribution pension sets up personal investment accounts; typically, the employee can make some choices about how the money in his account is invested.

Data for 2006, the latest full year of data available, show that union-negotiated pension plans fare consistently worse than their non-union counterparts. Among large plans – plans with 100 or more participants – 35 percent of non-union plans were fully funded, as compared to 17 percent of fully funded union plans. While a pension plan need not necessarily be fully funded at any given time to be stable, the Pension Protection Act of 2006 considers funds with less than 80 percent of their needed assets to be in "endangered" status. While 86 percent of non-union funds had 80 percent or more funds needed to pay expected costs, only 59 percent of union funds met the funding threshold. Similarly, while only 1 percent of non-union plans had less than 65 percent of required assets, also called "critical" status in the 2006 Act, 13 percent of union plans were critical.

The problems with collectively bargained pension plans extend even to smaller plans. Of non-union plans, 61 percent were fully funded, compared to 25 percent of union plans. Both union and non-union small plans were about as likely as their larger counterparts to have funding ratios below 80 percent. Fifteen percent of the small union plans were in critical condition, more than twice the ratio of small non-union plans.

Union leaders have contributed to this problem by negotiating for pension plans that are more generous than can be afforded, often seeking pension increases in the face of consistent employer complaints about costs. While union leaders have many incentives to bargain for increased benefits, they have few incentives to ensure that these benefits can be easily paid for. However, this is not the case with staff and officer pension plans.

Our analysis of 30 staff and officer pension plans relating to some of the largest 46 rank-and-file pension plans shows that officer pension plans may be better funded than those for rank-and-file. On average, the rank-and-file pension plans had 79 percent of funds needed to cover their obligations. Nine of the pensions were fully funded, while 24 were less than 80 percent funded. This is in contrast with the officer plans, which were 93 percent funded on average. While nine of the pensions were fully funded, eight were less than 80 percent funded.

Labor unions have been found to have contributed more than $130 million to the 2008 Senate, House and presidential election cycles. While there is nothing wrong with unions seeking to influence election cycles, it is important to note where this money came from and who decided how to spend it. The SEIU has been explicitly demanding that its membership finance its political agenda. Political spending, by law, is supposed to come from voluntary contributions, not the dues that members are required to pay. If unions divert dues money to political activity, union members may discover that their dues were earmarked to support candidates they oppose.

Eight union pension funds are analyzed as examples. The Plumbers' board of trustees has kept their contributions above normal costs, but they have regularly been using cred-

its to put off needed contributions towards shortfalls. Although the Sheet Metal Workers' leadership successfully lobbied for more benefits before 2008, they were not able to secure them, leading to reductions in many "adjustable" benefits. The South Carolina, Arizona, Colorado & Southern Nevada Glaziers, Architectural Metal & Glass Workers pension plan administrators made poor investment choices, leading to investment losses.

Until the passage of the Pension Protection Act of 2006, it was difficult to ensure that contributions matched liabilities. The Act has exposed more than 300 poorly funded plans, forcing them to take account of their insecure positions and to make efforts to rebuild since 2008.

However, the real problem is the opacity of union pension financing and the lack of accountability required of union leaders. Union members have few assurances that the trustees of their pension funds are truly acting in their best interest. The continued poor status of union-run pension plans suggests that union trustees are not adequately working towards ensuring that rank-and-file members have the stable financial futures they deserve.

III. What are Pensions?

Pensions are regular payments made to retired workers from money that they and their employers put aside during their working years. (In the United States, the best-known pensions are the monthly Social Security benefits that the federal government pays. However, they are not funded in the way that employer pensions are.) As well as Social Security, some workers have nongovernment pensions earned during their years of employment in the private sector; others have pensions earned working for state, local or federal government. In addition to these pensions, many Americans have retirement assets in the form of tax-favored savings accounts, such as Individual Retirement Accounts and 401(k) plans, some of which have contributions from past and current employers. In recent decades, there has been a steady decline in the number (and proportion) of private employers that offer pensions that promise a specific monthly retirement benefit.

All types of pensions can be considered deferred compensation— that is, a part of a worker's earnings not paid immediately. In an age when workers were expected to work at one company for most of their working lives, this was a useful tool to encourage company loyalty and get workers invested in staying on for many years. For workers, the promise of regular retirement income was attractive, and so they would work for an employer for decades, sometimes keeping a job that they found disagreeable or barely tolerable. Many pensions are not legally owed to a worker until he has worked at a company for several years, when the pension becomes "vested."

Pensions come in two broad categories: defined benefit pensions and defined contribution pensions. A defined benefit pension promises a specific monthly stipend for a retiree's lifetime. This sum is often calculated by using the number of years worked and some measure of the worker's earnings over that time. The worker may or may not contribute to the pension plans, but the employer always contributes.

A defined contribution pension plan sets up an investment account for each worker. If it is a "contributory" plan, the worker contributes part of each paycheck—perhaps four or five percent—into the account. The employer may make so-called "matching" contributions, although the term is something of a misnomer because the employer's payment is often less than the worker's, perhaps one-third or one-half. The money in the defined contribution account, often known as a 401(k) account, is invested and appreciates over time. How much retirement income the defined contribution account will generate depends on the amounts invested, choice of asset and how well it performs, and years invested.

The sponsor of a defined benefit plan (usually an employer, but see below) is required to make payments to retirees at the rate specified by the terms of the pension plan. The 1974 Employee Retirement Income Security Act (henceforth referred to as ERISA) dictated that sponsors must prepare to meet these future obligations by funding them beforehand—contributing a certain amount of money per participant every year into a pooled investment account.

The sponsor is meant to invest this money wisely in order to accumulate enough funds to pay promised benefits when they come due. This approach requires companies to predict how much they will pay into the fund in the future. These calculations, especially the future value of present contributions, make managing a defined benefit plan complicated. A financial manager (usually an institution) is hired to make investment decisions so that the fund will grow enough to meet the sponsor's future pension obligations to its employees.

Defined contribution plans create more predictable costs for employers, who, in collective bargaining contracts, normally agree to make contributions of a certain size, or to match employee contributions to a certain extent.

Upon retirement, holders of defined contribution accounts can purchase "annuities"—contractual promises by financial institutions, often insurance companies, to pay a certain amount of money every month for the rest of the holders' lives. Or retirees can simply withdraw the money and consume it at their own pace. If they buy an annuity, they effectively transform their defined contribution plans into defined benefit plans.

Some people prefer defined benefit plans because an employer is usually liable for the specific promised future benefits. However, there is usually a risk that a company will fail, even a big, "blue chip" company like General Motors, which went into bankruptcy in 2009. Even if employers become bankrupt, the pension fund cannot be used to pay off creditors. Sometimes, retired workers can expect the U.S. government's Pension Benefit Guaranty Corporation to pay their benefits, in part if not in full.

In contrast, participants in a defined contribution plan have a legal claim on the money they have contributed from their paychecks to personal accounts, as well as the investment return on this money. Workers have some say over how the money is invested—in bonds, stocks, or a mixture. Moreover, defined contribution plans are portable; workers take them when they change jobs. This is an important consideration in an economy in which lifetime employment is becoming increasingly uncommon. With portable accounts, workers are free to move to more attractive jobs. Of course, there are drawbacks to defined contribution plans. Without possibly costly investment advice, a worker may not have the expertise to invest his or her account wisely. And securities market downturns make the worker's retirement income vulnerable, especially if the worker retires when securities prices are falling steeply, as in the winter of 2008-09.

Unions often advocate defined benefit plans in part because they prefer employers to bear the risk of supporting the rank-and-file's retirement. However, as mentioned above, defined benefit plans have the effect of requiring workers to stay at unionized jobs in the same industry for most of their working lives, to maximize their retirement income. Unions that negotiate defined benefit plans create strong incentives for union workers not to leave for non-union jobs and to continue to contribute to the defined benefit fund. In other words, defined benefit plans may contribute to union security.

Another important distinction in pension accounting is the differences between "single-employer," "multiemployer," and "multiple-employer" pension plans. A single-employer

plan is sponsored by one firm to support the retirement of its workers. Single-employer plans may be adopted unilaterally by private employers or be created by negotiation with labor unions. Collectively-bargained single-employer pension plans are managed by the employer. While sums to be contributed may be negotiated, the employer is responsible for the health of the fund, and the employer (or designated fiduciary) makes all investment decisions.

Multiemployer pension plans are created and sponsored by a labor union in order to provide retirement income for workers in several different places of employment. This requires the union, the sponsor of the plan, to negotiate with each employer to join and contribute to the fund. They are often called "Taft-Hartley plans," and are managed by a board of trustees, which consists of an equal number of union and employer representatives[1]. The union negotiates with each employer and the board to determine contribution levels, and the board determines the level of benefits and manages the fund.

Finally, a multiple-employer pension plan is usually adopted by a parent company to provide pensions for employees in its affiliated companies. Trade associations or other groups of employers may also choose to form multiple-employer pension plans.

The rationale behind multiemployer and multiple-employer pension plans is that they allow firms to pool risk among several employers. Multiemployer pension plans allow workers to keep their pensions if they change jobs to another participating company. This consolidates union pension contributions into larger investment pools. Multiple-employer pension plans allow parent companies to transfer covered workers between subsidiaries with minimal paperwork.

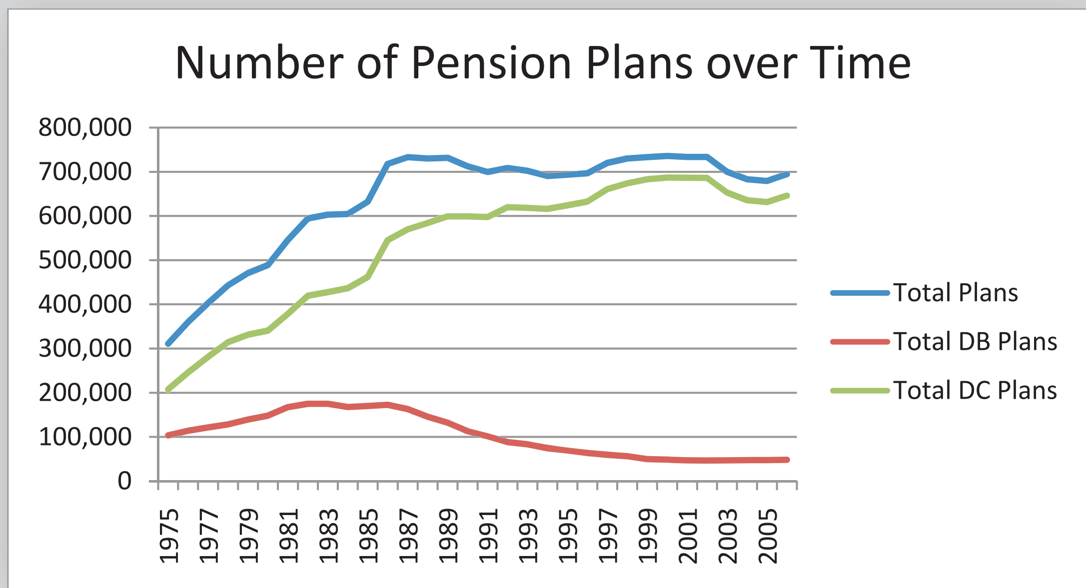
IV. Trends in Pension Coverage

In 1976, defined benefit plans accounted for nearly one-third of the 359,980 pension plans in existence in the United States. By 2006, about 7 percent of the 694,550 plans registered were defined benefit pensions. Defined benefit plans paid benefits to 22 million people in 2006, and covered another 20 million current workers. Over the past thirty years, while the number of total pension plans has nearly doubled, the number of defined benefit plans has fallen from a 1983 high of 175,000 plans to 48,600.

These shifts occurred for several reasons. First, workers began to view pension plans as an integral part of the compensation package. The growth in both defined benefit and defined contribution plans until 1983 indicates that employers were more generous with their offerings during this period. But since 1983, the number of defined benefit pension plans has fallen, while the number of defined contribution plans has increased and stabilized at about 650,000. *(See Chart 1)* These changes were due to shifts in the preferences of both employees and employers.

First, it became more common for employees to hold several jobs over their lifetime, making defined contribution plans more attractive for their portability. Second, employers began to view the long-term costs and liabilities of defined benefit pensions as uncertain and undesirable, and they developed a preference for the predictable annual costs of defined contribution plans.

Chart 1



Source: U.S. Department of Labor, "Private Pension Plan Bulletin Historical Tables and Graphs" http://www.dol.gov/ebsa/pdf/1975-2006historicaltables.pdf

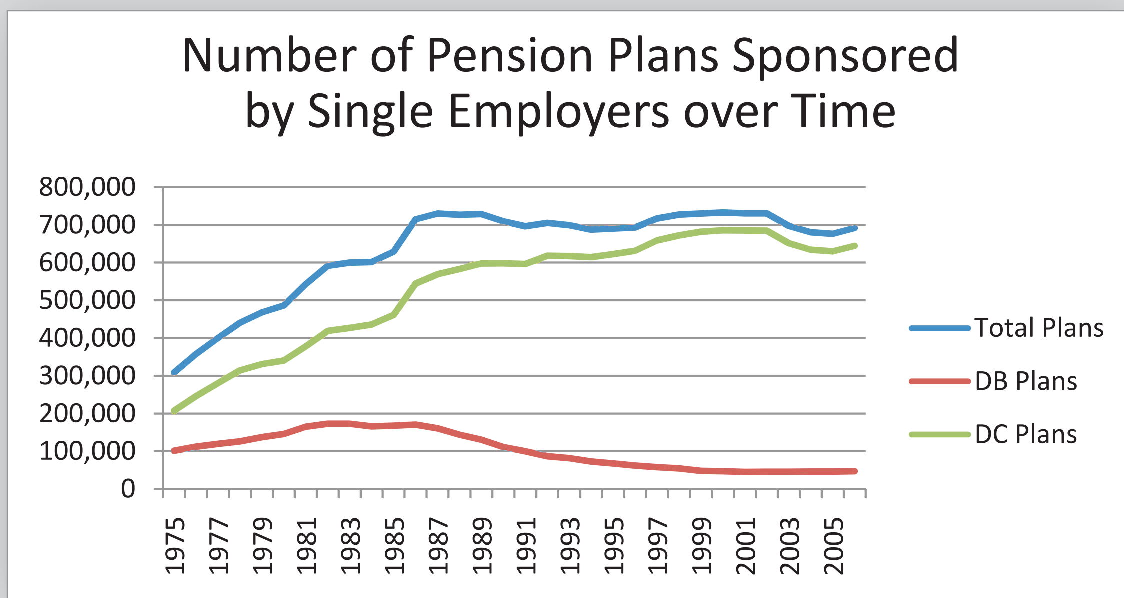
Single-employer plans, especially, have driven these shifts because most plans covering many firms are multiemployer plans, and tend to be union-run. Unions favor defined benefit plans, even if they do sometimes negotiate the creation of a defined contribution plan. *Chart 2* shows that single employers have strongly embraced the defined contribution plan as the preferred method of paying deferred compensation.

Chart 3 demonstrates how these trends have affected multiemployer pensions. While it is difficult for a single employer, much less several, to separate themselves from a collectively-bargained agreement, multiemployer pension plans have also begun to shift towards defined contribution plans. In 2006, over half of the 3,037 multiemployer pension plans were defined contribution plans.

In 2006, collectively-bargained defined benefit plans held approximately $890 billion in assets. Multiemployer defined benefit plans, most of them collectively-bargained, had approximately $340 billion. In light of the vast, acknowledged deficiencies in union pension funding, these assets should be much higher. At last count, 157 collectively-bargained defined benefit plans had reported being in "critical" status, that is, holding less than 65 percent of the assets needed to pay future obligations. Another 146 were in "endangered" status, generally reflecting funds with less than 80 percent of what was needed[2].

