U.S. Senate
Republican Policy
Committee

Legislative Notice

Jon Kyl, Chairman

No. 52 January 21, 2004

H.R. 3108 S Pension Funding Equity Act of 2003

H.R. 3108 was passed by the House of Representatives on October 8, 2003, by a vote of 397-2, and subsequently was referred to the Senate Finance Committee.

NOTEWORTHY

- Under a unanimous consent agreement reached December 9, the Senate may, at any time, take up H.R. 3108, the Pension Funding Equity Act, with amendments limited by number and subject matter. In addition to a managers' amendment, the Majority Leader and Minority Leader, or their designees, may each introduce three first-degree amendments limited to three topics [see discussion on p. 3]. Relevant second-degree amendments may be offered.

- As passed by the House, H.R. 3108 would provide two years of relief for all defined benefit pension plans facing required contribution levels that may be artificially inflated.

- The bill provides relief by replacing the discontinued 30-year Treasury bond interest rate with a rate based on a composite of long-term corporate bonds for years 2004 and 2005.

- It is expected that Senators Grassley, Gregg, Baucus, and Kennedy will propose an amendment altering the replacement interest-rate language and adding two additional provisions to the bill: relief from Deficit Reduction Contributions (DRC) for under-funded plans in the airline and steel industry, and relief for underfunded, multi-employer pension plans.

- The Administration has warned that it will "strongly oppose" any effort to "eliminate, suspend, or weaken the Deficit Reduction Contribution." The Pension Benefit Guarantee Corporation (PBGC), the government agency which insures defined benefit pension plans, also opposes weakening of the Deficit Reduction Contribution.

Background

Pension plans are facing required contribution levels that may be artificially inflated. Current law requires traditional pension plans, which are defined benefit pension plans (as opposed to defined contribution pension plans, such as 401(k) plans), to make annual contributions that reflect the realistic liabilities the plan will face. In calculating these future liabilities, the law requires that an interest rate be applied based on the 30-year Treasury bond rate. The Department of Treasury has stopped issuing 30-year Treasury bonds, which has caused the interest rate they yield to significantly decline. A lower interest rate requires pension plans to make higher contributions because they are assuming a lower rate of return. When the 30-year Treasury bond was discontinued, Congress enacted a temporary rate (120 percent of the 30-year Treasury bond rate) for the years 2002 and 2003. That temporary rate fix has now expired. Therefore, many sponsors of pension plans will be required to make very large contributions in 2004.

In the Senate, both the Committees on Finance and Health, Education, Labor and Pensions (HELP) have approved separate legislation to address this problem, but only the HELP bill (S. 2005) has been reported and placed on the Senate Calendar. The Finance bill, which does not have a number, would have replaced the 30-year Treasury bond interest rate with a mix of corporate bond rates for three years, and then would have phased in application of a yield curve, established by the Secretary of Treasury. S. 2005 would replace the 30-year Treasury bond interest rate with a mix of corporate bond rates for three years, and would establish a blue-ribbon commission to recommend an appropriate interest rate to use after 2006.

The House has passed two bills to create a replacement interest rate. H.R. 3108 simply replaces the interest rate for two years (passed October 8, 2003 by a vote of 397-2). H.R. 3521 does the same, but also reduces Deficit Reduction Contributions for two years for pension plans sponsored by airline industry employers. H.R. 3521 also contained numerous tax extenders and miscellaneous trade and technical corrections provisions (passed November 20, 2003 by voice vote, and referred to the Senate Finance Committee).

Bill Provisions

As passed by the House, H.R. 3108 would establish a replacement interest rate for 2004 and 2005 for pension plans currently obligated to use the artificially low 30-year Treasury bond interest rate. It requires pension plans to use “a rate of interest which is not above, and not more than 10 percent below, the weighted average of the rates of interest on amounts conservatively invested in long-term corporate bonds during the 4-year period ending on the last day before the beginning of the plan year." The bill would require the Secretary of Treasury to select the corporate bond rates on the basis of one or more indices.

