<u>United States Pension Benefit Plan Design Innovation: Labor Unions as Agents of Change</u>

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Labor Unions played an historic role creating the occupational pension system in the private and public sectors in the post-World War II era. That system, which was dominated by defined benefit pension plans, is in decline. The transition to a new system is economically and socially painful, and has been accelerated by two financial crises in the past decade. This paper uses a case study of a private sector union to demonstrate how labor unions can influence the renegotiation of the pension contract for American workers. The case study describes how one union evaluated the pension crisis from a sustainability viewpoint, and responded pro-actively by developing a hybrid pension plan that attempted to align the interests of all stakeholders through equitable risk sharing. The hybrid plan developed by this union eventually had a broader influence on the pension community at large and the public policy debate around the pension crisis.

<u>Keywords</u>

Labor Unions

Pension Crisis

Pension Contract

Hybrid Plans

Variable Defined Benefit Plan

Sustainable Pension Plans

“Above all, strong but independent employee representation is required on the governing boards of the pension funds. Both the present job and the future pension are employee interests. Both require guardianship for the employee through his representatives… and as a good many American labor leaders learned from New York City, the integrity of the employee’s pension fund assets (increasingly the employee’s main asset, and his main resource next to his job) needs to be protected.” Peter F. Drucker (1976)

“In the present crisis, unions continue to shoulder their traditional responsibilities of being spokesmen for employees in demanding that economic and political leaders take steps to propel the economy forward. The new question is whether the unions should also accept part of the responsibility of defining the policies, the directions, programs and projects for these ends, so as to help their following attain the desired level of high economic activity, and the rising economic and social well-being to which unions are committed. What steps should they take to discharge these responsibilities competently?” Solomon Barkin (1983)

The study of retirement and pension benefit design for the past thirty years has traditionally concentrated on the economics and behavioral features of defined benefit and defined contribution delivery systems. Little has been written about the institutions that sponsor and drive the direction of pension benefit design in our society. One institution that has shaped the United States retirement system in the post-World War II era is the Labor Movement. Labor unions played a key role in establishing defined benefit pensions for millions of workers in the late 1940s. The stage was set by the success and ingenuity of bigger than life union leaders, like Sidney Hillman and John L. Lewis, who established industry wide multiemployer pension plans in the clothing and coal industries. Their early efforts in achieving collectively bargained pension plans set the pattern for other major industries like steel and auto where by 1950, company pension plans were negotiated by the United Steel Workers and the United Auto Workers with the major industry employers (Sass, 1997).

The United States defined benefit pension system was not created in the corridors of Congress. Instead it emerged through a messy process of labor-management negotiations involving industrial strife, contentious litigation and threats of government intervention. Peter Drucker (Drucker, 1976) and Solomon Barkin (Barkin, 1983), whose statements introduce the beginning of this article, were prescient observers and commentators on the role of corporations and unions in the 20th century. Both experts looked beyond pure market economics, and focused on the role of institutions to better understand social, economic and political events and trends. They especially identified with and studied the role of unions as economic decision makers. The role that unions play in redesigning the future United States pension system is the subject of this paper.

Today, barely 65 years later, the United States defined benefit pension system is in the throes of an existential crisis. Two historic financial shocks in the first decade of the 21st century threaten the very existence of the system. The defined benefit pension plans that organized labor helped create in the mid-20th century began a long period of decline after 1980 and were displaced by the growth of defined contribution plans. The demise of the defined benefit plan system over this period correlates closely with the decline of Organized Labor in the United States. But if change and Schumpeterian ‘creative destruction’ are natural outcomes of capitalism, then the question of how social and economic change is managed and what replaces moribund institutions seems worthy of thought and study.

During the next 20 years the United States will experience the total transformation of the occupational pension system as we know it today. How this transition is managed and the form it takes will determine retirement outcomes for much of the American workforce. Even though the United States Labor Movement has been weakened, it is still strategically positioned in a number of high profile private sector industries and firms. Moreover, unions still play a dominant role in the public sector. This puts labor unions in a unique role to renegotiate the pension social contract in key parts of the American economy.

