

House Education &
the Workforce Committee

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BILL
SUMMARY

PENSION PROTECTION ACT: Strengthening Retirement Security, Protecting Taxpayers by Fixing Outdated Worker Pension Laws

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House Education & the Workforce Committee Chairman John Boehner (R-OH) and Employer-Employee Relations Subcommittee Chairman Sam Johnson (R-TX) have put together comprehensive legislation to fix outdated worker pension laws that present a danger to taxpayers, workers, and retirees.

WHY THE PENSION PROTECTION ACT IS NEEDED

The recent financial troubles and pension terminations at United Airlines underscore the need for fundamental pension reform. The airline situation and similar examples in other American industries are the consequence of outdated federal pension laws that don't reflect the realities of today's economy.

- **When worker pension plans are terminated as a result of outdated laws and the financial burden is placed on the federal government, workers and taxpayers both stand to lose.**
- When such terminations occur, the burden is assumed by the federal Pension Benefit Guaranty Corporation (PBGC), which now has an operating deficit that exceeds \$23 billion.
- As the financial condition of the PBGC continues to worsen, the prospect of a multi-billion dollar taxpayer bailout looms larger with each passing day.
- Comprehensive reform of our pension system is essential to ensure that millions of hard-working Americans who rely on these pension benefits can continue to count on them.
- **Without comprehensive reform to fix outdated federal pension laws, more companies will default on their worker pension plans – increasing the likelihood of a multi-billion dollar taxpayer bailout – and more companies will stop providing defined benefit pension plans to their workers entirely.**

PENSION PROTECTION ACT: SIX PRINCIPAL REFORMS

Chairman Boehner has outlined six key reforms to fix outdated pension laws, strengthen workers' retirement security, and reduce the prospect of a future multi-billion dollar taxpayer bailout. Boehner has vowed that the Committee-approved version of the bill will include:

- **Certainty.** Providing a permanent interest rate to accurately calculate employers' pension funding promises to their workers.
- **Common Sense.** Giving incentives to employers to better fund their worker pension plans during good economic times.

- **Stability.** Reducing funding volatility in worker pension plans by ensuring employers make adequate and consistent payments to their plans.
- **Honesty.** Prohibiting employers and unions from making promises to workers they know cannot be kept.
- **Transparency.** Giving workers more accurate and meaningful disclosure about the status of their pension plans.
- **Portability.** Resolving legal uncertainty to ensure hybrid plans such as cash balance pensions, which offer portable benefits that allow workers to earn more generous benefits steadily throughout their careers, remain a viable part of the defined benefit system. Staff is working to resolve details on this issue and expects to finalize the issue before subcommittee markup.

The *Pension Protection Act* shares many common features with the Bush Administration's pension proposal outlined in January 2005, and includes reforms to both the single employer and multiemployer pension systems. Following is a summary of the bill.

– SINGLE EMPLOYER PENSION FUNDING REFORMS –

Accurately Measuring Employers' Pension Funding Promises

Employers making major financial decisions must be able to predict and budget for their pension contributions every year or they'll simply freeze or terminate their plans and stop offering these voluntary benefits altogether. Workers also need to know that employers are making timely contributions to adequately fund their pension plans. The *Pension Protection Act* ensures employers use an appropriate interest rate to accurately measure their pension benefit promises and strengthens funding requirements to ensure that employers adequately and properly fund worker pension plans.

Modified Yield Curve Interest Rate. The *Pension Protection Act* includes a modified "yield curve" approach that provides a permanent interest rate for employers to calculate their pension contributions and more accurately measure current pension liabilities as they come due. It replaces the corporate bond interest rate that expires at the end of 2005.