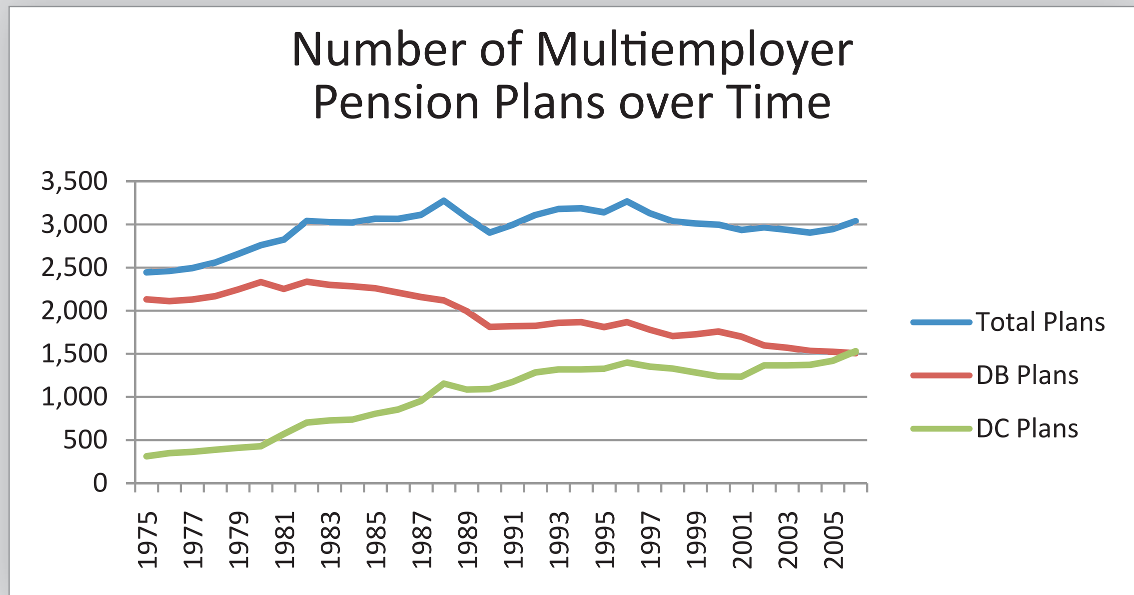
Under the Pension Protection Act 2006, deficient plans are required not only to report significant funding inadequacies but to make them up with reduced benefits or increased contributions .

Chart 2



Source: U.S. Department of Labor, "Private Pension Plan Bulletin Historical Tables and Graphs" http://www.dol.gov/ebsa/pdf/1975-2006historicaltables.pdf

Chart 3



Source: U.S. Department of Labor, "Private Pension Plan Bulletin Historical Tables and Graphs" http://www.dol.gov/ebsa/pdf/1975-2006historicaltables

V. Sources of Information on Pension Plans

Most pension funds must file Form 5500 annually with the Internal Revenue Service and the U.S. Department of Labor. Form 5500 includes information about the assets and liabilities of the pension fund; the number of participants; some details about the pension plan; and the investment earnings of the pension fund.

Form 5500 requires estimates of the value of funds' assets, liabilities, and the present value of all benefit payments. Because of the complexity of the calculation, companies are asked to calculate only their "accrued" liabilities. To do that they estimate the present value of all benefits they would have to pay if they closed at the end of the year and paid all promised benefits based on service to that time. That is, if benefits are 1 percent of wages per year of service, a person who had worked at the company for 10 years would be owed an annuity of 10 percent of his wages each year.

If the ratio of assets divided by liabilities is greater than or equal to one, the company would be able to pay all of its promised benefits assuming all actuarial assumptions are correct. This is an important qualification and will be discussed later. If this ratio is less than one, it indicates that the company has promised to pay more in benefits than it expects to have when benefits are paid. A ratio of less than one is the major indication to plan participants that their pension fund—and possibly their own benefits—are in danger. A ratio less than one, an "underfunded" plan, reflects mismanagement of funds, either inadvertent or corrupt.

The Employee Retirement Income Security Act of 1974 (ERISA), a law written to protect defined benefit pension plans, permits sponsors to delay required contributions, as long as they adhere to payback restrictions. However, another provision of ERISA, intended to encourage pension sponsors to keep their plans well-funded, has contributed to the deterioration of funds.

In any year in which a sponsor pays more than its required contributions, ERISA allows the fund to gain a "credit" that can be used to reduce future payments. That happened during the "dot-com bubble" of the late 1990s, when many pension funds ran up large credits due to unexpected appreciation of their stock-market assets. Sponsors substituted the credits for annual contributions. But when the bubble burst and stocks fell, the funds started performing poorly. Then fund administrators used the credits to pay off the debts they accumulated during the market's decline, and at times did not make any contributions to their pensions, even if their funded ratios had fallen significantly.

The data used in this study were drawn from the Employee Benefits Security Administration (EBSA) Research File, compiled by the Center for Retirement Research at Boston College. We would like to thank the Center for making these data available for this paper.

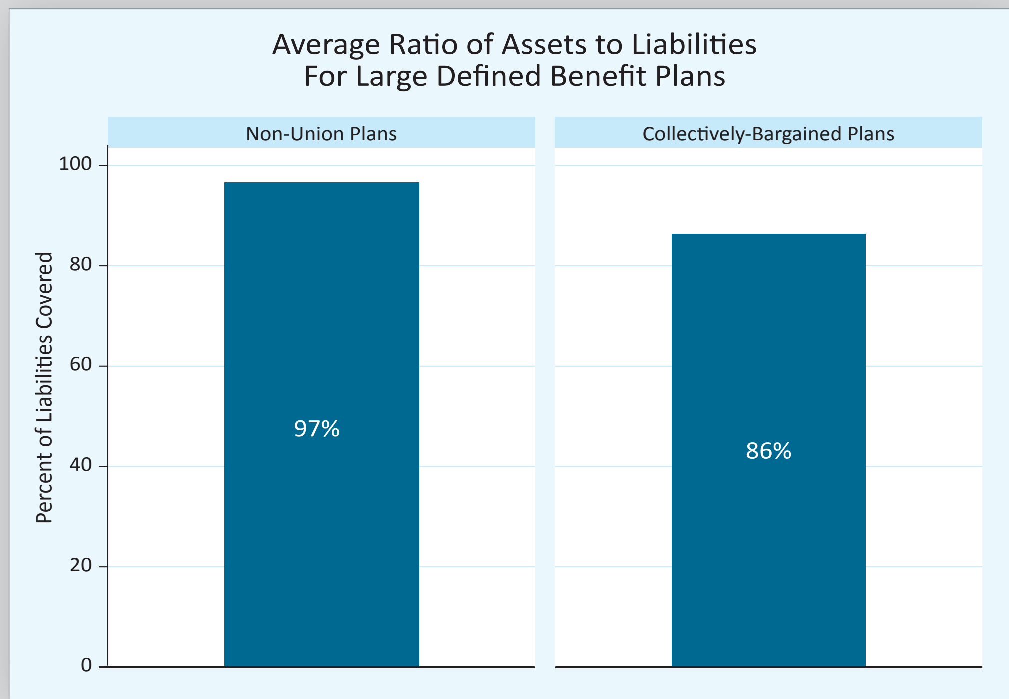
VI. General Health of Pension Plans in the United States

At the end of 2006, large defined benefit pension plans[3] were, on average, 92 percent funded[4]. The data came from 4,602 large non-union pension plans and 3,481 collectively-bargained pension plans. (The threshold for "large" was 100 or more participants.)

Collectively-bargained large plans, on average, were 86 percent funded. In contrast, non-union pensions were 97 percent funded (*Chart 4*). This suggests systemic underfunding among collectively-bargained pension plans. Non-union plans, 35 percent of which were fully funded, were more likely to be fully funded than their collectively-bargained counterparts, 17 percent of which were fully funded *(Chart 5)*. ("Fully funded" means that assets meet or exceed 100 percent of the value deemed necessary to pay all projected future obligations.)

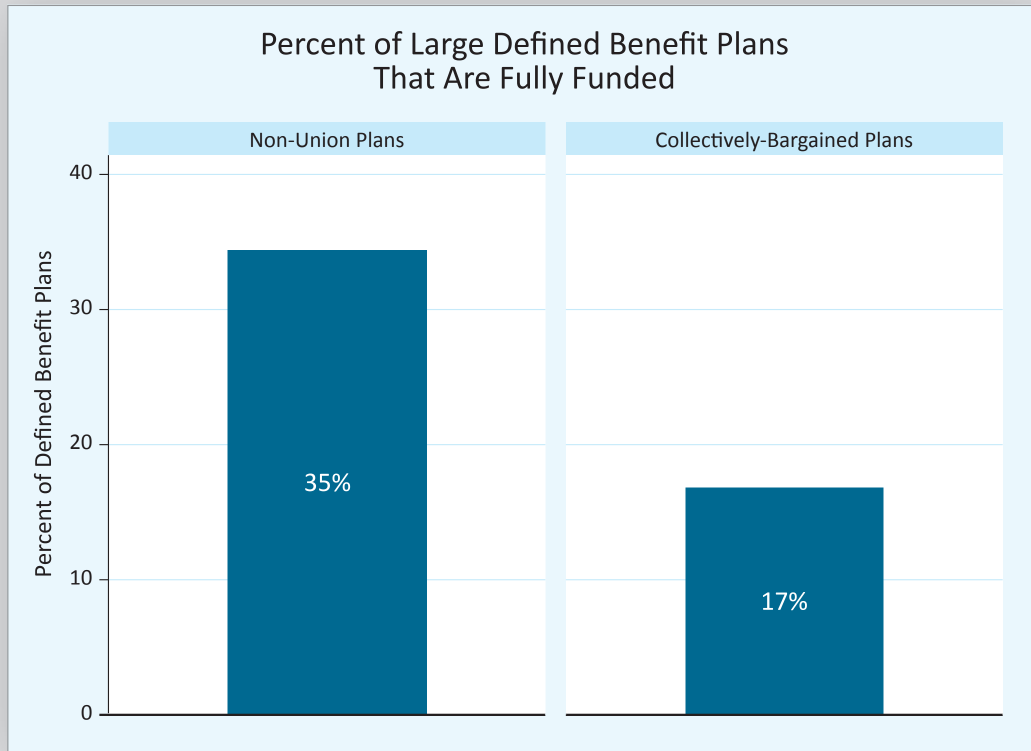
The 2006 Pension Protection Act, like ERISA (1974), recognized that a pension plan need not be fully funded at any moment in time to be stable. Dips in the stock market can reduce the funding ratio, requiring several years for recovery, even among well-funded pensions. Thus, while fund managers must make up shortfalls over the course of several years, there are few penalties if funding falls to or below 80 percent of projected liabilities.

Chart 4



Source: U.S. Department of Labor Employee Benefit Security Administration Form 5500 Data (2006), Center for Retirement Research at Boston College. 5500-CRR data: Panel of Current and Usable Form 5500 Data. Chestnut Hill, MA, and Hudson Institute calculations.

Chart 5



Source: U.S. Department of Labor Employee Benefit Security Administration Form 5500 Data (2006), Center for Retirement Research at Boston College. 5500-CRR data: Panel of Current and Usable Form 5500 Data. Chestnut Hill, MA, and Hudson Institute calculations.

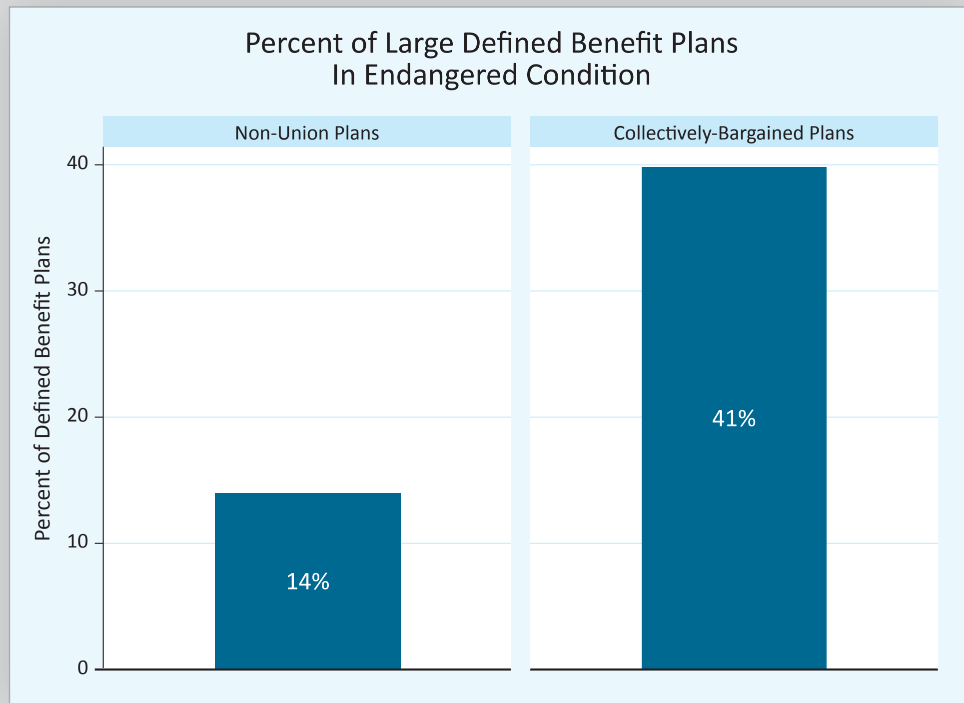
However, in 2006, collectively-bargained pension plans still performed poorly compared to non-union pensions. Of union plans, 41 percent had less than 80 percent of their needed assets, compared to 14 percent of non-union plans, shown in ***Chart 6.***

Unsurprisingly, the pattern repeats itself among the most troubled plans – those with 65 percent or less of their required assets, called "critical status" in the 2006 Pension Protection Act[5]. While only 1 percent of non-union pensions were in critical status, 13 percent of union pension plans were critical *(Chart 7).*

One possible reason for the superior performance of non-union plans is the use of funding credits to reduce mandatory payments to pension plans, a practice discussed above. While the Pension Protection Act held out incentives to discontinue this practice, it is possible that many plans relied on large funding credits to keep from having to make supplemental contributions even when the stock market fell, pulling down funding ratios.