The objective of this article is to relate through a case study how one labor union, the United Food and Commercial Workers International Union (UFCW), attempted to manage an ongoing crisis among its collectively bargained multiemployer pension plans by introducing a hybrid plan to serve as a replacement for its traditional defined benefit pension plans. This case study will describe the development of that hybrid plan and how it gained influence beyond the UFCW and the industries it represents.

Multiple Financial Crises in the 2000's De-stabilize the UFCW's Traditional Defined Benefit Plans

The UFCW is a North American labor union with 1.3 million members in the United States and Canada. Its membership predominately works in retail food and food manufacturing. Upwards of 90 percent of the UFCW's membership are covered by collectively bargained pension plans. Two thirds of the UFCW membership, mostly in the retail food supermarket industry, participate in defined benefit multiemployer pension plans that are administered by joint boards of trustees equally represented by labor and management. The UFCW and thousands of signatory employers together sponsor 60 multiemployer plans with $25 billion in assets covering a total of 1.4 million active workers, inactive workers who have earned a nonforfeitable benefit, and retirees. The ratio of active to in-active participants is about 1:1. UFCW members work in low to moderate wage industries characterized by high turnover and part-time work. The average pension benefit currently being paid is only $500-600 per month. However, long service career members often earn pensions that are multiples of three to five times the stated average pension.

Most UFCW multiemployer pension plans were strongly funded using expected return assumptions averaging 7.5 percent as they entered the 21st century. Elusory funding surpluses that grew during the frothy capital markets of the 1990s were used to pay for benefit improvements including expensive early retirement subsidies. Funding policy discipline waned as bargaining parties agreed to multi-year contribution holidays. Perverse federal tax policy that capped the tax deductibility of employer contributions for fully funded pension plans promoted bad behavior by stakeholders. Herd mentality drove plans to invest aggressively in high volatility growth assets. Allocations to public equities at 60-70 percent were the norm.

When the Tech Bubble in stocks burst beginning in 2000, pension plans were unprepared for a ‘perfect storm’ of asset drawdowns and declining interest rates. Funding ratios dropped on average by over 30 percentage points as markets slid for three consecutive years, something not experienced since the market crash in 1973-74. The UFCW’s response to these new, gaping funding deficits was multi-prong. At the fund level, trustees started assessing investment risk more seriously by diversifying portfolios away from public equity. At the bargaining table, labor and management crafted new pension funding agreements that increased employer contributions and reduced future service benefit accruals. A number of these funding agreements had automatic trigger mechanisms that required changes in contributions and benefits based on certain projected actuarial events.

As plans started slowly improving their funding position after 2003, it became apparent that funding recovery would be slow and that a number of plans had been badly damaged. Many plans were projected to trigger the dire regulatory status under ERISA, called ‘minimum funding deficiency’, which would impose onerous lump-sum contributions and surtaxes on employers. These events stimulated a movement to reform the Federal pension funding rules, culminating in Congress passing the Pension Protection Act of 2006 (PPA). This was the first major reform of pension funding rules since the passage of the Employee Retirement Income Security Act (ERISA) in 1974 and the Multiemployer Pension Plan Amendments Act (MPPAA) in 1980. The UFCW took an active role in lobbying for PPA, joining the retail food industry employers and the National Coordinating Committee for Multiemployer Plans (NCCMP), the multiemployer community lobbying arm, in an effective labor-management coalition.

PPA created a range of funding zone certifications for multiemployer plans from ‘safe’ (green zone) to ‘endangered’ (yellow zone) to ‘critical’ (red zone). Plans are required to annually certify their zone status to the Internal Revenue Service (IRS). If the plan certifies yellow zone (<80% funded), the trustees have 270 days to implement a Funding Improvement Plan (FIP) that returns the plan to financial health within 10-13 years. If the plan certifies red zone (<65% funded), the trustees must promulgate a Rehabilitation Plan (RP) that returns the plan to financial health within 10-13 years. Both FIP and RP plans provide direction and funding discipline to the collective bargaining parties. Plans in red zone had the ability for the first time under ERISA to reduce or eliminate accrued early retirement and disability benefits for all plan participants except retirees (PBGC, 2013).