Generally speaking, each pension plan has a unique schedule of future benefit payments that depends on the characteristics of the plan's workers and retirees. Under the modified yield curve in the *Pension Protection Act*, plans with more retirees and older workers, more lump sum pension payments, and shrinking workforces will make a greater percentage of their pension payments in the near future, while plans with younger workers, fewer retirees, fewer lump sums, and growing workforces will make a greater percentage of payments in later years as these obligations come due. This change will ensure that employers progressively make more contributions to pension plans as employees get older in order to meet their pension promises when workers retire. It also provides greater certainty and predictability for employers as they make financial decisions and budget to meet their future pension obligations.

The modified yield curve interest rate that employers will use under the *Pension Protection Act* to calculate their required contributions is based on the future date at which a pension plan's benefit obligations come due, as defined in three broad categories: liabilities due within five years, liabilities due in between five and 20 years, and liabilities due after 20 years and until the estimated end of the plan's obligations. Employers will use an interest rate based on when their pension obligations come due in these three time periods. For example, under the bill an employer would contribute more now to a plan on behalf of a 60-year old worker (within five years of retirement), than it would a 45-year old employee (six to 20 years before retirement) or a 30-year old worker (more than 20 before retirement). The specific interest rate for each time period will be determined by the Treasury Secretary's yield curve, which is based on an appropriate corporate bond rate comprised of several bond indexes.

The modified yield curve approach in the *Pension Protection Act* is designed to both ensure employers more accurately measure and fund their near-term and long-term pension obligations and give employers more predictability and certainty about their future pension costs.

Interest Rate for Lump Sum Distributions. The *Pension Protection Act* requires employers to use the three appropriate interest rates it uses under the modified yield curve to also calculate lump sum distributions for participants. Under current law, lump sum distributions are calculated using the artificially-low 30-year Treasury rate, which has the effect of inflating lump sum distributions that drain plan assets and are a major source of systemic pension underfunding. Using the same interest rates to calculate both employer pension contributions and lump sum distributions will ensure these benefits are calculated and funded properly and fairly without having an adverse impact on the rest of the workers and retirees in the plan.

Ensuring Underfunded Pension Plans Make Up Shortfalls. Under current law, the funding rules permit underfunded plans to make up their funding shortfalls over too long a period of time, putting workers at risk of having their plans terminate without adequate funding. Generally, today's rules only require plans to meet a 90 percent funded status target, or in some cases just 80 percent.

The *Pension Protection Act* requires employers to make sufficient and consistent contributions to ensure that plans meet a 100 percent funding target. If a plan has a funding shortfall, the bill requires employers to make additional contributions to erase the shortfall over a seven-year period. Under current law, there are several amortization periods for making up a shortfall, which in some cases can be up to 30 plan years. Experts agree this increases the risk of plan termination.

If an employer's plan falls below 60 percent funded status, it must make up the shortfall based on an "at-risk" liability funding target, which triggers significant accelerated contributions employers must pay. The change of a plan's funding assumptions to "at-risk" liability would phase in over a five-year period. In determining these extra contributions, employers must modify their actuarial valuations to assume accelerated retirement rates using the earliest retirement age or the most generous benefit distributions available under the plan. These new funding requirements will ensure employers have strong incentives to properly and adequately fund their plans in a timely manner.

Making Smoothing More Effective for Plans and Participants. Under current law, interest rates used to calculate pension assets and liabilities are "smoothed," or averaged, over five years for assets and four years for liabilities. Such smoothing is intended to reduce pension funding volatility and help make employer contribution requirements more predictable. Some have expressed concern that this is too long a period to smooth these rates. The *Pension Protection Act* reduces the smoothing of interest rates for both assets and liabilities to the maximum of the most recent three plan years using a weighted average (50 percent of the most recent plan year, 35 percent from the second year, and 15 percent in the third year) to protect pension plans against market and funding volatility on an annual basis.

Prohibiting Underfunded Plans from Using Credit Balances. The credit balance rules under current law contribute to plan underfunding, allowing employers with underfunded plans to replace cash contributions with credit balances accrued in previous years. This loophole allows underfunded plans to skip pension payments even if their plans are severely underfunded. The *Pension Protection Act* prohibits employers from using credit balances if their pension plans are funded at less than 80 percent.