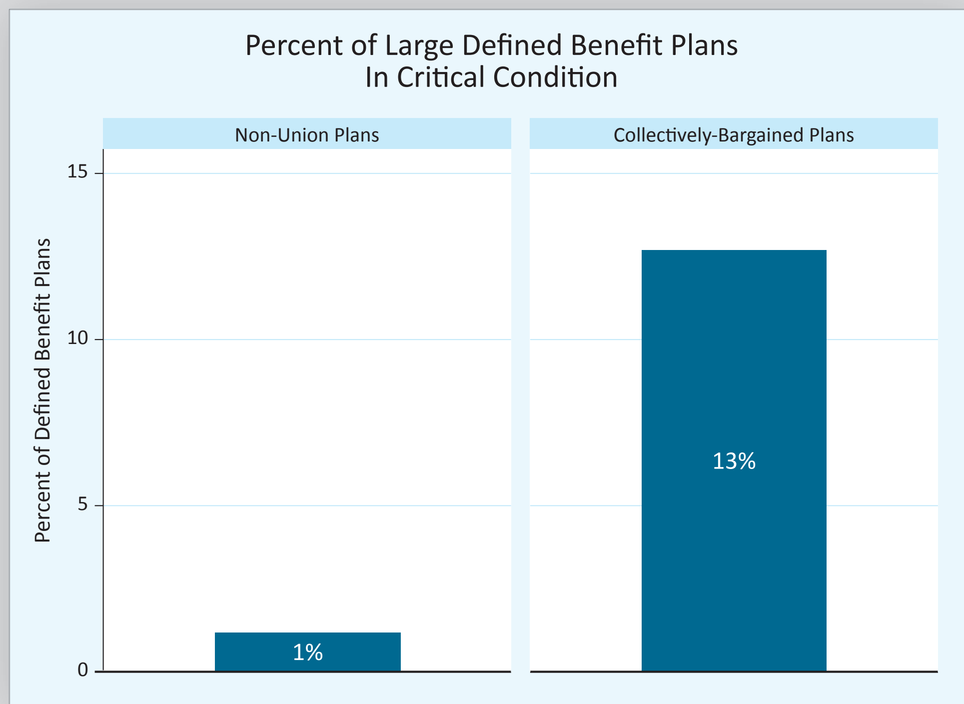
One way of lending strength to this theory is analyzing whether plans that were not fully funded received contributions equal to total annual charges, generally equal to the sum of the normal cost (see Appendix) and interest charges from funding deficiencies. In 2006, only 19 percent of the 2,882 union pension plans that were not fully funded, 548 plans, made contributions sufficient to cover their minimum annual costs. In contrast, 1,079, or 37 percent of the 2,944 non-union pension plans that were not fully funded, met annual costs *(Chart 8).*

Chart 6



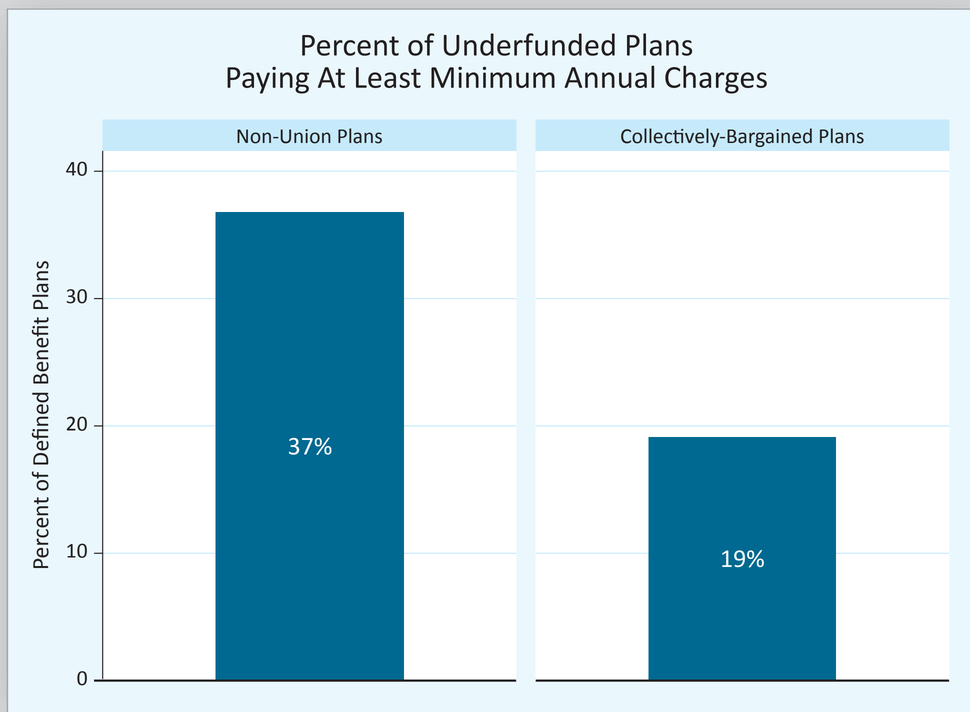
Source: U.S. Department of Labor Employee Benefit Security Administration Form 5500 Data (2006), Center for Retirement Research at Boston College. 5500-CRR data: Panel of Current and Usable Form 5500 Data. Chestnut Hill, MA, and Hudson Institute calculations

Chart 7



Source: U.S. Department of Labor Employee Benefit Security Administration Form 5500 Data (2006), Center for Retirement Research at Boston College. 5500-CRR data: Panel of Current and Usable Form 5500 Data. Chestnut Hill, MA, and Hudson Institute calculations

Chart 8



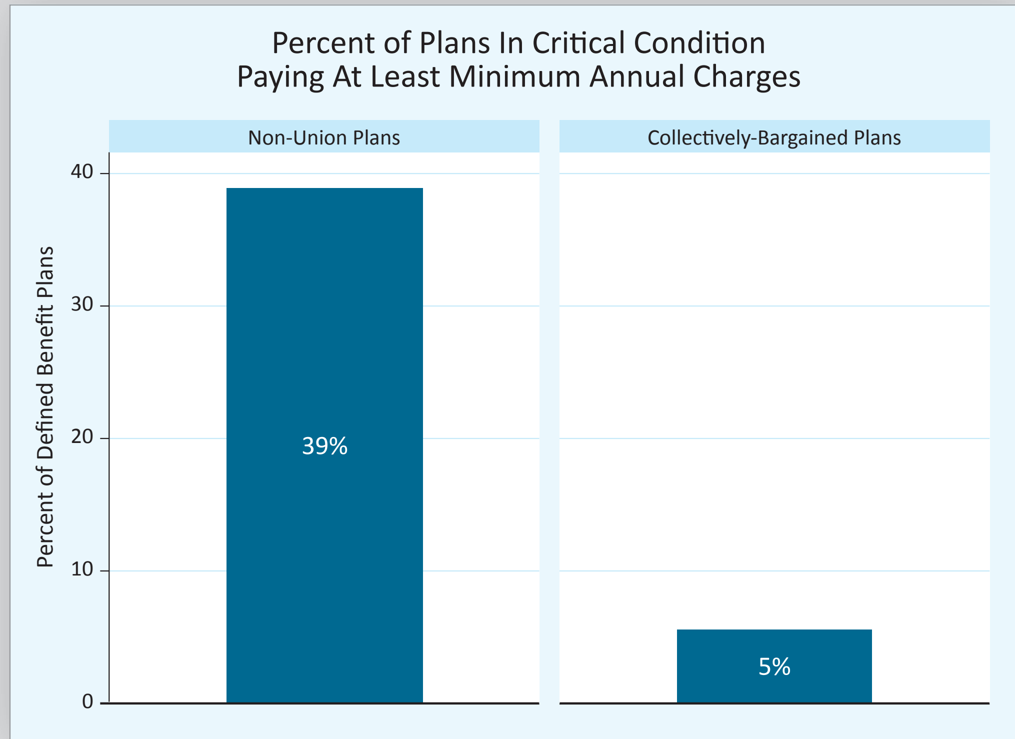
Source: U.S. Department of Labor Employee Benefit Security Administration Form 5500 Data (2006), Center for Retirement Research at Boston College. 5500-CRR data: Panel of Current and Usable Form 5500 Data. Chestnut Hill, MA, and Hudson Institute calculations

The situation was worse for plans in critical condition. Among 438 union pension plans in critical condition, only 24, or 5 percent, contributed enough to meet annual costs. Of the 54 non-union plans in critical condition, 21, or 39 percent, were in the same situation *(Chart 9)*.

Under the 1974 law, some pension plans in poor condition would have to make additional contributions. In 2006, 19 percent of non-union plans had to make additional contributions, and 20 percent of union plans had to make such contributions *(Chart 10)*. However, on average, union plans were forced to make contributions close to twice the size of those of non-union plans, $4.9 million compared to $2.5 million *(Chart 11)*.

Compared to 2005, pensions in 2006 fared worse as a whole. Union pensions were 88 percent funded in 2005, and non-union pensions 98 percent funded on average, making their 2006 showings small but noticeable losses. Both union and non-union pension plans saw a 2 percentage point drop in the number of pensions that are fully funded. Non-union pensions were half as likely to be in critical condition in 2006 as in 2005, while the 13 percent of critical union pensions were 2 points higher than 2005 union pensions. One would expect, in a year of stock market gains, for pensions to improve in health. It is therefore distressing to see their health deteriorate, and especially for the increased likelihood for union pensions to be in critical status.

Chart 9



Source: U.S. Department of Labor Employee Benefit Security Administration Form 5500 Data (2006), Center for Retirement Research at Boston College. 5500-CRR data: Panel of Current and Usable Form 5500 Data. Chestnut Hill, MA, and Hudson Institute calculations.

Chart 10

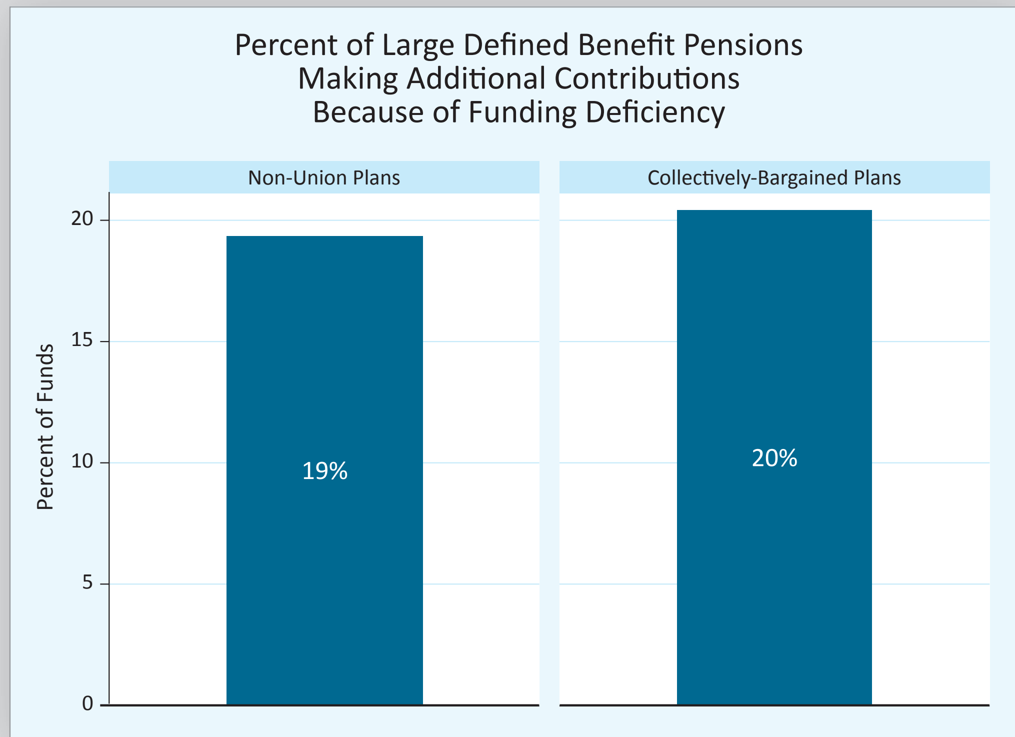


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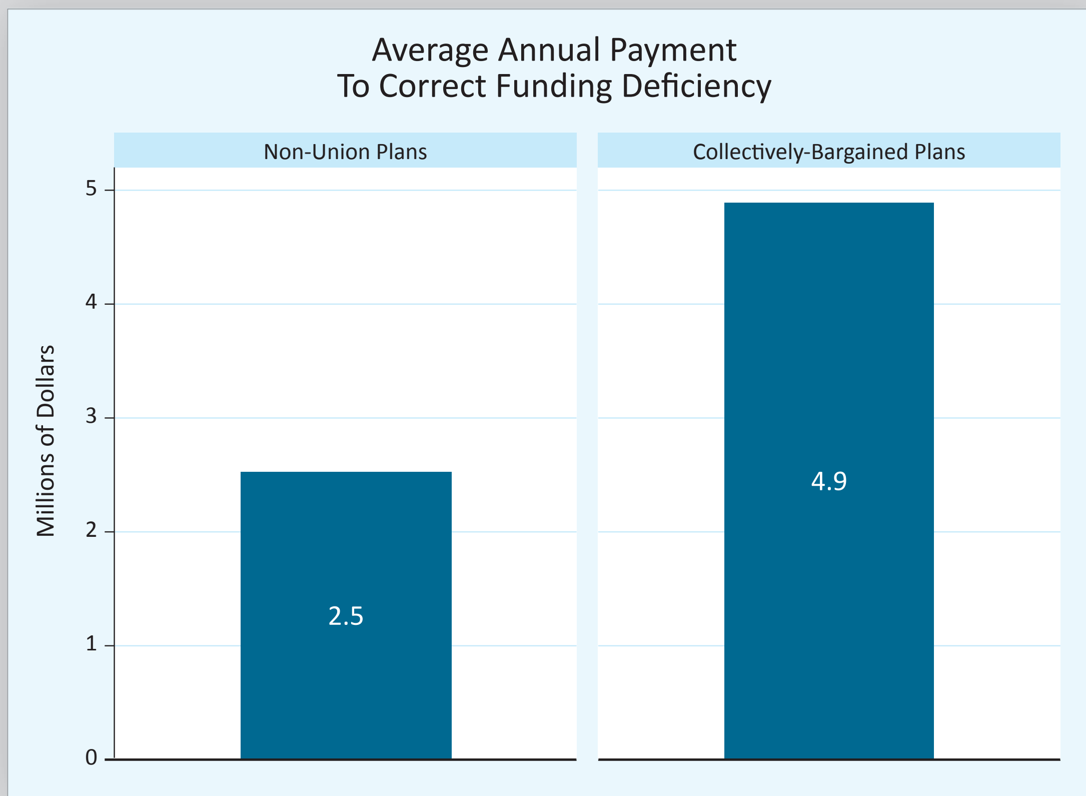
Chart 11



Source: U.S. Department of Labor Employee Benefit Security Administration Form 5500 Data (2006), Center for Retirement Research at Boston College. 5500-CRR data: Panel of Current and Usable Form 5500 Data. Chestnut Hill, MA, and Hudson Institute calculations.