Pension plans had not yet recovered from the asset drawdowns of the Tech Bubble when the devastating shock of the Great Financial Crisis in 2008-2009 struck. Plans lost the equivalent of 30 percentage points of funding in one year. As a result, 70 percent of multiemployer plans certified yellow or red zone in 2009. The funding damage was so dramatic that Congress passed an amendment to PPA titled the Worker, Retiree and Employer Recovery Act of 2008 (WRERA) that allowed plans to defer actions required under PPA for one year. A second phase of Congressional action in 2010, called the Pension Relief Act (PRA), allowed multiemployer plans to amortize investment losses incurred in 2008-2009 over 29 years, in contrast to the 15 year period legislated by PPA.

The UFCW Assesses the Damage of the 21st Century Pension Crisis

The UFCW reacted aggressively to these financial threats by conducting an internal review and critique of its pension plans that was unconstrained by prior beliefs or union politics. The union's response was somewhat unique due to two institutional advantages. First, it had created an internal staff capability and expertise to advise the leadership on all matters related to pensions and health insurance. Secondly, the union leadership, to its credit, had the confidence to objectively evaluate bad news and consider unconventional solutions that would resolve serious problems undermining the benefit security of its membership.

In early 2006, in anticipation of PPA legislation (Congress enacted and President Bush signed PPA in August 2006), the union conducted a funding analysis of its plans by applying a number of Pension Benefit Guaranty Corporation (PBGC) funding and solvency screens to measure plan sustainability. The results were sobering. Two thirds of the UFCW's plans triggered two or more of the PBGC's screens. More than one third of the UFCW's plans were under 70 percent funded. Just as troubling, a number of UFCW funds that were fully funded in

2006 were projected to have minimum funding deficiency problems in ten years or less, and were expected to trigger yellow or red zone status in four to five years based on draft PPA legislation.

At the same time that the UFCW was conducting its internal pension study, a number of accounting, financial, and regulatory pressures were emerging. The Financial Accounting Standard Board (FASB) proposed new rulemaking that would have required multiemployer plan corporate sponsors to report unfunded liabilities on their income and balance sheets at market value using risk free rates, versus the plan's discount rate. In addition, credit rating agencies, like Moody's and Standard & Poor, were focusing research on multiemployer plan sponsors and industries, highlighting the growth in off balance sheet pension debt by firm and industry (Moody's, 2006). Concurrently, Congress tripled multiemployer plan premiums to the PBGC, which was itself experiencing growing deficits, and required plans to report a current liability funding ratio based on annuity rates that suggested even weaker funding ratios for plans.

This confluence of events served as the background to the internal UFCW pension study that was presented to the Union's leadership in spring 2006. The report raised for the first time a series of difficult policy questions for the UFCW's leadership:

- Were UFCW multiemployer plans financially sustainable?
- What was the cost of plan sustainability? Can signatory employers afford this cost in the current competitive environment?
- What were the ramifications of the pension crisis to the stability of the UFCW's collective bargaining system? What were the economic trade-offs for the union and its members?

- In light of this pension crisis, assuming pension benefits are frozen for a generation, what were the economic consequences for members' retirement replacement income?
- If the Union determined that its current plans were unsustainable, what alternative plan designs should be considered?

The next series of strategic questions were a direct outcome of the union's internal study, and became a focal point for leadership deliberation. Unions are political institutions, and these policy questions raised a series of political dilemmas for the UFCW.

- How would the membership and local union leaders respond to the pension crisis? Would the membership internalize its fear and anger against the union?
- Would the UFCW and its sponsored plans be subject to litigation and class actions brought by its membership over the issue of benefit reductions and plan failures?
- Would the membership support a strategy by the union to reform and redesign its plans?
- How would the union manage inter-generational equity issues as pension benefits became more differentiated between demographic groups based on when they began working in the industry?
- Would pension plan failures inhibit the UFCW's ability to organize and attract new members?

After assessing the political risks, the UFCW leadership opted for a pro-active, solution-based approach to the pension crisis, deciding that the status quo was more dangerous than renegotiating a new pension contract.

The Question of Plan Sustainability

The pension crisis that started in the first decade of the 21st century coincided with a number of emerging structural trends synonymous with the maturing lifecycle of these plans, many of which were 50-60 years old. Plan demographics had changed dramatically by 2000 due to stagnant union growth and the emerging impact of technological change. The absolute number and growth of retirees each year had overtaken the active worker population, which was the only source of employer contributions. Active pension participants were now supporting one to two inactive participants, a reversal from earlier decades when the Plans were new and growing (Kocken, 2011).