Encouraging Employers to Better Fund their Pensions During Good Economic Times

Raising the Maximum Deductible Contribution. The current funding rules often force employers into the difficult position of being unable to make additional contributions to pension plans during good economic times and then being subject to accelerated contribution requirements during an economic downturn or market fluctuation. The *Pension Protection Act* permits employers to make additional contributions up to a new higher maximum deductible of up to 150 percent of current liability. Giving employers more flexibility to make generous contributions during good economic times will help provide workers and retirees greater retirement security by increasing the assets available to finance retirement benefits.

Ensuring Employers and Unions Don't Make Promises to Workers They Know Cannot Be Kept

Too often, employers and union leaders have negotiated benefit increases when plans are severely underfunded – misleading workers, digging a deeper financial hole, and increasing the likelihood that the PBGC will be forced to assume responsibility for paying the benefits, often at reduced levels, of terminated pension plans.

Limits on Benefit Increases and Accruals for Underfunded Plans. The *Pension Protection Act* restricts the ability of employers and union leaders to promise additional benefits when a plan is severely underfunded. The bill prohibits employers and union leaders from increasing benefits or providing lump sum distributions if a pension plan is less than 80 percent funded unless the plan sponsor immediately makes the necessary contribution to fund the entire increase or payout. Moreover, it prohibits further benefit accruals for plans with assets less than 60 percent funded status, which effectively freezes the plan.

Prohibiting Anti-Worker Executive Compensation Arrangements. The bill addresses a problem recently seen in the airline industry where executives of companies in financial difficulty are given generous nonqualified deferred compensation arrangements while the retirement security of rank-and-file workers is at risk. The *Pension Protection Act* restricts the use of such executive compensation arrangements if an employer has a severely underfunded plan.

The *Pension Protection Act* requires plans that become subject to these limitations to notify affected workers and retirees. In addition to letting workers know about the limits, this notice must alert workers when funding levels deteriorate and benefits already earned are in jeopardy.

Adjusting Premiums Paid by Employers to the PBGC

Two important steps are essential to improving the financial condition of the PBGC and ensuring its long-term solvency: (1) reforming the funding rules to ensure pensions are more adequately and consistently funded; and (2) increasing premiums paid by employers to the PBGC in a responsible fashion. It is important to note that ensuring employers fund their plans appropriately will prove more helpful to the overall defined benefit system than additional premiums paid to the PBGC. However, Congress has not raised premiums since 1991, so a reasonable increase is both prudent and necessary.

Flat-Rate Premiums. The *Pension Protection Act* raises flat-rate premiums employers pay to the PBGC but phases the increases in over time instead of hiking premiums immediately. For pension plans that are less than 80 percent funded, the bill raises the flat per-participant rate premium from the current \$19 to \$30 over three years. For plans funded at more than 80 percent, the premium increase is phased in over five years. The bill indexes the flat-rate premium annually to worker wage growth thereafter.

Variable-Rate Premiums. The bill indexes the variable-rate premium, currently \$9 per participant per \$1,000 of underfunding, annually to worker wage growth.

Ensuring that Cash Balance Pensions Remain a Viable Part of the Defined Benefit System

Cash balance pension plans – which are a type of defined benefit plan that is employer-funded, insured by the PBGC, and portable from job to job – represent an important component of worker retirement security. However, the threat of legal liability is creating ongoing uncertainty and undermining the retirement security of American workers who depend on these retirement plans.