Neither this bill, nor any amendment permitted under the UC agreement, applies to lump-sum distributions from the fund. Therefore, distributions made to participants who select lump-sum distribution will still be calculated with the 30-year Treasury bond interest rate. Because this rate is low, lump sum distributions will be higher than they would have been under the temporary corporate bond rate.

Possible Amendments

Under the December 9 UC agreement, permissible amendments to H.R. 3108 must be related to the following topics: pension discount rate; deficit reduction contribution relief; and multi-employer plan relief. At press time, it was expected that Senators Grassley, Gregg, Baucus, and Kennedy would offer one amendment covering each of these areas; it is described below. Additional first- and second-degree amendments related to these three topics may be offered.

Grassley, Gregg, Baucus, and Kennedy Amendment

It is anticipated that this amendment will cover all three of the permitted topics.

Pension Discount Rate

The pension discount rate refers to the interest rate used by single-employer sponsored pension plans to determine necessary funding levels. Senators Grassley, Gregg, Baucus, and Kennedy will adopt the approach taken in H.R. 3108, but will make technical corrections to that language based on the HELP Committee bill, S. 2005. For years 2004 and 2005, the amendment would replace the discontinued 30-year Treasury bond interest rate with a rate based on a composite of conservatively invested, long-term corporate bonds. The Treasury Secretary will select which bond indices will make up the rate and select a rate that is between 90 percent and 100 percent of that average.

Deficit Reduction Contribution (DRC) Relief

The DRC is a payment required from pension plans that are significantly underfunded. A DRC payment is required in addition to the pension plan sponsor's normal annual contribution. The amount of the DRC payment is generally 30 percent of the unfunded liability (i.e., the amount required to get a plan 100-percent funded).

The DRC relief in this amendment is available only to the airline and the steel industries, and likely one other single-employer pension plan (which will be identified in the amendment). The amendment would give two years of relief to plan sponsors that did not have to make DRC payments in

2000 (the theory being that sponsors which did make DRC payments in 2000 have chronic funding problems and should not be excused from meeting funding obligations). Plan sponsors that would normally be subject to DRC liability may elect instead to contribute only the *greater* of: 1) 20 percent of the DRC payment in 2004 and 40 percent of the DRC payment in 2005; or 2) the plan's expected current liability for benefits accruing during the year, minus the regular contribution.

To prevent plans from becoming further underfunded during the two years of DRC relief, plan sponsors would be precluded from increasing benefits for those two years *except* for benefit increases required by collective bargaining agreements and cost-of-living adjustments. Pension plans which are 75-percent funded or less would not be allowed to increase benefits during the moratorium under even those circumstances. Plan sponsors would also be required to notify plan participants that the sponsor has taken DRC relief, thereby putting the employees on notice that the plan sponsor is not fully funding the plan. Any plan which takes DRC relief must also report to the PBGC how much in DRC contributions the sponsor was spared, how long it would take the company to become fully funded if only regular required contributions were made, and how the amount by which the plan is underfunded compares with the capitalization of the company.

Multi-Employer Plan Relief

Multi-employer plans are utilized in industries where work is short-term or seasonal, such as for electricians and plumbers. Companies and unions negotiate for pension plan contributions to a pension plan operated by trustees appointed jointly by the union and participating employers. This amendment would provide two years of funding relief and permanently require greater plan funding transparency for multi-employer plan participants.

The contribution relief proposed by Senators Grassley, Gregg, Baucus and Kennedy differs somewhat from the DRC relief being proposed for single-employer pension plans, mainly because multi-employer plans are not subject to the DRC. Instead, employers paying into a multi-employer plan are subject to excise taxes if the multi-employer plan is not fully funded. The level of the excise tax increases with each year below full funding, ranging from 5 percent to 100 percent of the underfunded amount. Additionally, each employer participating in multi-employer plans is liable for the full amount of underfunding, even when that is far more than they had agreed to pay.