These demographic trends generated net negative cash flows, with annual benefit and administrative payments exceeding annual employer contributions, creating both a drag on asset growth and an additional burden on expected investment returns. The negative cash flow in a number of UFCW plans was projected to nearly double over the next decade.

Another characteristic of mature pension plans is that they become more dependent on investment income, making plans more at risk to investment return volatility. Investment income in mature pension plans accounts for 70-80 percent of total annual income. As pension plans discovered over the past decade, investment volatility can dramatically affect a plan's delicate funding balance. As the assets of mature pension plans grow, they become even more vulnerable to the rule of large numbers. A 10 percent drawdown on $1.0 billion is ten times that on a $100 million asset base. Larger pension plans are also highly leveraged, with assets equal to multiples of 30-50 times contributions. This makes it nearly impossible to recover from large asset drawdowns by increasing employer contributions.

Modern Portfolio Theory failed the pension system in the first decade of the 21st century. Pension portfolios that were assumed to be highly diversified, were, in reality, highly correlated to public equity risk and vulnerable to major asset drawdowns. The secular decline in interest rates completed the perfect financial storm for pension plans. Extraordinary monetary policy exercised by the Federal Reserve, in reaction to the threat of depression, sent interest rates even lower, adding to the investment pressures on pension plans. Pension plans with long liability durations face challenging asset liability mismatches with long bond rates below 4 percent. At the same time, the current situation creates perverse incentives for plans to take more investment risk than they can manage in an effort to earn expected returns of 7-8 percent. The mature defined benefit pension model became hypersensitive to capital market volatility. A few years of negative returns destroyed a decade of asset growth and funding, defunding once healthy pension plans, and driving many plans into a death cycle. This structural analysis of traditional defined benefit plans convinced the UFCW that the sustainability of their pension system was at risk and there was a need to search for alternatives.

Inspirations for Benefit Design and Governance Innovation

The UFCW has a history of pension benefit design innovation. In 1984, the UFCW National Pension Fund took advantage of high interest rates and eliminated its unfunded liabilities by purchasing an annuity from MetLife for the plan's past-service liability at highly favorable pricing. This transaction allowed the plan to re-start the fund as a future service only plan. Groups, differentiated by area and industry, were experience rated separately based on their individual demographics, but continued to share investment and administrative experience. The new future service plan was conservatively funded through a regimented process where the plan recalculated the actuarial cost of benefits every two to three years and required the collective bargaining parties to reset contributions in balance with those updated costs. This gave the plan a defined contribution quality, where labor and management determined the contribution/benefit formula that was right for their special market conditions. This unique funding/benefit system, with its self-adjusting mechanisms, was a major reason why the UFCW National Pension Fund remained fully funded and a PPA green zone plan throughout the crisis.

Another internal UFCW example of design/governance creativity was a plan sponsored by UFCW Local 1518 in British Columbia, Canada. The trustees of this multiemployer plan foresaw the secular decline in interest rates in the 1990s and made a politically courageous decision to move away from a pension model that measured liabilities based on expected returns to one that targeted liabilities to certain market interest rates. Instead of spending artificial surpluses in the mid-1990s on benefit improvements, the Local 1518 Plan adjusted its benefit liabilities to market interest rates and adopted a highly effective liability driven investment program that weathered the perfect storms of the first decade of the 21st century and maintained a fully funded status. The experience of the UFCW Local 1518 Plan suggested a viable investment risk management model that was worth emulation.

An important influence on UFCW staff was its consultations with Keith Ambachtsheer, an internationally-recognized pension strategist and big picture thinker who came to the attention of staff in the late 1990s. Ambachtsheer's concept of defined benefit plans as complex risk sharing arrangements and his rules of the 'pension deal' based on a contractual model, where terms must be clear and transparent and risk sharing must be fair and symmetrical, provided a theoretical framework for the UFCW to benchmark its ideas for building a hybrid plan. The Ambachtsheer principles of a clearly stated targeted pension benefit, a clearly stated expected cost of delivering the target benefit, a clearly stated risk-bearing deal between the various stakeholder groups, and a clear statement about how risk would be managed within the pension plan formed the philosophical building blocks for the UFCW benefit design. In addition, Ambachtsheer's work with leaders in two of the world's most successful retirement systems, the Canadian and Dutch, offered best practice insights into achieving optimum governance and benefit design (Ambachtsheer, 2007).