A few employer conversions from traditional defined benefit plans to cash balance plans have raised policy questions about whether such conversions are age discriminatory. Notably, the vast majority of conversions have been handled properly, within the rule of the law, and to the benefit of workers. In a typical cash balance plan, a participant's account is credited each year with pay and

interest credits. Cash balance opponents have argued that pay credits for younger workers provide higher benefits than identical credits for older workers because the younger workers' credits accrue interest over a longer period of time. This is tantamount to arguing the concept of compounding interest is age discriminatory, which would make the most basic savings account illegal. Recent court decisions made clear that no age discrimination occurs with these plans if the pay and interest credits attributed to older employee accounts are equal to or greater than those of younger workers.

Moreover, under the Employee Retirement Income Security Act (ERISA) benefits earned under a traditional plan cannot be reduced when they are converted to a cash balance plan. Despite assertions to the contrary, vested benefits earned by workers are never reduced in a cash balance conversion. The majority of courts have ruled that cash balance and other hybrid plans are NOT age discriminatory, including the most recent court ruling on June 10, 2004, in the *Tootle v. ARINC Inc.* case.

Resolving Legal Uncertainty Surrounding Cash Balance Plans. The *Pension Protection Act* as introduced will not include finalized cash balance provisions. Staff is working to resolve details on this issue and expects to finalize it before subcommittee markup.

– MULTIEMPLOYER PENSION FUNDING REFORMS –

Multiemployer pension plans are defined benefit pension plans maintained by two or more employers in a particular trade or industry, such as trucking or construction, that are collectively bargained between an employer and a labor union. These plans must have an equal number of employer and union representatives on the board of trustees, which manage the plan. While multiemployer and single employer pension plans have some similarities, there are some fundamental differences as well. While single employer plan sponsors generally may adjust their pension contributions to meet funding requirements, the contributions of individual employers in multiemployer plans cannot be easily modified because their benefit contributions are fixed by the terms of collective bargaining agreements. In addition, because multiemployer contributions are tied directly to the total number of hours worked by active workers, any reduction in the number of active participants results in lower contributions to multiemployer plans, which contribute to plan underfunding.

One of the major challenges facing the multiemployer system is that these pension plans are funded by a declining number employers (with a declining number of active workers) but are paying benefits to a rapidly growing number of retirees. This "risk pooling" pension funding setup was designed for a 1940s era workforce that expected the multiemployer labor base to continue to grow; it has not. Only five new multiemployer plans have been formed since 1992.

Establishing Funding Targets for Multiemployer Pension Plans

All defined benefit pension plans, including multiemployer plans, must meet minimum funding standards. Multiemployer pension plans, however, are subject to different rules than single employer plans. Single employer plans generally aim to be at least 90 percent funded in order to avoid the trigger of additional contributions. There is no such funding target for multiemployer plans.

The *Pension Protection Act* establishes a structure for identifying troubled multiemployer pension plans, providing appropriate triggers for determining when plans are underfunded as well as quantifiable benchmarks for measuring a plan's funding improvement. The bill quantifies the health of certain underfunded multiemployer pension plans and separates them into two broad categories: (1) plans between 65 percent and 80 percent funded are "yellow zone" plans in immediate financial danger; and (2) plans that are less than 65 percent funded are critical "red zone" plans in need of reorganization.

The bill includes new requirements for multiemployer pension plans regardless of funding status. Specifically, it changes the amortization schedule for any plan benefit amendments from 30 years to 15 years. In addition, it increases the maximum deductible limit to 140 percent of current liability, providing additional funding flexibility for plans each year.

Endangered “Yellow Zone” Multiemployer Plans. Under the *Pension Protection Act*, if a plan is less than 80 percent funded or will hit a funding deficiency in seven years, plan trustees must design and adopt a program that will improve the health of the plan by one-third within 10 years. The bill prohibits trustees from increasing benefits if the increase would cause the plan to fall below 65 percent funded status. In addition, the plan trustees must adopt certain other measures for increasing contributions and restricting benefit increases until the plan meets that one-third benchmark.