VII. Why Union Plans Tend to Perform More Poorly

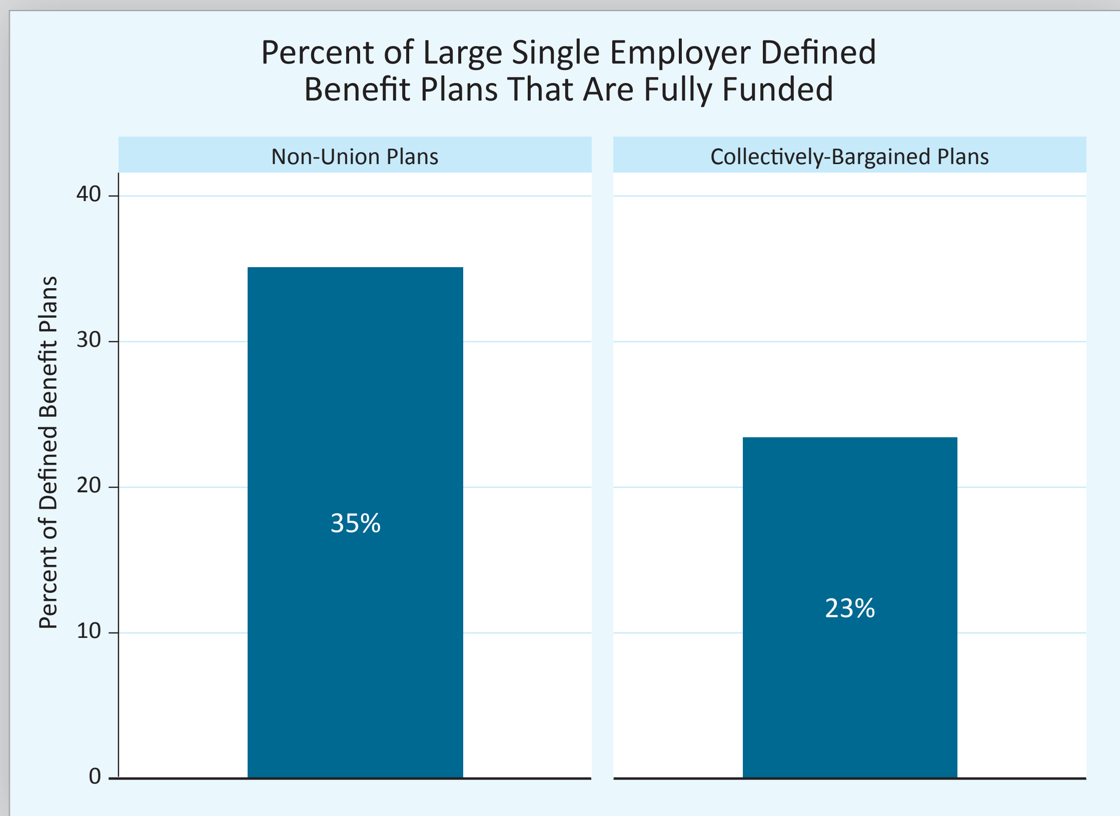
As noted above, union pension plans are more commonly underfunded than are non-union plans sponsored unilaterally by employers. One possible reason for the disparity is that collectively-bargained pension plans are not usually renewed annually. As a result, annual contributions by employers (and possibly employees) may not respond quickly to market downturns or other unexpected drops in pension funding ratios. Furthermore, when a union must negotiate with several different employers (which is the case when a union sponsors a multiemployer pension plan), this problem may be exacerbated. The data suggest this explanation has merit. Of multiemployer pensions, 6 percent were fully funded in 2006. In contrast, 33 percent of multiple employer and 31 percent of single employer pensions were fully funded.

Unfortunately for this hypothesis, the disparity between union and non-union plans

exists even within different employer groups. Among single employer plans, 35 percent of non-union plans were fully funded, compared to 23 percent of single employer union plans. *(Chart 12)*

There are other possible explanations for the poorer showing made by union pensions. One involves the incentives of union officers, what might be called internal trade union politics. Union leaders like to achieve expanded future pension benefits for their members when they renew collective contracts. It makes their re-election more likely. But leaning on employers to ensure that the pension plan is kept well-funded takes much work for little visible effect—and may well work against winning richer benefits by underscoring their cost to the employer. It sounds much more proactive for union leaders to deliver expanded pension benefits or to protect benefits from employer-initiated cuts than to protect already-earned benefits.

Chart 12



Source: U.S. Department of Labor Employee Benefit Security Administration Form 5500 Data (2006), Center for Retirement Research at Boston College. 5500-CRR data: Panel of Current and Usable Form 5500 Data. Chestnut Hill, MA, and Hudson Institute calculations.

Union leaders also may not want to advertise to members that safeguarding pension plan funding requires effort. It is part of trade union doctrine that defined benefit plans are safe. For the leadership to acknowledge that it must struggle to sustain adequate funding suggests that the annual contributions are inadequate to assure rank-and-file members a stable retirement. The implication that larger contributions are needed may apply to employees, if the plan is contributory, as well as to the employer. Or it might imply that the plan should become contributory. It might even be inferred by the membership that the leadership has bargained for gold-plated benefits that are unrealistic. In sum, confronting under-funding is a headache for union leaders and the path of least resistance is to avoid such engagement.

Finally, employers may be more disposed to grant pension benefit increases than wage increases because the former are largely future costs. Union leaders understand that and may tilt their demands in that direction, especially if the employer is in straitened circumstances and cannot afford to raise wages.

It should be noted first that all of these reasons listed are hypotheses. There appears to be some evidence to support them, and they are plausible given the current environment, but we cannot actually determine what drives a union leader's decisions.

But while not all of these proposed causes for disparity between non-union and collectively-bargained pension plans are due to outright malice or incompetence, they still merit concern. Annual reports are as a rule optimistic about the future of a pension plan, often using the plan's accumulated assets as a context-free index of pension health. While optimism is commendable, union leaders' tendency to project rosy futures for pension plans leaves rank-and-file members unaware when or how their pensions may be at risk. And without that understanding, union members have no metric by which to judge the management by their leaders of their pension plan.

This is a problem because a secure retirement is one of the primary enticements to join a union. Many of the major national unions advertise that union members are more likely to have better retirement plans, explicitly defined benefit retirement plans, than workers without a union. This promise would be far less persuasive were potential union members to understand that a pension is not guaranteed just because it has been created.

In fact, looking at union communications, it is clear that union leadership prioritizes raising benefits over securing them. Nowhere is this clearer than in criticisms of the Pension Protection Act. The Teamsters, for example, criticize full funding requirements as this provides a legal reason for employers to refuse to increase pension benefits[6]. Unions frequently lambaste their employer opponents for opposing increased benefit plans, usually listing their proposals as "reasonable" or "affordable." But it is rarely in a union's interest to say that it is pushing for reforms of uncertain cost that employers may not be able to afford. The fact that unions often push for benefit increases in the face of employer protests of unreasonable cost lends weight to the argument that they place more importance on the promised level of benefits than on the actual security of those benefits.

There are advantages to defined benefit pension plans, but these benefits are contin-

gent on the plans being fully funded. Union rank-and-file members need to understand the complexity of defined benefit pension plans, and hold their leaders responsible for maintaining stable funding ratios. Certainly it is in employers' best interests to refrain from increasing benefits during negotiations, but they also have a stake in ensuring the benefits they pay are sustainable. Short-term business gains, for example, are no justification for increasing benefits, in part because it is much harder for a business to rescind increased benefits during down times than to not increase them in the first place.

But more important than acknowledging the possibility that employers may at times be accurate about the feasibility of union benefit plans, rank-and-file workers must recognize the difficulty in keeping a defined benefit pension stable, and properly place responsibility for that task. Employers are responsible for making the contributions stipulated in their contracts, and, since they also serve as trustees, they need to make sure that the plan is stable. It is the union leaders' responsibility to negotiate stipulations that enable the pension plans to remain stable.

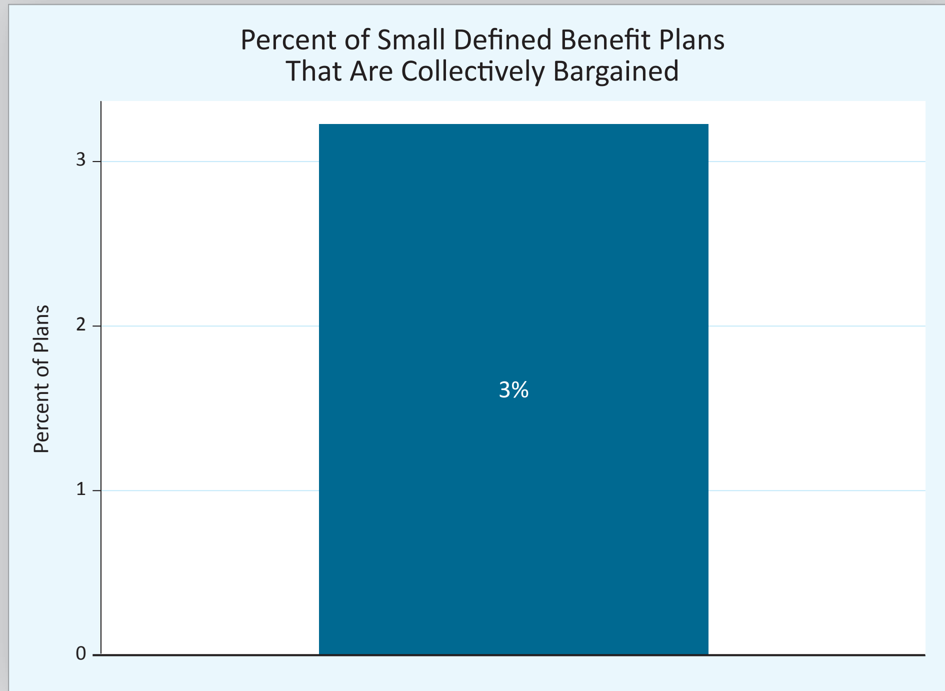
VIII. Small Plans

Like businesses, pension plans are often analyzed by size. Small plans, those covering 100 or fewer people, make up the majority of defined benefit pension in the United States, or 25,720 out of a total of 33,803. Labor Department data from the 2006 Forms 5500 showed that of these small plans[7], 827, or 3 percent, were collectively bargained, as opposed to the 43 percent of large pensions that are collectively bargained (See *Chart 13* and *Chart 14*). These 827 union plans were, on average, larger than non-union pension plans. Small union plans covered on average 69 workers, while non-union pensions covered an average of 13 people apiece *(Chart 15)*.

Small plans enjoy a natural advantage with respect to funding. The fewer people the plan must cover, the more likely it can accurately predict future obligations and adequately prepare to meet them. Furthermore, beneficiaries of small pensions may be more likely to know and have contact with their union representative, giving them greater opportunity to seek and maintain accountability. One can, therefore, expect small plans in general to do better than larger pensions.

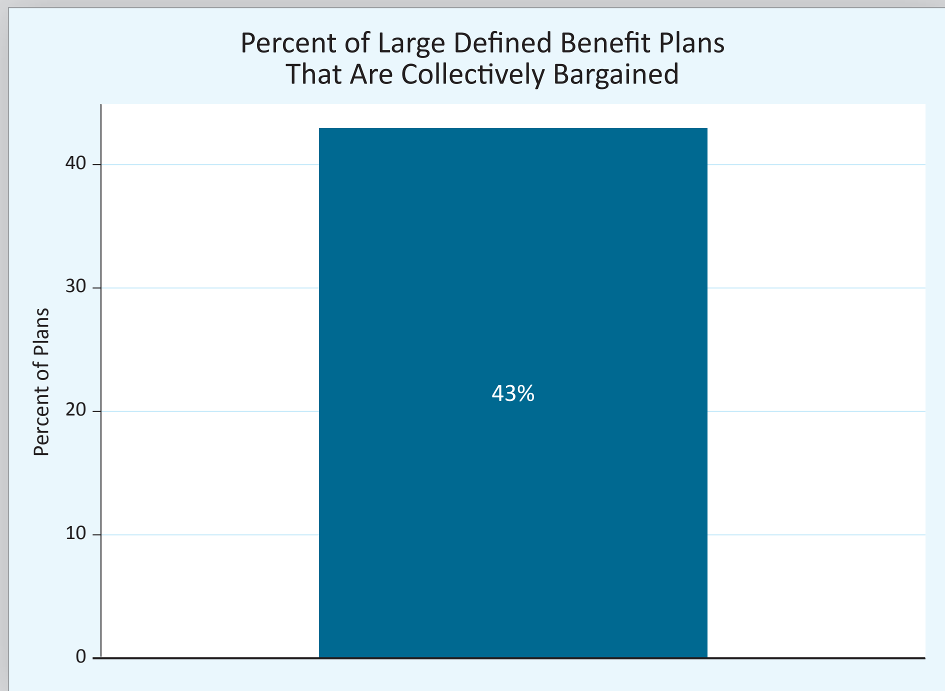
Of non-union small plans, 61 percent were fully funded, compared to 25 percent of union plans. Both sets outperformed large plans in this respect, but, taking account of underperforming funds, neither did well. Both union and non-union small plans were about as likely as their larger counterparts to have funding ratios below 80 percent. Small and large union plans were nearly three times as likely to be poorly funded as were non-union pensions. Worse yet, 15 percent of small union plans had funding ratios below 65 percent—more than twice the ratio for small non-union plans.

Chart 13



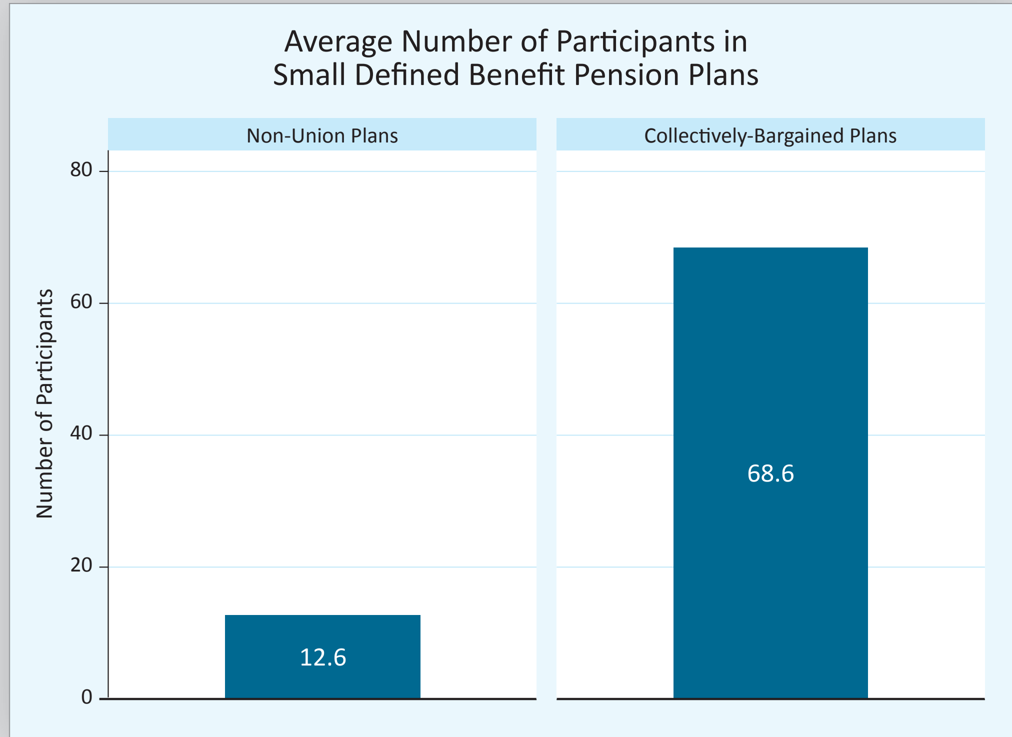
Source: U.S. Department of Labor Employee Benefit Security Administration Form 5500 Data (2006), and Hudson Institute calculations

Chart 14



Source: U.S. Department of Labor Employee Benefit Security Administration Form 5500 Data (2006), and Hudson Institute calculations

Chart 15



Source: U.S. Department of Labor Employee Benefit Security Administration Form 5500 Data (2006), and Hudson Institute calculations

One would hope that smaller union plans would be better off than those run by large, national unions, but it appears that the endemic problems with collectively-bargained pension plans extend even to smaller plans. A local union negotiating a pension for 100 workers ought to be easy to hold accountable for plan performance, but the data suggest it is not so. Even small plans are far too often in unstable financial condition, to the possible future detriment of the covered workers.

IX. Rank-and-File Versus Officer Pension Plans

Many unions have separate pension plans for rank-and-file members and for the staff and officers of the union local and national organization, because many union officers and staff are employees of the union, not of an employer with whom the union bargains.

How do these pension plans for union leadership and staff compare to the pension plans for the rank-and-file?

It is not possible to perform an analysis of all staff pension plans. While Form 5500 provides information to indicate whether a plan is collectively bargained or not, and indicates

whether a plan is large or small, officer pension plans cannot be easily distinguished from rank-and-file plans. Few unions provide easily accessible information on the pension plans of their officers, and there is no central resource for locating and examining them.