The amendment would defer the obligation to make contributions compensating for losses realized between June 30, 2002 and July 1, 2006 for up to two years, but would not defer regular contributions. The obligation to make amortized payments on the losses realized from those years would be deferred, and excise taxes for failing to fully fund the plan would be waived for two years. Those multi-employer plans that elect to defer these catch-up payments and that are not at least 75-percent funded may not increase benefit levels unless the plan fully funds the increase over a shortened period of time. Additionally, the amendment adds permanent transparency requirements to give plan participants and contributing employers annual, written notice about their multi-employer pension plan, including: the funding level, asset level, ramifications of underfunding a plan, and description of the guaranteed benefits under the plan.

Additional Amendments

Amendments to provide relief from the DRC and to provide relief for multi-employer plans may face opposition from Republican Senators concerned about the deteriorating financial condition of the PBGC, which experienced an $11 billion loss in the single-employer insurance program in 2003 and has been placed on the Government Accounting Office list of “high risk” agencies.

DRC Amendment to Protect Taxpayers

Senator Kyl will likely offer an amendment to protect taxpayers from covering the losses of pension plans that become underfunded due to reduced DRC payments and default. The amendment will contain two provisions. First, it will hold the PBGC harmless for the obligations defaulted plans accrued while DRC payments were reduced. Benefits accruing during acceptance of DRC relief will not be insured by the PBGC should a plan default either during the DRC relief period or for two years after the DRC relief period. If a plan fails more than two years after the DRC relief period ends, the PBGC would insure the plan's full obligations. Second, the amendment will prohibit pension plans that accept DRC relief from applying for a "general funding waiver" from the Department of Treasury for the two-year period following the DRC relief. When granted by Treasury, general funding waivers may defer all or part of a plan's normal required contribution and DRC.

Multi-employer Pension Plan Procedural Fairness

Senators Lott and Smith may offer an amendment based on their legislation, S. 1857, the Multi-employer Pension Plan Procedural Fairness Act. The amendment would shift the burden of proof in disputes between multi-employer pension plan sponsors and former subsidiaries of employers who have withdrawn from the multi-employer plan. Current law provides a right of action against companies that spin-off subsidiaries in order to avoid paying their full portion of the liability for withdrawal from the plan - *this amendment would not change that.* However, current law presumes the employer is liable by requiring the employer to prove, by a preponderance of the evidence, that the intent of the separation was not to evade withdrawal liability. Moreover, current law requires payments to begin on such a claim within 60 days of receiving the claim – which can mean that employers must begin making payments even before a determination of liability has been made. This amendment would shift the burden of proof to the multi-employer plan instead of the employer, requiring that the plan prove by a preponderance of the evidence that the purpose of the employer’s separation was to evade withdrawal liability. It would also amend the law to require payments on withdrawal liability only once a final determination of liability has been made.

Cost

On November 21, 2003, the Congressional Budget Office reported that H.R. 3108 would increase federal revenues by $2.7 billion in 2004, $4 billion over the 2004-2008 period, and $304 million over the 2004-2013 period, by decreasing mandatory pension contributions and therefore increasing taxable profit. CBO estimated that the bill would decrease the amount of premiums paid by defined benefit pension plans to the Pension Benefit Guarantee Corporation (PBGC) by $279 million over the 2005-2013 period. CBO quantifies that estimate as a $279-million increase in direct federal spending.

Administration Position

The Administration issued a Statement of Administration Position (SAP) on H.R. 3108 on October 8, 2003, prior to House passage of the bill. The SAP expresses support for temporary replacement of the 30-year Treasury bond interest rate with a corporate bond rate blend. The Administration warned that it will "strongly oppose" any effort to "eliminate, suspend, or weaken the Deficit Reduction Contribution."

The Administration is expected to issue another SAP prior to Senate consideration of the bill. That information will be forwarded to all Republican Senate offices by email.

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