Critical “Red Zone” Multiemployer Plans. The *Pension Protection Act* includes a series of requirements to address multiemployer plans funded at less than 65 percent that face significant and immediate funding problems. The bill strengthens the funding requirements for “red zone” multiemployer plans and requires trustees to develop a rehabilitation proposal to exit the red zone within 10 years. Multiemployer plans must provide sufficient and timely notice to workers, contributing employers, unions, employer bargaining representatives, as well as the PBGC, Internal Revenue Service, and Department of Labor that the plan is in reorganization.

Under the bill, the rehabilitation plan must include a combination of employer contribution increases, expense reductions, funding relief measures, and restrictions on future benefit accruals. These changes must be adopted by all bargaining parties. If, within 60 days of the due date for the rehabilitation plan, the trustees have not agreed upon a plan, any trustee may require the plan to enter into an expedited dispute resolution procedure. If the plan cannot emerge from reorganization within 10 years, the rehabilitation plan must describe alternatives, explain why emergence from reorganization is not feasible, and develop actions that the trustees must take to postpone insolvency.

The bill also requires multiemployer plan trustees to provide contributing employers, within 30 days after the plan provides the notice of reorganization status, with a series of automatic contribution surcharges. The surcharge will end when a new collective bargaining agreement is implemented that adopts a schedule of benefits based on the rehabilitation plan.

– SINGLE AND MULTIEMPLOYER DISCLOSURE REFORMS –

While ERISA includes a number of reporting and disclosure requirements that provide workers with information about their benefits, their timeliness and usefulness should be improved. The two chief sources of information are Form 5500, the “federal tax return” both single and multiemployer plans must file with the Department of Labor and Form 4010, which certain underfunded single employer plans must file with the PBGC.

Too often in recent years, participants have mistakenly believed that their pension plans were well funded, only to receive a shock when the plan is terminated. Without basic information, workers, contributing employers, lawmakers, and the federal agencies that oversee pension plans are left without the most complete and accurate information about the true funded status of these pension plans, which has troubling implications for workers who are relying on them for their retirement, and taxpayers who ultimately could face the risk of bailing out these plans.

Providing Workers with Meaningful Disclosure About the Status of Their Pension Plan

The *Pension Protection Act* gives workers, investors, and lawmakers more timely and useful information about the status of defined benefit pension plans to ensure greater transparency and accountability.

Enhancing Form 5500 Notice Requirements. The principal source of information about private sector defined benefit plans is Form 5500, the equivalent of a pension plan’s federal tax return. The *Pension Protection Act* requires both single and multiemployer plans to include more information on their Form 5500 filings. Specifically, if plans merge and file one Form 5500, the plan must provide the funded percentage for the preceding plan year and the new funded percentage after the plan merger. In

addition, a plan's enrolled actuary must explain the basis for all plan retirement assumptions on the schedule B, the actuarial statement filed along with Form 5500 that provides information on the plan's assets, liabilities, and compliance with funding rules. The bill also requires multiemployer plans to include on its Form 5500 filings the number of contributing employers in the plan as well as the number of employees in the plan that no longer have a contributing employer on their behalf.

Making Form 4010 Disclosure Publicly Available. Under current law, employers who sponsor single employer defined benefit plans that are underfunded, in the aggregate, by more than \$50 million must disclose to the PBGC certain information annually on Form 4010. The *Pension Protection Act* enhances these disclosure requirements and makes all Form 4010 information filed with the PBGC available to the public, except for sensitive corporate proprietary information.

Specifically, the bill requires employers to provide certain additional information to workers and retirees within 90 days after Form 4010 is due, including notifying them (1) that a plan has made a Form 4010 filing for the year; (2) the aggregate amount of assets, liabilities, and funded ratio of the plan; (3) the number of plans maintained by the employer that are less than 75 percent funded; and (4) the assets, liabilities, and funded ratio for those plans that are 75 percent funded or less.