However, it is possible to analyze a sample of staff pension plans, and this is the approach taken in this study. We examined 30 staff pension plans relating to some of the largest 46 rank-and-file pension plans. Rank-and-file plans cover employees in the International Brotherhood of Teamsters, SEIU, UNITE HERE, UAW, the Communications Workers of America, IAMAW, the Sheet Metal Workers, the United Steelworkers, the UFCW, the Plumbers and Pipefitters, the Actors' Equity Association, the International Union of Painters and Allied Trades, the AFL-CIO, the Carpenters, LIUNA, the International Union of Bricklayers, the Bakery, Confectionery, Tobacco Workers and Grain Millers, and the International Brotherhood of Boilermakers.

Staff pension plans include affiliates of national unions such as AFSCME, the American Postal Workers[8] and the Graphic Conference of the Teamsters. Rank-and-file pensions for these unions are consolidated in their parent union's pension. In addition, they include the International Association of Iron Workers, the International Association of Bridge Workers, and the International Brotherhood of Electrical Workers[9].

In 2006, rank-and-file plans each covered at least 25,000 active workers, and together covered over 2.7 million active employees. On average, the rank-and-file plans had 79 percent of the funds needed to satisfy their obligations. Nine of the plans were fully funded, and 24 were less than 80 percent funded. Eleven of those 24 were less than 65 percent funded, and four were listed by the Department of Labor as being in critical condition.

The 30 officer funds were on average 93 percent funded. Nine were fully funded, and eight were less than 80 percent funded. Of the eight, two were less than 65 percent funded. These data suggest that staff pensions may be better funded than rank-and-file pensions.

There are two hypotheses already discussed that offer an explanation for the disparate funding rates of rank-and-file and officer pension plans. Most officer pension plans are perks of the job, not collectively bargained but dictated by the union's bylaws. Furthermore, they are single employer pension plans. Both of these distinctions have biases towards better funding.

It is enlightening to observe, when looking at the rank-and-file plans, that of the 46, 17 are single-employer or multiple-employer pension plans. These plans are, on average, 96 percent funded, compared to 70 percent funding among the multiemployer rank-and-file union plans. Nine of these are fully funded, and only four are less than 80 percent funded. None are in critical condition. While these statistics can not necessarily be generalized to the rest of the pension universe, they do indicate that officer pension plans fare about as well as single-employer rank-and-file union pension plans. This suggests that officer pension plans fare better than rank-and-file plans in part due to the ease with which officers can manage their own pensions.

Union officers make many of the business decisions for the union. They, or someone they know, are aware of the financial status of the union, and therefore what pension

benefits are affordable. This is similar to the reason that single employer plans fare better than multiemployer pensions. That is, when a single entity is responsible for determining pension benefits, its sole responsibility for benefits and its flexibility allow it to better keep the pension well-funded.

However, unlike a business with a collectively-bargained pension plan, union officers are not constrained by shareholders to keep large pension deficits from arising. They are motivated by self-interest: they are managing their own pensions. That gives the officers a greater incentive to ensure that their own pensions are managed well than they have for keeping their members' pensions well funded. It is not clear that they expend more effort protecting their own pensions, but the outcomes suggest that union leaders are more effective in protecting their own futures.

Pay-for-performance is one of organized labor's favorite tools for criticizing management. One of their complaints is that among large corporations, few incentives exist for upper management to increase profits. Organized labor argues that golden parachutes, vested stock options, and other complex forms of compensation ensure that most CEOs and other senior corporate officers make dozens of times the average worker's salary, even in periods of declining profits or mass layoffs. Union leaders say that business leadership should not be rewarded when ordinary workers are suffering.

Union leaders, however, are vulnerable to the same criticism. Officer pensions are rarely connected to performance of rank-and-file pension plans; few union leaders' future incomes are threatened when an employer must cut pensions, or plans fall into critical condition. Note that the 2006 slip in union pension funding occurred during a year of stock-market gains. If unions wish to encourage managers to work in the best interests of their companies by connecting performance connected to profits, perhaps the unions ought to set that example first.

X. Underfunded Pensions and the Employee Free Choice Act

The sorry state of union pensions is one reason that unions are embracing the Employee Free Choice Act, EFCA, a bill pending in Congress.

If enacted, the bill would require a union newly certified as a bargaining agent and the employer that cannot agree on a contract within 120 days, to submit to mandatory interest arbitration. Resulting contracts would, by law, hold for two years. The arbitrators, at least as the bill was drafted, would have the power to force newly-unionized firms into underfunded pensions. A union might propose such an assignment to pump up a plan's funding ratio. Changes in the bill's language that Congress should consider would resolve that problem.

This legislation originally attracted much attention because it would have allowed workers to designate a union as their bargain-

ing agent by checking a card circulated and retained by the union—hence the name "card check"—rather than through a secret-ballot election, as required since the Taft-Hartley Act. Card check ran into intense opposition in 2009 because it opened the possibility of union intimidation. Union officers can visit workers outside the plant or at home, and they will know who signed and who refused. (Interestingly, the unions assert that they have lost secret-ballot elections because of intimidation by management.) Because several Senate Democrats oppose card check, including Blanche Lincoln and Mark Pryor of Arkansas, Diane Feinstein of California, and Arlen Specter of Pennsylvania, it has reportedly been dropped from the bill.

However, the mandatory interest arbitration part of the bill would remain in any alternate version of EFCA. Unions want mandatory interest arbitration because they believe that the threat of arbitration, followed by the arbitration itself, will force employers to offer better compensation packages in the initial bargaining. Employers oppose interest arbitration on the grounds that it could require them to pay excessive compensation to workers and impose upon them onerous union work rules, eventually forcing them out of business. The contrast between the financial position of the unionized Big Three Detroit auto companies and the non-unionized foreign-owned transplants shows how unionization affects a firm's competitive position.

Binding interest arbitration could have even more pernicious consequences than ending the secret ballot. It would allow a government arbitration board, appointed by the Federal Mediation and Conciliation Service, to set compensation packages for firms and workers that they must accept, possibly including requiring firms to join underfunded multiemployer pension funds. The bill, as pending in mid-2009, did not specify eligibility criteria for appointment to arbitration boards.

Unlike voluntary arbitration, the parties would not have an opportunity to choose members of the panel. Nor would they have recourse to the courts if they were dissatisfied with the arbitrators' decision. With just a few lines of legislative language, Congress would revoke for newly-organized firms and workers a critical principle of free collective bargaining—that employers and unions may walk away from a proposed contract they find unsatisfactory. Workers could be required to accept a lower compensation package than they could get elsewhere, and firms could be forced into unproductive agreements that could eventually lead to bankruptcy.

Mandatory interest arbitration would allow organized labor to replenish the coffers of its underfunded pension plans. That's why it has been endorsed by union pension fund managers. On May 11, 2009, a group of these investors, including representatives of the AFL-CIO and the Service Employees International Union pension plans, endorsed EFCA in a letter to two senior Democrats, Senator Tom Harkin of Iowa, cosponsor of the Employee Free Choice Act, and Representative George Miller of California, chairman of the House Education and Labor Committee. "As fiduciaries with broadly-diversified portfolios," the signatories wrote, "we must be cognizant of these trends and their impact on our investments." [10]

If an arbitration panel were to require a firm to join an underfunded plan, the firm could become liable for the pensions of work-

ers, some already retired, of other employers. This would generate an inflow of new cash to the plan but might harm the financial position of the newly organized firm.

Under EFCA, if a trucking company were unionized by the Teamsters and could not reach an agreement with the union, the case would go to mandatory arbitration. Arbitrators could require the company to participate in a Teamsters pension fund, such as the Central States Pension Fund, which was 46.6 percent funded in 2006 and is used by many trucking companies.

Under a multiemployer pension fund such as the Central States fund, if some contributors go out of business then others have to pay the obligations. This concept is known as "last man standing." Only if all the companies go out of business will the Pension Benefit Guaranty Corporation, a government pension insurance fund, pay retirees a maximum benefit, now $12,870 for 30 years of service.

With fewer workers joining unions, the collectively-bargained multiemployer pension funds are characterized by an increasing number of retirees supported by fewer younger workers. Many poorly funded pensions are similar to Ponzi schemes, with new contributions paid out in benefits rather than being saved for contributors' retirement. Union pension funds can survive only through new contributions. That is why unions will do anything to recruit new members —including forcing workers into underfunded pension plans through mandatory arbitration. But just as workers deserve secret ballots in union elections, they also deserve the right to consider judiciously their labor contracts, and walk away from those that they deem unattractive or unfair.

XI. Political Spending

Rather than focusing on funding pensions for rank-and-file workers, some unions have concentrated their efforts on politics. For example, in the 2008 elections, many organizations poured billions of dollars into the House, Senate, and presidential races, and many unions were quick to back Barack Obama. With his promises of supporting legislation such as the Employee Free Choice Act, universal health care, and other union agenda items, he was a clear choice for union leaders. But he was not necessarily a clear choice for union members. Certainly, the unions would have liked their members to vote overwhelmingly Democratic, and their campaign contributions reflected this preference.

According to the Center for Responsive Politics, an organization that compiles Federal Election Commission (FEC) data on campaign contributions, labor unions contributed more than $130 million to the Senate, House, and presidential races. There are several different ways for a union to influence an election. One is to file their union under Section 527 of the U.S. Code, labeling their organization a 527 group. Such groups are allowed to make contributions to influence national and local elections, so long as the funding does not

directly advocate one particular candidate. Aside from some unions, 527 groups also include "issue" groups, who seek to influence elections based on differing positions on vital issues, such as abortion rights, gun control, and, of course, labor issues.

Exempt from many contribution and disclosure laws, 527 organizations across the political spectrum have been criticized for their lack of accountability. Union-sponsored 527 groups contributed close to $57 million in the 2008 election cycle. The Service Employees International Union contributed the most, close to $28 million[11]. Seven other union 527 groups were among the top 50 contributors.

But this is hardly all of the spending in which unions engaged to influence the election. Union political action committees (PACs) made their own contributions, to the tune of $66.4 million, to congressional and presidential races[12]. These PACs contributed another $6.75 million to national parties; 92 percent of these contributions went to Democratic candidates or to the Democratic Party itself[13].

And this does not cover all costs incurred by unions to support candidates. Unions are also allowed to advertise to their own members, encouraging them to vote one way or another. FEC filings are required to identify specific unions' independent expenditures. These data are illuminating.

The SEIU spent over $6.5 million in 2008 canvassing, producing flyers, T-shirts, buttons and the like to persuade their members to vote for Barack Obama. The American Federation of State, County, and Municipal Workers spent $12.5 million communicating to their members about the election, although much of the money went to supporting Hillary Clinton's bid. The American Federation of Teachers spent $4.5 million trying to influence their members' votes.

There is nothing inherently wrong with unions seeking to influence national elections. The First Amendment guarantees their right to express their opinion, and unions arguably have a duty to attempt to sway national politics in ways that benefit their members.

But looking at SEIU's contributions of more than $70 million to influence 2008 elections[14], for example, one wonders where this money came from and who decided how to spend it. The SEIU Committee on Political Education (COPE) is funded by SEIU. While many SEIU members were willing contributors, the 2008 SEIU constitution tells a different story, namely that money to pay for political "education" does not come only from voluntary contributions. In 2008, the following amendment to the SEIU constitution was adopted:

"Every U.S. Local Union shall contribute an annual amount equivalent to at least $6.00 per member per year, or as determined annually by the International Executive Board, to support the overall SEIU political education and action program…If a Local Union fails to meet its annual SEIU COPE fundraising obligation, it shall contribute an amount in local union funds equal to the deficiency plus 50%, or such other amount determined by the International Executive Board, to support the overall SEIU political education and action program."[15]

When the policy was highlighted in the press, the union admitted that discipline like this had always been in place, and that the amendment had simply formalized it.[16] The union may suggest that locals encourage vol-

untary donations, but under the threat of a penalty of 50 percent (or higher, if the International Executive Board so decides), local unions come under pressure to mobilize "voluntary" contributions of at least $6 a year from each member. These contributions cannot be considered voluntary.

This policy, however, highlights the biggest problem with respect to union political spending. Such spending, by law, is supposed to come from voluntary contributions, not the dues that members are required to pay. If unions divert dues money to political action, union members may discover that their dues were earmarked to support candidates they oppose.

Of course, union leaders can claim that they know best which candidates, if elected, will strengthen unions and benefit workers, but that is a patronizing attitude. Unions were not created because workers did not know what policies were best for them. They were created to unite workers into a collective bargaining entity with more power than any one worker could exercise. Any worker has the right to be upset that union monies are spent to support candidates that union leaders decide are the best, rather than spent on the worker's preferred candidate, or, better, on representational activities alone.

Federal law prohibits the use of compulsory union dues for political purposes. This is why the SEIU encourages locals to increase voluntary contributions to COPE, and why the union constitution no longer states that COPE funds may come from local union dues revenue.

The following language in resolutions made by SEIU during its 2008 convention demonstrates SEIU's commitment to increasing its financial weight in the political arena: "By December of 2009, 20% of every Local Union's members should be giving at an average of at least $7 per month to COPE…Once a Local has achieved this 20% goal, the Local should increase the number of members giving at an average of $7 or more per month by at least 10% each year until a majority of members are giving at this level…"[17]

The SEIU hopes that it can persuade its members to donate an average of $16.80 a year, and eventually achieve a rate of at least $39 a year. That is, SEIU aspires to talk its membership into $78 million of political funding each year[18].

The SEIU appears to be the union most explicitly demanding that its membership finance its political agenda, by writing into its constitution a requirement that local unions fund its political endeavors. But the money to fund union 527s may come from local and national union contributions (union 527s almost exclusively)[19], and thus ultimately from union membership dues. And if there is one certainty looming over the horizon, it is that enactment of the Employee Free Choice Act with a card-check provision would give unions the means to rapidly expand their financial bases. SEIU has made the equation explicit: every union member shall ante $6 a year for political funding. Other unions have similar expectations for their members to generate political funds, money to strengthen unions' political influence in government at all levels. Yet a more responsible path for unions would be to make sure that their pension promises could be fulfilled before turning to the political agenda.

XII. Eight Case Histories

The following eight case histories illustrate issues related to union pension plans. Until the passage of the Pension Protection Act of 2006, the Department of Labor did not have the authority to impose corrective action on underfunded plans. As a result, a number of weaknesses in union pensions grew to harm rank-and-file union members. There have been instances of outright wrong-doing—embezzlement, kickbacks, and similar illegal activities—but far more harm has been done by the implicit forms of negligence discussed in previous sections.

Fortunately, some of the issues discussed in these case histories were addressed in the Pension Protection Act, to the consternation of union leadership. These case histories should act as cautionary tales that teach union members to be vigilant, to use all the tools the law gives them to keep a close eye on their pensions, and their leaders.

Service Employees International Union

On July 11, 2008, in response to an article published in the July 9 edition of the New York Sun by Diana Furchtgott-Roth on the state of union pensions[20], the Service Employees International Union (SEIU) issued a blistering press release. The article stated "Yet in 2006, the SEIU National Industry Pension Plan, a plan for the rank-and-file members, covering 100,787 workers, was 75% funded. That is, it had three-fourths of the money it needed to pay benefit obligations of workers and retirees. In contrast, a separate fund for the union's own employees, numbering 1,305, participants was 91% funded. Even better, the pension fund for SEIU officers and employees, which had 6,595 members, was 103% funded."

The SEIU lambasted the article and claimed that the SEIU National Industry Pension Fund had achieved high funding levels, 92 percent in 2006, and 96 percent in 2008[21]. Now, perhaps the union's internal calculations showed the SEIU pension plan was in good shape, but in 2009, the SEIU National Pension Fund reported to the DOL that it was in critical status—a sign of serious funding deficiencies that suggests the SEIU's arguments were ignorant at best, and disingenuous or worse if they were aware of these problems[22].