The UFCW was also influenced by the introduction in 2006 of the 'Retirement Shares Plan' (RSP), conceived by Don Fuerst and Mercer Consulting. RSP was a form of Variable Benefit Plan that had been established by IRS Revenue Rulings in the 1950s that allowed accrued benefits to vary based on plan investment performance. Variable Benefit Plans fell out of favor after the 1973-74 market crash, when these plans had no choice but to enforce severe cuts in retiree benefits. A major Variable Benefit Plan that survived that era is the Pension Plan of the Major League Baseball Players. RSP is similar to a defined benefit career accumulation pension plan. A percentage of each year's pay is used to buy retirement shares at the year-end purchase price of the shares. The benefit earned each year varies up or down with investment performance. The employee can change the investment mix each year and adjust his individual risk. At normal retirement, the employee receives an annual retirement income based on the number of retirement shares accumulated over his working life. During retirement, annual income varies based on investments (Fuerst, 2006). The RSP risk sharing approach became a model for the UFCW benefit design project.

<u>Deciding on Pension Design Priorities: The UFCW Evaluation Process</u>

The UFCW constituted a team of pension experts, including legal experts, actuaries, and pension investment consultants, to research and develop a new hybrid design. The team met regularly from late 2006 through 2009. In early deliberations the UFCW pension task force (the Committee) started formulating its goals and objectives. A substantial part of this discussion focused on pension legacy issues and how to transition to a new pension system. These legacy and transition issues are critically important, but are not the subject of this paper (Blitzstein, 2013).

The Committee began its work by rejecting the traditional defined benefit and defined contribution models. The UFCW's concerns about the recurring structural flaws in the traditional defined benefit plan were described in an earlier section of this paper. The Great Financial Crisis had effectively exposed the myth that all investment risk in defined benefit plans was absorbed by employers. Plan participants' recent experience with multiple rounds of pension benefit reductions since 2002 suggested otherwise. At the same time, the UFCW recognized the various risks facing corporations as plan sponsors. Changes in pension accounting rules, the opinions of credit rating agencies, and the ability of firms to withstand the balance sheet volatility of pension liabilities had to be recognized by the UFCW in its new plan design exercise. The risk of generating unfunded pension liabilities became a priority in the UFCW design exercise.

The Committee considered 401(k) plans, but these popular plans were rejected because their design imposed unacceptable risks on workers and retirees. The direct shifting of investment, mortality and retirement risk to participants by defined contribution 401(k) plans ruled them out as an alternative design. The Committee was suspect of the behavioral economic foibles embedded in the defined contribution model in regard to both contribution and investment decisions by participants. In addition, the low to moderate wage nature of the industries represented by the UFCW raised questions about the ability of the defined contribution model to generate affordable and adequate retirement benefits. The inflexibility of defined contribution plans to provide early retirement options, disability benefits and lifetime annuities further influenced the Committee's decision to discard the defined contribution model.

Similarly, the Committee also rejected cash balance plans. The cash balance design failed to offer an equitable alignment of risk between employee and employer. Employees gained no upside investment opportunity, and employers were still at-risk to investment downside. The fact that annual floor accruals decrease with age presented the UFCW and others with concerns about inter-generational conflicts among its membership. Another problem was that cash balance plan forfeitures from turnover automatically reduced employer costs instead of remaining within the plan asset pool. The final negative on cash balance design was the emphasis on lump sum payment at retirement versus lifetime annuity.

This exercise of evaluating existing plan designs was valuable because it focused the UFCW's efforts to build a customized retirement model. As stated earlier, the Mercer Retirement Shares Plan (RSP) provided an inspirational model for the Committee. However, even the RSP contained features that were contrary to UFCW's goals and principles. For example, the UFCW rejected the concept of employee investment choice within the risk sharing structure of RSP, and did not adopt the RSP benefit variability feature for retiree benefits.

This internal analysis led to a new plan set of design goals:

- Benefits should be fairly priced using interest rates more representative of long term historic interest rates.