New Notice to Workers and Retirees. Within 90 days after the close of the plan year, the *Pension Protection Act* requires both single and multiemployer pension plans to notify workers and retirees of the actuarial value of assets and liabilities and the funded percentage of their plan. Such notice must also include the plan's funding policy and asset allocations based on percentage of overall plan assets. The bill also requires multiemployer plans to make available certain information within 30 days of the request by contributing employers or labor organizations, including (1) copies of all actuary reports received by the plan for a plan year; and (2) copies of all financial reports prepared by plan fiduciaries, including plan investment managers and advisors, and/or plan service providers.

Multiemployer Withdrawal Liability Notice. The *Pension Protection Act* requires a multiemployer plan to notify a contributing employer of their withdrawal liability amount within 180 days of a written request. The notice may only be provided once within a 12-month period for a minimal fee. The notice must include the cost, per participant, of all workers in the plan without a contributing employer.

Summary Annual Report. The summary annual report (SAR) provides basic disclosure of information from the Form 5500 to workers and retirees. However, because this notice isn't required until 110 days after the Form 5500 is filed, the information is often already out of date. The bill requires both single and multiemployer pension plans to provide this notice within 15 days following the Form 5500 filing deadline.

– HIGH QUALITY, PROFESSIONAL INVESTMENT ADVICE –

Now more than ever, rank-and-file workers need access to high quality investment advice to help steer them through today's maze of investment options. What many workers may not realize, however, is that outdated federal rules discourage employers from providing workers with access to professional advice. As a result, millions of rank-and-file workers today are needlessly denied tools that could help them make better investment decisions to enhance their retirement security. Thousands of rank-and-file Enron and WorldCom employees might have been able to preserve their retirement savings if they'd had access to a qualified adviser who would have warned them in advance that they needed to diversify.

The *Pension Protection Act* includes a comprehensive investment advice proposal that has passed the House three times in the last several years with significant Democrat support, twice in the 107th Congress and once in the 108th Congress. It allows employers to provide rank-and-file workers with access to a qualified investment adviser who can inform them of the need to diversify and help them choose appropriate investments. The bill also includes tough fiduciary and disclosure safeguards to ensure that advice provided to employees is solely in their best interest.

Important Fiduciary Safeguards. The *Pension Protection Act* includes important fiduciary safeguards and new disclosure protections to ensure that workers receive quality advice that is solely in their best interests. Under the bill, only qualified “fiduciary advisers” that are fully regulated by applicable banking, insurance, and securities laws may offer investment advice. This ensures that only qualified individuals may provide advice. Under the bill, investment advisers who breach their fiduciary duty will be personally liable for any failure to act solely in the interest of the worker, and may be subject to civil and criminal penalties by the Labor Department and civil penalties by the worker, among other sanctions. Fiduciary standards are the highest form of duty and loyalty the law provides. In addition, existing federal and state laws that regulate individual industries will continue to apply.

Comprehensive Disclosure Protections. In order to provide advice under the *Pension Protection Act*, advice providers must disclose in plain, easy-to-understand language any fees or potential conflicts. The bill requires advisers to make these disclosures when advice is first given, at least annually thereafter, whenever the worker requests the information, and whenever there is a material change to the adviser’s fees or affiliations. The disclosure must also be reasonably contemporaneous with the advice so that employees can make informed decisions with the advice they receive.

Clarifies the Role of the Employer. The *Pension Protection Act* also clarifies that employers are not responsible for the individual advice given by professional advisers to individual participants; this liability is assumed by the individual adviser. Under current law, employers are discouraged from providing this benefit because liability issues are ambiguous and employers may be held liable for specific advice that is provided to their employees. Under the bill, employers will remain responsible under ERISA fiduciary rules for the prudent selection and periodic review of any investment adviser and the advice given to employees.

Voluntary Process. The bill does not require any employer to contract with an investment adviser and no employee is under any obligation to accept or follow any advice. Workers will have full control over their investment decisions, not the adviser.