In addition, three of SEIU's pension funds were in endangered status as of 2008, and this year the 1199 Pension Fund declared critical status[23].

The Local 32BJ District 36 Building Maintenance Pension and the Local 32BJ District 36 Building Operators Pensions cover together 7,000 people. And the SEIU 1199 Greater New York Pension covers another 29,000, or 36,000 in New York in all.

Under the 2006 Act, these workers are not allowed to win increased pensions in new rounds of bargaining, and in many cases have to accept lower benefit accrual rates—which imply smaller annuities than promised and expected—until the fund is fully funded again.

While these endangered plans may cause hardship for some or many of the 36,000 workers when they retire, the status of the

1199 Pension Fund (a distinct fund from the Greater New York plan) endangers the future income security of close to 200,000 health care workers in New York, Maryland, Massachusetts, and New Jersey. At the beginning of 2007, this fund had assets of $8.3 billion, but in the two years following the last Form 5500 filed by the fund, it lost one-third of its value[24]. This would be enough to reduce the funding ratio from 90 percent to 60 percent, assuming the one-third loss occurred starting in 2008. It would be easy to blame this decline on the economy and the stock market, and it is true that many pensions lost a lot of money as a result of the recession and stock-market slide. But it is also true that a large number of well-funded pensions did not lose one-third of their assets as a result of the recession.

While the SEIU National Industry Pension Fund bragged about its well-funded plan, a 2007 letter from the trustees reveals that the stability was achieved at the cost of cutting union members' future pensions[25]. The 1199 representatives, however, according to one source, refused to bring a reduction in future pension benefits to the bargaining table when they entered into negotiations to repair the failing plan[26]. Their desire to protect rank-and-file pensions would be admirable, were they not holding out for a promise they cannot keep—not without more money that neither the union nor employers have.

The national union is not responsible for the funding status of a district pension fund. The leaders of that district, together with the employers' representatives, have that responsibility. But the national pension fund had the right idea, cutting future benefits in the face of an international economic crisis. This sort of advice would have been critical to the 1199 Pension Fund in 2007, when it still had a strong funding ratio, but the national union leaders that claim credit for keeping the national plan well-funded did not deem fit to share this insight with their locals.

The end result is stunning in its inequity: 1,000 District of Columbia and Maryland nurses are facing a failing pension while the national pension—not to mention the 102 percent funded officer pension plan—flourishes. In the future, before bragging about its stability, SEIU should ensure that all of its workers are reaping the benefits.

E.I. DuPont

In 2007, the union pension plan for E.I. Du Pont De Nemours & Co. covered 157,794 people, 31,693 of them current workers. This plan was negotiated by the International Brotherhood of DuPont Workers (IBDW), which represents employees of E.I. Du Pont and its subsidiaries. In 2007, the plan was 109 percent funded, and according to pension documents is expected to recover from 2008 losses by the end of 2009.

It is not in any way the best-funded pension plan in the country, but the DuPont Pension Plan is well ahead of the curve among plans of comparable size, and even performed better than average in 2008. It is at no risk of falling into endangered or critical status, and DuPont and the International Brotherhood of DuPont Workers entered arbitration in May regarding the continuation of the defined benefit pension plan.

That the DuPont Pension Plan is a single-employer plan gives it natural advantages in easing negotiations and focusing workers' at-

tention on the responsibilities of union and employer alike to keep the pension well-funded. But single-employer plans are not certain to do well, even among smaller plans.

According to IBDW, their organization is unique. All members of the union – rank-and-file, officers, and even the executive board – are employees of DuPont or its subsidiaries and spin-off companies[27]. There are eight locals in IBDW, and the parent union's president can note how local presidents deal with the year's challenges individually. When DuPont considers layoffs, President Jim Flickinger of IBDW is defending his own interests as well as that of his constituents. And when the pension plan falls behind on its funding, every member of union management faces a real threat to his or her retirement security.

This may not be the perfect union paradigm, but there is a great deal to be said for the fact that its leadership is personally invested in the well-being of its members.

International Brotherhood of Teamsters

At the end of 2006, the Central States Pension Fund covered over 451,000 workers, with about 155,000 of them current workers. Yet on January 1, 2008, UPS, the parcel delivery company, bought out the contracts for 44,000 of those workers, paying the fund $6.1 billion and shrinking the number of current workers covered by the plan to about 106,000. The cash infusion, however, was not enough, and the fund determined it was in critical status in 2008[28]. At the end of the first quarter of 2009, the fund had $15.66 billion in assets—down from $17.36 billion at the end of 2008 and $20.67 billion in 2007[29]. Given that the fund's liabilities were more than $44 billion, forming a nearly $24 billion deficit in 2007, it is unsurprising that the fund declared itself to be in critical status when first required in 2008.

However, one of the Central States' sister funds, the Western Conference Teamsters pension, was in no such difficulty and anticipates few, if any problems in the future. In 2007, its funded ratio was 80 percent, and according to the annual funding notice from the fund's actuary, it was 97 percent funded in 2008[30]. It has dropped back to an 85 percent funding level in 2009, but reasonably expects to be fully funded without any extraordinary efforts.

So, what is the difference between these funds?

The major differences are three. First, the Central States Fund is managed by J.P. Morgan and Goldman Sachs, a holdover from a court decision made in response to the late Jimmy Hoffa's mismanagement of Teamster pension funds decades ago. (Hoffa was president of the international union in 1958-1971.) The Western Conference is controlled by the union and participating employers. It is tempting for unions and their supporters to blame the banks for poor performance, except that the same problems have plagued union pensions not controlled by court-appointed banks.

Another difference is investment strategy, a far more persuasive point. Over two-thirds of the Central States investments are in stocks, making its fund value heavily dependent on market performance[31]. The Western Conference funds are slanted towards more conservative, diversified assets. In 2004, the West-

ern Conference trustees held 56 percent of the fund in government and corporate bonds, 39 percent in stock, and 5 percent in real estate[32]. The Central States Fund's latest filings list 1.5 percent of their assets held in "other, primarily real estate related" sources[33]. But this is a disingenuous statistic, given that Central States' fund holds 33 percent of its assets in "fixed income" investments[34]. According to a Charles Schwab tutorial, "fixed income" securities include real estate investment trusts[35] and GNMA mortgage-backed securities[36]. It is therefore uncertain how much of the fund is and was invested in real estate, an ironic state of affairs given that the current pension structure came about as a result of Central States' historical real estate investments maintained by organized crime.

Arguments have been made that the bank-managed pension fund has a bias towards high-risk, high-reward investments, rather than the more conservative, and thus more stable, investments the Western Conference engages in. But saying that the trustees have no capacity to suggest or require more conservative investment strategies is dubious. It is far more likely that the trustees have been in favor of the high-risk strategy in the hope of high rewards. After all, the pensions on the line are for rank-and-file members, not the trustees.

The third difference between the funds is one that Central States can't blame on the economy, the fiduciary managers, or employers. In 2001-03, the Central States struggled with poor performance and a falling funding percentage. There were serious concerns that the Pension Benefit Guaranty Corporation (PBGC) would be forced to take over the fund, reducing guaranteed pensions to a maximum $12,870 a year for a worker with 30 years of service[37]. This was averted only by the Central States and its contributing employers developing a rescue plan that involved reducing future accruals of benefits, shuffling health and welfare benefit contributions to the pension plan, and requesting the IRS to waive minimum funding standards for a decade[38]. This waiver was contingent on the Central States maintaining a stable funding ratio, which they failed to do, and the fund applied for a second waiver in 2008[39].

In 2003, the Western Conference embarked on a similar recovery plan. Poor economic performance had caused $5 billion in losses that required the fund to cut accruals for future benefits[40]. They expected current benefits to soon exceed the fund's assets, which could hoist red flags at the IRS.

When the Western Conference reduced future benefits to protect the plan's funding ratio, it was already fully funded[41]. The actuaries knew that future benefits had to be reduced to keep the fund's ratio from slipping in the future, and did so to ensure that the benefits the rank-and-file had accrued would be protected.

The Central States, meanwhile, was trying to portray its fund's critical status as somehow positive. It argued in a 2008 newsletter to members that endangered plans are required to significantly increase contribution rates, develop a strict 10-year recovery plan, and possibly eliminate future benefit accruals[42]. The "red zone" – reserved for plans in critical condition – allows a longer recovery period and does not allow the fund to reduce benefit accruals below the Central States' current rate. While Central States did not lie about regulations, this rosy picture was a

sugar-coated —and self-serving—way for the Central States administrators to tell members that their pension plan won't be solvent for more than a decade, while better-off plans will have recovered faster, not to mention the fact that the plan would still have one-half or less of assets needed to pay all obligations.

The Teamsters for a Democratic Union[43], a dissident faction within the union, recognized that the administrators were not telling them enough. This faction thought Teamsters members ought to be able to see what was being done with their retirement money and demand accountability for poor performance. They asked to see the plan's quarterly financial reports, and when that failed, sued for access[44].

The problem with the Central States has been going on for years without stop. Only the Pension Protection Act, fiercely opposed by the Teamsters, forced the Central States to take decisive action to shore up its pension fund. The Western Conference fund shows that it is possible for a plan to remain solvent even in deteriorated economic conditions. All it takes is a little foresight, a little restraint, and a willingness to explain yourself. The Central States seems to have none of these.

Plumbers and Pipefitters

In 2008 the Plumbers and Pipefitters National Pension Fund (also called the UA National Pension) covered over 153,129 people. In 2008, it had a funding ratio of 55 percent[45]. This was a favorable and welcome development for a union with problems. In 2004, most of the board membership was ousted after a lengthy lawsuit over a poorly-run real estate deal[46]. An increase in the funding ratio two years after replacement of most of the board of trustees indicated that the fund was not doing as poorly as it might have.

However, at 55 percent, the fund was not doing well. Like many pension funds, after the stock market bull market of the late 1990s, the Plumbers' pension had a huge "amortized credit"—an imaginary number supposedly reflecting how much excess money the fund had due to previous contributions above minimum required payments and appreciation of investments.

Every year, a pension plan accumulates additional pension costs due to the additional year of service achieved by workers. This is called the "normal cost", and a pension plan that fails to acquire at least as much money over the year is falling behind. When a plan falls behind in its funding due to poor market performance, skipped payments, or similar events, it racks up debt that must be paid back in annual payments, much like a mortgage. When a plan is ahead on funding, it accumulates credits that it can use to reduce future minimum annual contributions.

The Plumbers' board of trustees has, in recent years, been paying its normal cost, but has not been paying back its debt accumulated in previous years. They use accumulated credits to reduce annual payments on the pension's debt, reducing money owed on paper while the plan still lags in value.

The Pension Protection Act lessened the Plumbers' ability to use this financial sleight of hand to keep from shoring up its low funding ratio, but the law came into effect only in 2008, delaying when we will see its effects on the Plumbers. It is yet uncertain why EBSA has not recognized the Plumbers as being in

critical condition, since their 2008 plan summary admits to a 55 percent funding ratio.

Southern California, Arizona, Colorado and Nevada Glaziers

The pension trust of the South Carolina, Arizona, Colorado & Southern Nevada Glaziers, Architectural Metal & Glass Workers Pension Plan is in poor condition. In 2007, it had 12 percent of the assets necessary to support present and future retirees, or a deficit of about $234 million. In 2008, the first year in which such a designation was required, the pension trust filed "critical status" notification with DOL[47]. The union had plenty of scapegoats to blame for this poor performance—and did. Unfortunately, the explanations all reflected poorly on the union's leaders' judgment.

In 1989, two men named Robert Ferrante and Peter Sardagna convinced the Glaziers pension managers to invest $34 million in a parcel of land in Carson, California. The land, which had previously been a landfill, was to be cleaned and resold as a shopping center, and so the pension fund could expect to realize a profit. The administrators continued to pay Sardagna as an independent consultant until 1995[48].

The union and plan administrators then agreed to the creation of a tangled financial relationship: the Glaziers' pension plan formed a limited-liability corporation to manage the property and agreed that Sardagna would aim to earn the pension a 15% return, plus $6 million (about $10 million in total). For some unfathomable reason, the administrators agreed that if the property sold for more than $44 million, Sardagna would receive 99 percent of the profits above that amount, even though the union had put $34 million at risk. Furthermore, they agreed to sell the property only with Sardagna's consent[49].

Had they known of it, this should have been a warning bell to union members. Not only was a man totally unconnected with the union given power over deciding the fate of a large asset of their pension fund, but money earned by union investments was going to be lost to an outsider, with the consent of their union leaders. These facts alone suggested the possibility of a corrupt relationship between Sardagna and union officials.

The union itself, had staff or officers made a diligent inquiry, would have known that Sardagna's savings and loan had collapsed on charges of bad loans and accusations of fraud (for which he was later acquitted). The fact that he blamed the collapse on bad loans related to the property later bought by the union pension fund ought to have been another warning sign. But under the advice of its investment manager, William Seay, the pension trust went ahead with the purchase.

However, when the pension trust was sued by the California government to clean up the landfill, the trustees turned around and sued the oil companies that they said were responsible for contaminating it. They eventually discovered that their fund administrator, William Seay, who had recommended the purchase, had been a part-owner of the land. Moreover, he contributed to unfounded union optimism about the value of the land, encouraging the union to continue to invest up to its eventual $34 million despite hefty

clean-up costs needed to make it a viable construction site. If that were not bad enough, he had once been a limited partner in the original owner of the property, and had "long ties" with Robert Ferrante[50].

Eventually, the union leaders wised up and sued Sardagna for full ownership of the former landfill when he held up a possible sale of the property to a man hoping to develop it for a National Football League stadium. This lengthy litigation ended in the fund's favor, but the opportunity had passed, and the land's value is still uncertain as of mid-2009.

In 2005, the union won back $243,945 from kickbacks Ferrante accepted from a real estate developer[51], and in 2003 Seay was convicted on charges of mail fraud for deceiving the union regarding his financial interest in their investments[52]. The Glaziers finally sold the property in 2004 for $30 million, at a loss, to a development group looking to create a shopping center and residential area[53]. It is possible the site will eventually show a profit, but the rank-and-file of the Glaziers will not realize these gains.

Technically, the wrongdoers in this case were Sardagna, Ferrante, and Seay. But the pension trustees saw nothing wrong with their investment advice and Sardagna's questionable financial arrangements until the corruption became fully evident. The trustees were not skeptical and vigilant from the beginning, as their fiduciary responsibility required. The union leadership gets points for ousting Seay, and for disentangling itself from Sardagna. But it is the union's responsibility to appoint responsible managers to its pension funds, and to perform due diligence in ensuring the managers did their jobs. Given Seay's history, it appears he managed the other Glaziers' funds poorly. Unions can easily blame fund managers for poor performance, but when the fund is free to choose its own administrators, the fault lies with the overseers – union leaders appointed to the board of trustees.

United Auto Workers

The UAW is practically synonymous with what were the fabled Big Three of the American auto industry—General Motors, Ford, and Chrysler. The trio was considered in the second half of the 20th century to be a cornerstone of American manufacturing. That history explains much of the 2008-09 panic around the GM and Chrysler's bankruptcies. Contract negotiations between UAW and the automobile companies have always been tense, in part because of the energy UAW puts into doing the best it can for its workers.