- The new plan design had to be structured in a way that aggressively managed investment risk.
- The new plan design had to support stable employer contributions, along with a high probability of plan full funding.
- The stakeholders should expect the plan design to meet regulatory standards and scrutiny.
- The new plan design had to be matched with an effective and disciplined governance model.
- Pension benefit payments would be paid in the form of lifetime guaranteed annuities.
- The new plan design had to deliver on the contractual pension promise.

The Mechanics of the UFCW Variable Defined Benefit Plan Take Shape

By the end of 2007, the UFCW hybrid plan design had taken on form and structure. The Committee referred to their creation as the Variable Defined Benefit Plan (Variable Plan). (It was later referred to as the Adjustable Pension Plan or APP.) The Variable Plan was structured like a defined benefit plan in that retirement and longevity risks were pooled, and all assets were pooled and managed professionally. But in contrast to defined benefit plans, the Variable Plan shared positive and negative investment performance between the Employer and the plan participants. The Variable Plan benefit is the greater of two benefits that are separately calculated each year—a 'floor' defined benefit (that can be either a flat benefit accrual or salary-based career average formula) and a 'variable' benefit that fluctuates depending on actual investment performance. The benefit accrual each year can never be lower than the floor benefit.

The floor benefit is priced using the ‘floor interest rate’ plus plan demographics. An initial floor benefit was modelled to be $600 per year (the equivalent of $50 per month per year of service). The floor accrual does not change due to plan investment experience. However, the Variable Plan design anticipated that the floor benefit accrual was sensitive to changing plan demographics and would have to be recalibrated periodically.

The floor interest rate is also the performance benchmark for the variable benefit. The Variable Plan design envisioned setting the floor interest rate at 4.5-5.0 percent, a rate 30-40 percent lower than the expected return rates used by multiemployer private and public plans. The basis for the floor interest rate was long term corporate interest rates (20-30 year maturities). The median corporate interest rate between 1919-2007 was 5.25 percent. The 25th percentile for this historic period was 3.75 percent. In 2007, the average corporate long term rate was priced at 4.7 percent.

The variable benefit accrues in units (similar to RSP shares). Start-up unit values are set with an arbitrary value (e.g., $10.00 per unit). Unit values are adjusted each year based on actual investment returns compared to the floor interest rate benchmark. Every year the units earned equals the floor accrual divided by unit value at the beginning of the year (e.g., units earned = $600 divided by $10 = 60 units). The variable benefit is equal to the number of units times the unit value. This structure is important because, in combination with the floor benefit, it complies with the definitely determinable benefit accrual rules of ERISA, and allows for variable benefit changes year to year. In effect, participants are accruing units not benefit dollars.

In regard to the variable benefit, the Committee created rules of surplus management for the purpose of safeguarding plan funding:

1. Any surplus return in excess of a designated percent (e.g., 7-10%) would be capped ('Surplus Cap') and not applied to the variable benefit. These excess returns would become a reserve or margin that would be available as a contingency against future negative investment performance.
2. Excess returns earned below the Surplus Cap would be applied to the variable benefit by increasing unit values or units held (not by increasing the floor accrual rate). This approach does not increase the member's ultimate benefit, and as a result does not increase the employer's risk for unfunded liabilities. Issuing additional units provides the greatest flexibility for allocating excess returns through the variable benefit.

The Committee also applied the lessons of asset/liability leverage in maturing plans, discussed earlier in the paper, to the payment of retiree benefits. A Variable Plan would establish a policy that required the plan to annuitize or immunize all retiree payments when they became effective. The purpose of this approach was to insure the retiree liability as best as possible, and ensure that large asset/liability mismatches didn't occur and that retiree liabilities didn't dominate the plan's balance sheet over time.

The Committee devoted much of its limited budget to testing the financial robustness of the Variable Plan. Two Canadian consulting firms with insurance liability modelling capabilities were asked to recommend the most efficient investment strategy to deploy in order to meet the Variable Plan objectives. The Committee set a twofold strategy objective:

1. Achieve a minimum return of 5 percent each year with a risk parameter that anticipates a low standard deviation of 5 percent.
2. Seek an excess return above 5 percent without impairing objective number one.

