

# ***PENSION POINTERS.....***

## **PLEASE FORWARD TO THE LA FOR PENSIONS:**

In the near future your office again will be asked to take a position on pension reform. The currently pending bills are the most significant reform bills since ERISA passed in 1974. The choices made in crafting a final bill will encourage employers to establish and maintain defined benefit pension plans – or will encourage them to avoid those plans. The bills also make significant changes to rules governing defined contribution plans.

To assist you in understanding this critical legislation, we will be sending you short briefs on key issues in the bills. This brief discusses recent press coverage regarding whether the bills as approved by the House and Senate are stronger than current law. Put it in a special folder so you will have it readily available when the time comes for your office to determine whether the bill will help, or hinder, pension coverage in the future.

## **MYTHS AND FACTS REGARDING RECENT PRESS COVERAGE OF PENSION REFORM**

The pension bills pending before Congress, if modified in certain critical respects, would strengthen the pension system without pushing some companies toward bankruptcy and without leading other companies to stop providing pension benefits. Unfortunately, recent press coverage of pension reform has painted a misleading picture based on incomplete and inaccurate information. Set forth below are the myths as well as the actual facts.

**MYTH:** from the N.Y. Times, March 19, 2006, “Major Changes Raise Concerns on Pension Bill”, by Mary Williams Walsh (“N.Y. Times Article”). “With a strong directive from the Bush Administration, Congress set out more than a year ago to fashion legislation that would protect America’s private pension system.... Then the political horse-trading began.... In the end, the lawmakers modified many of the proposed rules.... As a result, the bill now being completed in a House-Senate conference committee, rather than strengthening the pension system, would actually weaken it....”

**FACTS:** According to the Congressional Budget Office (as quoted below), the two key funding proposals that arguably require less funding than under current law are the yield curve and 7-year amortization. These proposals are, in fact, drawn directly from the Administration’s proposal, not from “political horse-trading” as the article alleges. The studies that have claimed that the bills weaken current law have defined “current law” as requiring use of the 30-year Treasury bond rate to calculate pension liabilities. However, this rate has been recognized by essentially everyone – Republicans and Democrats in both the House and Senate, the Administration, labor, and business – as an inappropriate rate that does not accurately measure liabilities. The Administration’s proposal does not rely on this rate but rather on a corporate bond yield curve. Further, the 7-year amortization period included in the bills reflects the *strictest* period of time in the range of 7-10 years initially suggested by the Administration. In addition, as discussed below, the nature of these two provisions seriously undermines the legitimacy of the claim that the bills would actually weaken current law.

On October 17, 2005, Douglas Holtz-Eakin, Director of the Congressional Budget Office, wrote to Chairman Enzi, stating that:

The Administration’s pension reform proposal would increase PBGC’s 10-year costs by \$7 billion.... [The bill reported out of the Education and the Workforce Committee] would increase PBGC’s 10-year net costs by \$9 billion... The largest effects on overall net costs from both proposals are due to (1) extending

the use of corporate interest rates rather than reverting to Treasury interest rates for discounting future pension obligations, and (2) lengthening the period over which underfunding is amortized....

(An October 11 letter from CBO concluded that S. 1783 (as then in effect) would similarly increase PBGC costs by \$9 billion.)

As described by Mr. Holtz-Eakin and as noted above, the primary reasons for the adverse effect on the PBGC are (1) the switch from the 30-year Treasury bond rate to the yield curve and (2) the use of 7-year amortization instead of the current-law rules, which can require 4-year amortization for the worst-funded plans. One must seriously question whether these two provisions would actually weaken “current law.” Since the 30-year Treasury bond was discontinued near the end of 2001, the unadjusted 30-year Treasury bond rate has not been in effect for several years. Thus, a comparison based on the 30-year Treasury bond rate is hardly a valid comparison to current law. In addition, if the Administration itself recognized that 4-year amortization puts far too great a burden on companies, it is highly questionable whether struggling companies would be able to continue to make the contributions required under current law, or whether alternatively many of the companies would be forced into bankruptcy.

Thus, the so-called “weakening” of current law (1) is based on proposals drawn directly from the Administration’s proposal, and (2) relies on measures that are outdated and that all parties concerned agree are inappropriate.

**MYTH:** from N.Y. Times Article: “In the end, lawmakers modified many of the proposed rules, allowing companies [a] more time to cover pension shortfalls, [b] to make more forgiving estimates about how much they will owe workers in the future, and [c] even sometimes to assume that their workers will die younger than the rest of the population.”

**FACTS:** (a) The Administration proposed 7 to 10-year amortization; Congress chose 7-year amortization. Thus, Congress, instead of allowing more time to cover shortfalls, chose the more stringent end of the Administration’s proposal.

(b) The “forgiving estimates” reference is presumably a reference to the use of smoothing to measure liabilities. In fact, if no smoothing were allowed today, pension contributions would decrease because of recent increases in interest rates. Over time, smoothing by definition neither increases nor decreases liabilities; smoothing simply makes contributions more predictable.

(c) Under both bills, a company would be permitted to assume that its workers die younger only if the company can prove that this is true to the Treasury Department based on historical data.

**MYTH:** from N.Y. Times Article. “The biggest single-industry pension break in the bill passed by the Senate is for the airlines, to allow them to keep their unstable pension plans going.”

**FACTS:** Why is it a bad thing to allow plans to “keep going” and thus prevent them from terminating? Termination of the plans would reduce workers’ benefits and shift liabilities to the PBGC.

**MYTH** from N.Y. Times Article. “[T]he airlines... would also be allowed to factor in highly optimistic assumptions about their investment returns when calculating how much they needed to contribute to their pension funds each year.”

**FACTS:** Under the law, the airlines would not be permitted to assume investment returns greater than they have earned historically and can reasonably expect to earn in the future. Investment returns like 8% are what the article refers to as “highly optimistic”.

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If the Administration's funding proposal were to become law, a very large number of companies would stop providing pension benefits. And many other companies would be forced out of business. The bills pending in Congress address the shortcomings in the Administration's proposal to some extent, but more work is needed. Specifically:

1. **Funding obligations should not be increased due to a company's poor credit rating.** To impose huge additional funding burdens on struggling companies will have a severely counterproductive effect on companies' ability to recover, thus leading to more bankruptcies and terminations of underfunded plans.
2. **Pension assets and liabilities must be smoothed over at least three years. Smoothing provides companies with the predictability they need to make business plans.** If companies cannot predict their pension costs, they will not maintain pension plans.
3. **Credit balances must be preserved without onerous new rules.** Adverse treatment of credit balances would (1) disrupt business plans made in good faith reliance on the law in effect when the contributions were made, and (2) discourage companies from contributing more than the minimum amount required. The Administration's proposal to eliminate credit balances has already led to major declines in funding, as companies fear that they will not receive credit for extra contributions.
4. **The new funding rules need to be phased in.** The new rules can increase funding burdens by hundreds of millions of dollars, or billions in some cases. To impose these burdens too quickly would hurt companies, employees, the economy, and the PBGC.

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