This history paints a rosy picture of the union, and for the most part, it is deserved. While UAW-negotiated wages have been competitive with that of Toyota's U.S.-based factories, hourly labor costs—wages and benefits—have run close to $70 at union plants, compared to about $46 at some non-union plants, and even lower in the South[54]. UAW's negotiated pension plans were doing well. In 2006, the UAW Chrysler plan, covering 52,500 active workers, was 87 percent funded. The UAW GM plan, covering 80,000 active workers, was 102 percent funded. And the UAW Ford plan, covering 85,200 active workers, was 105 percent funded in 2005, the last year available.

Part of this health came from the UAW's wisely giving concessions to the companies in 2003, when the Big Three were no longer

flush with profits. While UAW has resisted company proposals to reduce future pension benefits, the union, recognizing the companies' narrow circumstances, accepted 2004-2008 contracts with no new costs[55].

But unlike many of the case studies presented here, the UAW pension funds are sponsored by private corporations. With pension obligations a part of the auto companies' balance sheets, they truly have a vested interest in keeping the funds afloat. The Big Three funds are doing well, if not equally so.

Like the Western Conference of Teamsters, the GM pension trustees reacted to the stock market fluctuations early in the decade by shifting to a more bond-heavy investment strategy[56]. Ford suffered more losses after 2006 because it did not subscribe to GM's investment philosophy. Chrysler's fund after 2006 is a mystery because the company was bought out by a private equity group which did not have the disclosure obligations of a public company. None of these funds has even reached endangered status.

In fact, in 2003, GM took it upon itself to sell $20 billion of bonds and contribute the proceeds to its pension fund to cover shortfalls, long before the Pension Protection Act would have forced the company to notify its workers of a possibly critical status[57].

This highlights some of the strengths of single-employer plans mentioned earlier in this paper. Single-employer plans, like the Big Three's plans, give employers the responsibility for maintaining the pension fund, while multiemployer plans have nebulous responsibility, making it difficult to determine who, if anyone, should make payments if the fund experiences shortfalls. Furthermore, companies have an incentive to keep their plans well-funded that union leaders lack. Even privately-owned companies are forced to answer awkward questions if they let their pension funding slip, while publicly-owned companies could face losses in market value if a failing pension becomes public knowledge. Unions, however, have a host of scapegoats available if it looks like their pensions are in trouble.

If companies have much to gain from keeping their union pension plans funded, giving single- employer plans a funding edge, why do unions prefer to get companies to buy into their multiemployer plans? On paper, a multiemployer plan sounds like a good idea in some union industries, such as construction, where workers may change jobs often. But that benefit is diminished if the pension plan isn't well-funded.

Some unions argue that giving control of the funds over to the company is worse than leaving it in the hands of trustees "who are legally obligated to act in the best interests of the participants."[58] This is a disingenuous argument that assumes the same principles of funding and responsibility do not apply to single-employer pension trustees. Given recent history of union trusts using their funds as leverage against corporations that don't adhere to their worldview[59], one possibility is that unions are loathe to lose control of these large funds as tools for their agenda. Of course, that may not be in the union members' best interests.

Sheet Metal Workers

Starting in 2008, the Sheet Metal Workers National Pension Fund began a desperate attempt to rebuild its failing pension

plan. Covering 136,000 workers, 70,000 of whom were still working, the plan had slightly more than 50 percent of the assets required to cover its liabilities[60]. To comply with the Pension Protection Act, the Sheet Metal Workers, whose pension fund was in critical status, had to develop a 10-year plan to rebuild its funding ratio and ensure that it could pay promised pensions.

Like many failing pension plans, the Sheet Metal Workers had put much of its assets in stocks—62 percent in 2007. Naturally, this left the union vulnerable to stock market downturns, as its stock holdings lost 39 percent of their value in 2008, according to pension financial documents[61]. A chart provided by the union to discuss 2008 performance revealed another difficulty—the increasing costs of benefits. Through 2007, benefit costs increased steadily, while assets lagged in 2003 to 2005[62]. Perhaps more clearly than any other union pension plan, the Sheet Metal Workers' plan demonstrates one of the most common pitfalls to a collectively-bargained, union-run pension plan.

Before 2008, the pension plan offered a wide variety of extra options: an annual cost-of-living adjustment to the pension[63], a lump-sum payment option, a subsidized early retirement plan, a disability payment equal to maximum possible early retirement benefits, a 10-year guaranteed payment (that would go to a designated beneficiary after the retiree's death), and others. The sum of these benefits (most especially the cost-of-living adjustment) contributed to steady increases in the plan's required annual benefits payout.

Despite all the promised retirement benefits won by the Sheet Metal Workers' leaders through dogged bargaining with employers, they failed to put equal effort into securing those benefits. Because rank-and-file workers likely believed that benefits earned could not be reduced, there was little incentive to devoting energy to matching assets and liabilities—until forced by declining performance metrics. And even then, the leadership dissembled to conceal the extent of the problem.

In a 2007 letter to the rank-and-file, chairman Michael Sullivan assured his constituents that "critical" status "does NOT mean that the NPF [National Pension Fund] is unable to pay pensions. Rather, it means the actuary projects that if the NPF did nothing, it would have a funding deficiency within the next few years."[64] This statement is grossly misleading. The Pension Benefit Guaranty Corporation has assumed control over pension plans better funded than the Sheet Metal Workers, meaning that to the government, a plan that is 50 percent funded is in danger of being unable to meet its obligations.[65] Furthermore, the claim that "critical" status simply means the plan will have a funding deficiency in the future glosses over the fund's severe actuarial deficiency at the time of writing.

As a result of its critical status, the fund has had to cut back on many of its "adjustable" benefits. The cost-of-living adjustment was denied to new retirees and rolled back for those receiving it. Early retirement benefits were reduced. Lump sums and other optional forms of payment were eliminated. And, depending on the plan negotiated by individual employers, either benefit accrual was reduced to a minimum of 1 percent and certain early retirement options disallowed, or benefit accrual was to be set at 1.5 percent and annual contributions increased by 7 percent[66].

Union presidents do not like coming to

their members with bad news. The excerpt from Michael Sullivan's early notification demonstrates that. That tendency towards dissembling carries over into contract renewals, when union leaders highlight benefits won without acknowledging the costs. An increased pension is not simply a victory for a union. It is an obligation and a trust on the part of the pension sponsor, often the union that won the benefit. The effort put into maintaining that pension needs to be significant, lest the "adjustable" portions of that pension be lost.

UNITE Here Fund Administrators, Inc.

In 1922 the Amalgamated Clothing Workers, a predecessor to the present-day UNITE-HERE union, founded a bank in Chicago to service the financial needs of blue-collar working people, especially union members. (The ACW founded a sister bank in New York City in 1923.) The Amalgamated Bank of Chicago's board is today still heavily weighted with union leaders and supporters, and retains connections to its founding organization. UNITE-HERE's relationship with the financial services industry has given it a leg up in creating financial services entities to serve the union world and the public.

Among these was Amalgamated Life, founded in 1943 to offer insurance services to the UNITE-HERE (then Amalgamated Clothing Workers of America) funds. While originally created to serve members of the UNITE-HERE constituent unions, in 1992, Amalgamated Life received permission to sell its services to the public.

Another service created by UNITE-HERE is the UNITE Here Fund Administrators, which in 2007, according to its IRS Form 990, "performed administration work for six health & welfare funds and five retirement funds." UNITE Here Fund Administrators in 2007 charged $33 million for its services, when it was carrying an employee payroll of $15 million.

UNITE-HERE should be concerned about the continuing entanglements of these three organizations and their inherent conflicts of interest. The first worrisome sign is that 21 UNITE-HERE leaders, including president Bruce Raynor and hospitality industry president John Wilhelm, are reported as having a controlling relationship to Amalgamated Bank. All told, UNITE-HERE holds a 57 percent interest in the bank, and its leadership earned $428,600 in compensation from the bank, an average of $20,400 each.

The UNITE HERE Retirement Fund has a number of stock holdings, including all of the common stock of Alico Services Corporation. Alico, in turn, owns UNITE Here Fund Administrators and the Amalgamated Life Insurance Company. It is one thing for UNITE-HERE to have founded all of these organizations, and quite another for UNITE-HERE's administration to directly control all of them. It is a direct conflict of interest to have pension funds invested in related organizations. And although the DOL determined the arrangement was legal, it is decidedly odd that in 2005 UNITE-HERE sought to purchase 15 percent of Alico's stock[67].

Technically, UNITE-HERE does not directly control UNITE Here Fund Administrators. Its president, secretary, and vice presidents are Ronald Minikes, Mark Schwartz, Michael

Hirsch, and Paul Mallen. However, all save Ronald Minikes are vice presidents at Amalgamated Life, all earning salaries in excess for $100,000 for their services. But the directors of UNITE Here Fund Administrators include such people as Bruce Raynor, Noel Beasley, and Edgar Romney, among other senior UNITE-HERE officers. Many of these same people are the trustees of the UNITE-HERE National Retirement Fund, which manages pensions for the union's own employees.

Despite the Retirement Fund's assertion that "the Fund has a written code of ethics which covers conflicts of interest," it is hard to imagine that the competing interests of fund administrators, the union, the pension fund itself, Amalgamated Life, and the Amalgamated Bank have had no effect on UNITE-HERE's financial status. This is not to say the fund is in dire straits—in 2007, it was 83 percent funded.

But Amalgamated Bank made close to $2.8 million in 2007 from investment fees from the UNITE HERE Retirement Fund, and the UNITE Here Fund Administrators took $13 million in fees for managing the fund. The Fund Administrators' fee amounts to $47 per participant. In contrast, the staff pension plan was administered by Alicare, one of Amalgamated Life's companies, for $129,000, $22 per participant. It is unclear why rank-and-file members are being charged more than twice the amount the union's staff pays for plan administration.

Presumably these relationships have existed long enough that the federal government would have identified any wrongdoing, but the arrangement still produces a curious set of financial relationships. There is no clear explanation why the staff pension plan is managed by a different entity than the rank-and-file pension, one that does its job more cheaply and more effectively[68]. Non-profit records give no indication how UNITE-HERE's administrators keep separate the interests of their numerous financial holdings. And nothing suggests how the leaders of UNITE-HERE find time to manage their union and make significant bonuses from Amalgamated Bank at the same time.

The case of UNITE Here Fund Administrators highlights another problem in the world of union finances, especially defined benefit funds. Even with the level of transparency required, administrators can easily cloak administrative and management fees in mystery to keep workers from understanding just how their pensions are being managed. And in complex situations like that of UNITE-HERE, administrators can generate opportunities for profit even without resorting to embezzlement.

XIII. Conclusions

Despite their rhetoric, unions cannot deliver a retirement more secure than that offered by non-union plans. By standardized measurements, union-run pension plans fare consistently worse than their non-union counterparts. As noted above, while 59 percent of union funds had 80 percent or more of the assets needed to pay expected costs, 86 percent of non-union funds did. Unions may promise their members superior benefits, but they do not deliver.

Union leadership has contributed to this problem by negotiating for pension benefits that are more than affordable, often seeking pension increases in the face of consistent employer warnings about cost. Many unions believe that increasing benefits is more important than keeping pension funds fully funded.

Trustees need to make wise, informed decisions to help pension funds remain stable. Funds with conservative investment strategies, especially those with lower stock and real estate holdings, have fared far better than those with high-risk investment strategies. But negotiators have to commit themselves to supporting higher funding ratios, as well, even though the riskier, more volatile growth stocks chosen to pay for future benefits are also more volatile. The Pension Protection Act has gone a long way towards forcing unions with troubled funds to negotiate for more affordable benefits, but labor needs to work more proactively. After all, it is cheaper to pay now to keep a fund from slipping than to wait until assets depreciate and someone is required to pay again to keep the fund solvent. Furthermore, labor leaders ought to recognize how benefits influence overall pension costs and how this affects funding ratios. Even modest sweetening of benefits can cause large increases in future obligations. In short, benefit increases are not always in the workers' best interests. Unsustainable gains in benefits lead to expectations that must ultimately be disappointed.

Union leaders have few incentives, however, to take such a proactive, cautious view. Their own pension plans are often separate from their members', meaning that a failed rank-and-file pension plan has no personal, pocketbook impact on the leaders. The sound condition of union leaders' pension plans relative to the condition of rank-and-file plans demonstrates that union leaders know how to properly manage pension plans, and therefore must have some idea about how they are endangering workers' futures. Furthermore, the fact that officer pensions tend to be run by officers themselves lends weight to the proposition that individuals are far better off when in charge of their own financial future.

The real problem is the opacity of union pension financing, and the lack of accountability required of union leaders. The Pension Protection Act has exposed more than 300 poorly funded plans, forcing them to take account of their insecure positions and to make efforts to rebuild. Yet, even with the Act, bizarre entanglements like those of UNITE-HERE are possible, and the expenses of some pension funds are still shrouded in mystery.

The Act has had other positive effects,

some lambasted by unions. Struggling plans cannot increase benefits, and must limit non-standard pension options, preventing plans in poor condition from further expanding pension costs. The Act also requires unions to give participating employers options when their workers' pension plans are in trouble. No union can simply demand an employer increase contributions to support a flagging pension fund.

Yet the law deals only with the symptoms of the problem. Forcing pension plans to bring their accounting back into order is a good idea, but fails to address the age-old principal-agent problem. That is, union members have few assurances that the trustees of their pension funds are truly acting in their best interest. But the continued poor status of union-run pension plans suggests that union trustees are not adequately working towards ensuring that rank-and-file members will have stable financial futures.

Unions are eager to point out the flaws in defined contribution plans, and certainly the current economic downturn demonstrates there are flaws in these plans. But defined benefit pension plans have fared just as poorly, and unlike with a defined contribution plan, workers cannot identify the exact loss and its impact on them. Given the expertise union leaders have shown in managing their own pensions, they could easily offer advice to workers to help them protect their futures.

Whether workers continue to prefer defined benefit plans or push for more defined contribution plans, it is clear they need to demand more accountability from union leadership, to ensure that they can achieve the benefits that union leaders promised them.

Appendices

Appendix I: *How Do Pensions Work?*

A defined benefit pension plan is a promise to pay each participant a specified sum of money during each year of retirement. Such annual payments (usually divided into 12 monthly disbursements) are called an annuity.

Annuities can result from pension payments and they can be purchased from insurance companies. Let's examine how this aspect of finance works. The calculations that follow are a simplified model of how these plans work in the real world. Few individuals make these calculations themselves, but the example is intended to illustrate a simplified version of the process that pension actuaries go through.

Imagine a 35-year-old woman (we will call her Susan) who wants an annuity to pay her $50,000 a year after she retires[69]. If her bank promises a flat, unchanged interest rate of three percent, she can plan her retirement income with a fair degree of certainty. Susan will first calculate how much money she must have earning 3 percent to generate $50,000 a year after she reaches 65. Then Susan will calculate how much a year (or a month) she must pay under her contract to fund the annuity. The younger she is when she enters into the annuity contract, the more payments she will make, but the lower each annual contribution must be.

According to the Social Security Administration, a 35-year-old woman can expect to live approximately 46.22 years, to age 81. Susan wants to play it safe, so decides to assume that she will live until age 85. Thus she will need the annuity to provide her payments for 20 years, from age 65.

Susan first thinks that her annuity account will need to have $1,000,000 ($50,000 x [85—65]) in it on the day she retires at age 65. She quickly realizes that this is incorrect. Every year, the remaining balance in her account will grow by three percent, even as she withdraws $50,000 annually. If she has $1,000,000 on the day she retires, she will have more money than she needs because of the 3 percent interest rates.

So she looks at it another way. Say she were retiring next year, and wanted her bank account to have $50,000 in it. She would need to invest $48,543.69, because (1.03) x $48,543.69 = $50,000. If she wanted her bank account to have $50,000 in it two years from now, she would have to invest $47,129.80 today, because (1.03)2 x $47,129.80 = $50,000.