After running a number of optimal asset allocation strategies, the Committee selected a beta-test asset allocation scenario that consisted of 5 percent cash, 36 percent investment grade bonds, 8 percent below investment grade bonds, 15 percent inflation-linked bonds, 25 percent hedge funds, 10 percent real estate and 1 percent commodities. When back-tested within the limitations of historic financial information and capital market assumptions, this asset allocation portfolio generated a 6.83 percent return with a standard deviation of 3.54 percent. Using the most recent highly volatile period 1998-2009, the portfolio returned on average 6.64 percent, including -5.96 percent in 2008, but with all other years returning above 5 percent. The Committee enhanced this strategy by adding a cash matching Liability Driven Investment (LDI) strategy that matched the plan's projected liability cash flows each year for the next 20 years of liabilities. Stochastic modeling results suggested that this combined strategy would generate plan surpluses consistently, allowing for variable benefit upside for benefits accrued.

The Committee was satisfied that it had created the appropriate policies and funding safeguards for the Variable Plan that fulfilled the original objectives and principles for introducing a hybrid plan to its affiliate local union officers, trustees, and employers. The superstructure of the Variable Plan embraced risk sharing within a defined benefit floor that was priced conservatively, with upside benefit potential controlled by a surplus return cap, and with funding risk managed by a flexible unit value benefit system and complimented by a low volatility investment strategy anchored by LDI cash matching liabilities.

The Committee debated what could possibly go wrong with their model, and determined that the one uncontrollable factor in the future of the Variable Plan was governance and policy discipline. The ultimate question was whether boards of trustees could break with the conventional investment and governance practices of the past, and instead, adopt and enforce policies unique to the Variable Plan. The Committee was convinced that it couldn't legally bind boards of trustees from deviating from the original policy rules of the Variable Plan. Only constant trustee education and institutional memory could secure the future.

The UFCW Takes the Variable Plan Public

In January 2009, The UFCW presented the Variable Plan for the first time to the employer members of the Joint Labor Management Committee of the Retail Food Industry (JLMC). The JLMC was established in 1974 by the organized supermarket companies along with the UFCW and the International Brotherhood of Teamsters (IBT). The JLMC provides a forum for union and company officers to discuss strategic public policy and collective bargaining issues. In a bold and brutally honest presentation about the pension crisis, the UFCW introduced the Variable Plan concept as a potential solution for the industry. The employers were impressed with the Union's directness and the pro-active nature of the presentation. After the JLMC meeting, the Kroger Company, the largest employer of UFCW members, invited the UFCW to present its analysis of the pension crisis and the Variable Plan to its February 2009 conference of Kroger trustees.

At the same time, the UFCW leadership mobilized an internal education campaign to address solutions to the pension crisis. Presentations were made to the UFCW's two most important governing bodies, the UFCW Executive Board, consisting of 50 vice presidents, and the Local Union Advisory Committee, accounting for about 80 local unions and councils not already represented on the Executive Board. The UFCW local union leadership was receptive to the Variable Plan idea and appreciative that the UFCW leadership and staff were taking the initiative by actively seeking practical responses to the pension crisis.

In May 2009, the UFCW held a one day ‘Pension Summit’ for union trustees. The Variable Plan was showcased at this conference and described in detail by the special taskforce members. Keith Ambachtsheer, Director of the Rotman International Center for Pension Management at the University of Toronto, was a guest speaker and offered expert guidance and support to the UFCW’s efforts to renegotiate its pension contracts and establish a new, more sustainable pension design model. During the conference, UFCW trustees responded positively to the Variable Plan. Consensus support developed in favor of advancing the Variable Plan idea and beginning a dialogue with Employers.

Throughout 2009-2010 the UFCW met with its largest Employers and presented the Variable Plan. In 2011, Kroger, the largest traditional U.S. supermarket chain, and the UFCW began a serious discussion about restructuring four multiemployer plans covering 180,000 participants, where Kroger was the dominant contributing employer (Blitzstein, 2013). All four plans were underfunded and certified red zone plans. Kroger was receptive to the UFCW strategy of issuing public debt to accelerate funding of the legacy pension deficits. The cost of bringing these merged plans to full funding was nearly $1.0 billion. The UFCW pressed for the adoption of the Variable Plan, but Kroger rejected the hybrid plan because of the uncertainty of the Variable Plan’s regulatory status, and the cost of replicating current benefits using lower interest rates required by the Variable Plan. The UFCW and Kroger reached an historic pension deal that became effective January 1, 2012. The new pension contract which created the UFCW Consolidated Fund was 10 years in duration, merged the four plans, prohibited benefit reductions during the contract term, established a new salary-based future service plan that targeted an agreed to replacement income, and committed Kroger to fully funding the plan and keeping it green zone under PPA through 2022.