The bank advises Susan that in its 3 percent retirement plan she must save $12,500 a year, or about $1,050 a month.

If defined benefit pension plans were this simple, companies would not have so much difficulty with them.

Unfortunately, there are a number of complications that make the people who plan and track these funds (called actuaries) have much more calculating to do. Most of this work arises because companies prefer to make level payments every year to stabilize cash flows. There are also uncertainties that will arise over the years as the employer's payroll expands or shrinks, as compensation changes and as investment outcomes deviate from the original assumptions.

For all of these reasons, a plan may find itself underfunded or overfunded.

Earnings

Most defined benefit pension fund benefits are a percentage of an employee's annual earnings. The formula can be based on "average" earnings, as is Social Security, or it can be based on the worker's earnings during his last year or several years of work. In either case, it is tremendously difficult to predict how much a worker will earn during his last several years, perhaps 20

years into the future. So, for many workers, actuaries do not know in advance precisely how much their accrued benefits will be. Actuaries address this problem by making assumptions about the percentage growth of an employee's wages each year, and use that number in their calculations.

Experience

It is a common feature for one's defined benefit stream to be equal to a percentage of income per year worked. For example, a retiree whose benefit is one percent per year and who had worked for the employer for 10 years would receive 10 percent of his income, and if he had worked for 40 years, 40 percent of his income. This requires actuaries to develop models suggesting how much experience workers, on average, will have acquired before retiring or leaving the company. In other words, individuals who work for the company for 10 years will earn a much smaller pension than people who work there for 40 years.

Retirement Age and Lifespan

If employees are promised the same pension regardless of when they retire, then a person who retires earlier costs the company more than one who retires later. Consequently, pension plans reduce benefits for those who retire early and augment them for those who work beyond normal retirement.

Companies keep track of traditional retirement patterns, and try to estimate when their workers will retire. If workers tend to retire earlier, companies will try to increase contributions so that the employees can make larger payments for a shorter period. Their estimates are important for determining how much the company expects to owe each year.

Lifespan is another key variable. Workers who live to be 90 will receive much more in pension payments than workers who die at 70. If life expectancy increases over time by one year, the fund's pension liability increases.

Real Fund Growth

Susan, above, could predict exactly how much money she needed because she knew that the contractual interest rate was three percent, and always would be. Defined benefit plans do not put their money in banks, but invest in a wide variety of stocks, bonds, and other financial products that give different returns on the investment. The plans must assume that their money will grow at some rate, but have no guarantee that it will. This creates uncertainty about the future value of the fund. As some of the experience cited in this paper demonstrates, a defined benefit fund may find that it is overfunded and can relax contributions, or that it is underfunded and needs to augment contributions (assuming unchanged promised pension benefits). In either situation, employers and unions may have conflicting ideas about what should be done.

Normal Cost

The phrase "normal cost" refers to the annual expected increase in pension obligations. Normal cost involves increases based on additional experience earned by workers, increases due to increased wages earned, and costs incurred by adding workers into the pension fund. Given the model's assumptions, normal cost is easy to calculate. It is the minimum contribution one can make to a fund performing within expectations to ensure that the fund will have all necessary assets to pay future obligations. As a result, it is a good base for determining whether a fund is remaining stable or slipping in its funding ratio.

Actuarial Cost

The phrase "actuarial cost" refers to changes in pension obligations caused by changes in the underlying assumptions of the actuarial model. These include changes in expected retirement age, lifespan, and returns on investment. As actuarial cost often involves unexpected changes in obligations, it enters pension calculations as a series of amortized charges—debts held by the pension plan that function much like mortgages. Each year, the amortized charges require a certain flat payment be made to reduce it. A credit enters the equation when changes in returns or assumptions exceed expectations. Until recently, credits could be used to reduce the payments needed to be made to cover amortized charges or even normal costs, enabling a pension sponsor to avoid making any payments to the fund in years when credits were high enough.

Appendix II: *The Pension Protection Act*

Congress passed the Pension Protection Act of 2006 in response to growing worries over the defined benefit pensions of workers across the country. It intended to require pension sponsors to keep their funds actuarially sound, in the hope that the statutory requirements would ensure that no company or union would make promises to workers they could not keep.

The law prohibits plans that are less than 80 percent funded from increasing benefits. Further, it prohibits funds with less than 60 percent of their expected benefits from paying beneficiaries more than a monthly annuity payment, that is, no bonus payments.

Another of the Pension Protection Act's main provisions is a requirement that plans keep their funds financially sound, or "on target," with specific provisions to prevent funding lapse. In 2008, this target was 92 percent of all accrued liabilities; it increases annually to 100 percent in 2011.

The act calls upon pension sponsors to consider their total assets to be nominal assets—the bonds, equities and real estate the plan owns—reduced by their credits for appreciation of securities that are publicly traded. These modified assets would be the test of how well funded a plan is. Pension plans that are less than 80 percent funded or 70 percent funded using "at-risk" assumptions that mark up liabilities, are forbidden from reducing their calculated annual obligation to pay benefits by applying credits. The sponsor can otherwise use credits to reduce contributions to the plan.

Sponsors can discard credits in order to increase the value of their adjusted assets. This allows them to use past overpayments to bring poorly-performing funds up to their required funding ratio. Both choices reduce credits on the plan's books, and therefore increase assets allowable for calculating funding percentage.

Further, the Act requires at-risk plans (those with less than 60 percent funding) to contribute at least the normal cost each year.

The Pension Protection Act requires multiemployer plans, beginning in 2008, to absorb their entire funding liability as a 15-year debt. Multiemployer pension plans with less than 65 percent funding will have to identify themselves as in "critical" status, requiring the submission of a plan to the Department of Labor to regain proper funding status. Plans less than 80 percent funded are "endangered" and required to adopt a plan to revise benefits downward. The critical and endangered provisions apply only to multiemployer plans.

Both programs follow a similar path: the sponsor must provide two schedules to all participating parties. One reduces future benefit accrual (not currently-earned benefits), and the other increases contributions. Plans in "critical" status are specifically required to develop more complex action plans so that they can emerge from that status within 10 years.

In short, the Act's central purpose is to require plans to remain well-funded; it lays down specific statutory provisions to prevent lapses.

Starting in 2008, critically-funded union plans (assets are less than 65 percent of accrued liabilities) came under stricter scrutiny, as unions were forced to help employers and workers negotiate a middle ground between decreased benefits and increased costs.

Appendix III: *Data*

The Labor Department's Form 5500 has several options for listing plan assets and liabilities. How assets and liabilities are presented can influence the totals that matter for determining whether a plan is adequately funded.

There are chiefly two ways to calculate the assets of a plan. The first is to list the market value of assets at the date a balance sheet or report is issued. This is called the "current value" of assets. The other starts with the fund's assumed growth rate and averages any difference between current values and assumed growth over a period of time (usually five years). This is called the "actuarial value of assets", or AVA[70].

In this paper, the actuarial value of assets is used to represent plan assets. Especially in a time of great financial volatility, the asset smoothing aspect of the AVA prevents a single uncharacteristic year from significantly altering a plan's status. As a result, a funded ratio presented in this paper may show a traditionally well-funded plan to be well off, even if it has suffered in the recession. It may also show a poorly funded plan to remain in that status, even if it has experienced unexpected growth in one year.

One significant effect of this methodology would be that some plans may still be reflecting losses incurred as early as 2001, meaning that some would not reflect gains made in 2006 due to still-unrealized losses in previous years. ("Unrealized losses" means that an asset has been retained, not sold, and has a market value below acquisition cost.)

There are, in general, several ways to calculate plan liabilities. The first is a usually a "level percentage or dollar amount of contributions… to fund all anticipated benefits, whether earned or not earned…"[71] This is called the "accrued liability". Another method, the "RPA 94 current liability" is a standardized measure of benefits earned to date, using formalized interest rates. The accrued liability is calculated with interest rates chosen by plan administrators; the resulting value varies with demographics and investment policy, among other factors.

When comparing the funded ratios between plans, the RPA 94 current liability is more appropriate that the accrued liability because it is more conservative. The RPA 94 current liability tends to be larger than the accrued liability, and therefore leads to lower funded ratios than would be achieved by using the accrued liability to determine plan benefit costs. This bias, however, affects all plans, whether union or non-union, and does not affect the quality of comparisons between plans. And the Vice President of the Pension Practice Council of the American Academy of Actuaries, in a 2006 letter to Moody's, opined that the RPA 94 current liability was likely an appropriate measure to use in determining underfunding of pension plans, bringing into question whether this tendency of the measurements should be considered biased[72].

It is difficult to determine a single way to accurately measure assets and liabilities for defined benefit pension plans, given the great uncertainty inherent in these values. We have presented the reasoning behind our choice of variables, and some of the effects they have on our data.

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Endnotes

1 "Taft-Hartley" refers to the Labor-Management Relations Act of 1947.

2 DOL EBSA, 2009. This represents only reported endangered and critical statuses. Backlogs in filing and processing may have prevented certain funds from being listed.

3 A number of types of plans were excluded from the study. Frozen plans (those taking no new workers), plans acquired by the Pension Benefit Guaranty Corporation (those in severe difficulty or owned by defunct companies), cash balance plans (a fixed-interest defined contribution plan), and plans in their first or last year of operation were excluded.

4 All references to funding use a ratio of the actuarial value of assets held by a given defined benefit pension plan and the RPA '94 current liability. For further explanation of the use of these statistics, see the Appendix.

5 A much larger number of plans are less than 65 percent funded than are in "critical" status. This is due in part to the fact that "critical" notifications are required only by multiemployer pension plans, and due in part to delays in status notification. Some plans in apparent critical status in 2006 may have improved in the interim. Still, we will use "critical" to refer to all plans with funding ratios of 65 percent or less, for consistency.

6 Teamsters for a Democratic Union (TDU), 2006

7 These data refer to plans either filing as a small plan or with 100 or fewer active participants. Frozen plans, PBGC-run, and cash balance plans were omitted from the study. Again, those in the first or last year of operation were omitted, as were plans covering a single individual.

8 AFSCME and APWU pensions are typically public pensions. Their accounting rules and regulations differ from those of private pensions, and so are beyond the scope of this paper.

9 The IBEW Pension Benefit Fund is a "non-qualified" pension plan. It is a promise of a specified rate ($4.50 per month per year of service) of payment. Because it lacks certain qualities, the fund's investment earnings are taxed normally, and the fund need not adhere to certain reporting and minimum contribution requirements. The most meaningful result of this is that the funding level of this fund is not disclosed. However, for completeness' sake, we will report that in FY 2006, the plan paid out $101.7 million to beneficiaries and $46 million in contributions from member dues, and $286.7 million in earnings. The fund made $220.8 million over the year, a 12.6 percent gain.

10 Retrieved from AFL-CIO's EFCA page, http://www.aflcio.org/joinaunion/voiceatwork/efca/upload/Investor_EFCA_Congressional_Letter.pdf

11 Center for Responsive Politics, Federally Focused 527s by Industry

12 Center for Responsive Politics, PACs

13 Center for Responsive Politics, Business-Labor-Ideology Split

14 This includes the $27 million spent by the union and the $48 million the PAC filed as contributing, both drawn from FEC filings.

15 Service Employees International Union, 2008b, Article XV, Sec. 18(a)

16 *Wall Street Journal*, 2008

17 Service Employees International Union, 2008a, p 38

18 Based on calculations using the above commitment statement, and SEIU "fast facts", http://www.seiu.org/a/ourunion/fast-facts.php

19 While PAC contributions are often from individuals, FEC data show that PACs sometimes receive contributions from unions. And unions qualify as 527 groups, allowing them to contribute union funds for political purposes.

20 Last retrieved 9 August, 2009, from: http://www.nysun.com/opinion/holding-up-a-mirror-to-the-seiu/81472/

21 Service Employees International Union, 2008

22 Retrieved from EBSA's Critical and Endangered Status notification page, http://www.dol.gov/ebsa/critical-statusnotices.html

23 1199 SEIU, 2009

24 Massey, 2009

25 Board of Trustees of the National Industry Pension Fund, 2007

26 Massey, 2009

27 IBDW, 2009

28 Central States Funds, 2009, pg 3

29 Central States Funds, 2009, pg 8

30 Bolen, 2009, pg 1

31 Mc Garr, 2009, pg 8

32 32 Western Conference of Teamsters Pension Plan, 2003, pg 2

33 33 Central States Funds, 2009, pg 9

34 34 Central States Funds, 2009, pg 9

35 Real estate investment trusts (REITs) are companies that own and lease or rent real estate property.

36 Charles Schwab, 2009

37 This is based on PBGC documents regarding multiemployer plans. The plan covers up to $11 per month per year of service, and 75 percent of accrual rates above $11 per month per year, up to the maximum of $35.75 per month per year, or an annual pension of $429 per year of service. The explanation can be found here: http://www.pbgc.gov/practitioners/multiemployer-plans/content/page13111.html

38 Central States, Southeast and Southwest Areas Health and Welfare and Pension Funds, 2003, pg 6-10

39 Central States, Southeast and Southwest Areas Health and Welfare and Pension Funds, 2008b, pg 12

40 Western Conference of Teamsters Pension Plan, 2003, pg 2

41 Western Conference of Teamsters Pension Plan, 2003, pg 2

42 Central States, Southeast and Southwest Areas Health and Welfare and Pension Funds, 2008a, pg 5

43 A rank-and-file Teamsters organization dedicated to improving benefits and holding Teamster leadership accountable for their actions

44 TDU, 2008

45 Board of Trustees, Plumbers and Pipefitters National Pension Fund, 2009, p 8

46 McNamara, 2005

47 Moskalenko, 2008

48 Bronstad, 2003

49 Dolan, 2002

50 Abrahamson, 1998

51 Department of Justice, 2005

52 Christensen, 2003

53 Shearin, 2007

54 Maynard, 2008

55 Detroit Free Press, 2003

56 Walsh, 2008

57 Walsh, 2008

58 TDU, 2005

59 The Georgeson report on corporate governance (see References) shows that in 2008, the IBEW sponsored a resolution for electing board directors by a majority vote at Washington Mutual. LIUNA sought to separate the Chairman and CEO of Walgreen, and to link pay to performance for Wal-Mart. SEIU sought to "redefine" what an independent Board Chairman is at Bank of America, and sought to separate the Board Chairman and CEO of Wells Fargo. And the Teamsters sought to link pay to performance at Allergan (a health care company). Few of these companies have large union presences, nor are the unions even in the same industry of the companies whose governance they wish to alter. And all of these proposals follow a union narrative of "good corporate governance", rather than one of improved returns.

60 Sheet Metal Workers' National Pension Fund, 2009, p 1

61 Sheet Metal Workers' National Pension Fund and its Subsidiaries, 2008, p 2

62 Sheet Metal Workers' National Pension Fund, 2009, p 6

63 Beneficiaries received a thirteenth payment from the pension fund each year, equal to the percent increase in cost of living.

64 Sullivan, 2007, p 1

65 Pension Benefit Guaranty Corporation, 2009, indicates assumption of the Precision Custom Components, LLC pension plans, which were 58 percent and 53 percent funded.

66 Sheet Metal Workers' National Pension Fund, 2009, p 12

67 Department of Labor, 2005, p 47236

68 "Effectively" indicates that of 2007, the staff plan was fully funded, while the rank-and-file plan was not.

69 This assumes she intends to leave no money to heirs or other groups, wishing to consume all of her capital over her life.

70 If assumed growth is 8 percent, and in one year, growth is 13 percent, assets will be increased by 9 percent each year on the actuarial value of assets.

71 Segal, 2006, p 2

72 Segal, 2006, p 2

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