The first attempt to introduce the Variable Plan failed. One could argue that the Variable Plan served a purpose by giving the UFCW a certain level of bargaining leverage and credibility with Kroger and other employers, supporting the union's goals in stabilizing four underfunded plans. Under the new pension deal with the UFCW, the union conceded its fiduciary authority over the Consolidated Fund's investment policy. In contrast to the beliefs of the UFCW and many pension experts, Kroger argued that it could manage the investment risk of a traditional defined benefit plan. Kroger, an investment grade company, was also confident that its strong cash flow and balance sheet could absorb the investment risk of the Consolidated Fund. The 10 year UFCW/Kroger pension contract will test Kroger's theory and resolve.

The Variable Plan Model Gains Acceptance Outside the UFCW

Today, the Variable Plan has gained attention and notoriety in pension public policy circles and the Labor Movement. The Variable Plan was presented to the Conversation on Coverage sponsored by the Center for Pension Rights and the Pension 20/20 Research Initiative led by the Society of Actuaries (SOA). Several unions made inquiries about the Variable Plan and a number of collectively bargained plans outside the UFCW have adopted the Variable Plan. Variable Plans have been established by Hotel & Restaurant Local 26 in Boston, Massachusetts; the Masters, Mates, and Pilots in Baltimore, Maryland; the Newspaper Guild (an affiliate of the Communications Workers of America) with both the New York Times and the Consumers Union; and the Sheet Metal Workers' National Fund. In addition, the Maine Public Employees

Retirement System enacted legislation to adopt the Variable Plan for new hires starting January 1, 2015.

The Variable Plan has also gained attention in pension reform conversations. In 2013, the National Coordinating Committee for Multiemployer Plans (NCCMP), the lobbying arm of the multiemployer community, presented Congress with a set of proposals to reform the multiemployer pension system. These proposals were based on a study commission called the Retirement Security Review Commission which published their findings in a study titled, 'Solutions, Not Bailouts' (DeFrehn, 2013). The section of the Commission study that promotes 'innovation' proposes that the Variable Plan be formally added to the IRS code. In Congressional hearings, the Variable Plan has gained a number of endorsements from Congressional leaders and staff.

Don't Waste a Crisis

The United States occupational pension system has experienced a painful and disruptive decade. The retirement paradigm that emerged after World War II is disappearing in the private sector and faces political and financial challenges in the public sector. Recent news involving the Boeing/IAM negotiations in Seattle and the Detroit bankruptcy provide further evidence of the unraveling of the pension deal. The transition from the old order to a new one has been ongoing since 1980, but has accelerated over the past decade due to major economic and financial fault lines. The future retirement security of tens of millions of American workers and retirees is in the balance. How American society adjusts and renegotiates the pension contract will determine success or failure with stark political and social ramifications.

The study of how stakeholders respond to these challenging events can be instructive to the pension crisis debate by identifying potential pathways to constructing a fair and equitable pension deal. The behavior and the decisions made by unions in the current environment will greatly determine the course of history. Traditional economic theory ignores or minimizes the institutional role of unions and other pension stakeholders in the private and public pension system. Other academic disciplines and theoretical frameworks, from sociology to political science, may add to the discourse over reforming pensions.

This paper questions the conventional research approach to the study of pension systems by introducing a case study that highlights the role of labor unions as agents of change. Jim Leech, the CEO of the Ontario Teachers' Pension Plan has advanced the union stakeholder concept in his recent book, *Third Rail: Confronting Our Pension Failures* (Leech, 2013). In two of the three case studies that frame his book, New Brunswick, Canada, and the Netherlands, unions played a decisive role in transforming their respective pension plans into sustainable systems. The United States Labor Movement, along with other pension stakeholder decision makers, should take note and grasp an historic opportunity to renegotiate the pension contract in America.

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