Defined Benefit Security Act
Enzi-Kennedy[-DeWine-Mikulski] Substitute

Summary

Title I Single-Employer Funding Rules

The Chairman's substitute adopts a stringent new funding regime to ensure that defined benefit plans are fully funded. The new rules require the amortization of all liabilities over ten years, based on assets averaged over no more than 3 years and liabilities measured over a modified yield curve (3 segments) that is smoothed over 3 years. Full funding is raised under the bill from 90% to a 100% target, but phased in over 10 years to avoid severe disruptions. Credit balances would continue to be available to companies in order to promote enhanced funding, but assets must be marked to market performance. To prevent funding holidays and ensure cash is always going into the plan, the substitute requires that plans funded at less than 80% must pay the greater of their normal costs or 25% of their minimum required contribution. The bill requires that lump sum distributions be anticipated in the plan's actuarial projections.

Special new rules are established to encourage funding and prevent adverse actions. A new category of liability, known as "at-risk liability" is created which requires plans that fall below 60% funding to calculate additional actuarial expenses on the basis that employees will leave early and take lump sums and early retirement subsidies, thus accelerating the decline in the plan if stronger funding rules are not triggered. At-risk status, however, is not based on the credit rating or financial health of the company sponsoring the plan. Benefit limitations are also included in the bill. Plans falling below an 80% funding level may not increase benefits unless they are paid for up front, nor pay out lump sums, except at a reduced proportional rate based on the funding percentage of the plan. Severely underfunded plans (60%) would be required to freeze new benefits accruals. No exception is created for collective bargaining agreements negotiated before a plan's funding level falls below these triggers. In those instances, companies would be required to fund up to the trigger percentage to prevent the limitation from taking effect. Finally, companies of plans funded below 60% would be prohibited from enhancing deferred compensation for top executives.

Title II Multiemployer Funding Rules

In addition to restating current funding rules under ERISA, the substitute adopts a new regime for multiemployer plans facing funding crises. Generally, plans that face a funding deficiency within 7 years would fall into the "endangered" status, and must implement a funding improvement plan that is designed to improve funding by 1/3 over 10 years. More severely underfunded plans, that fall into "critical" status, would be required to reduce accruals prospectively and increase contributions as part of a rehabilitation plan designed to lift the plan out of "critical" status in 10 years. The Chairman's substitute does not include provisions allowing cutbacks of accrued benefits nor automatic employer surcharges.

Title III Interest Rate Assumptions

The Chairman's substitute requires that lump sums be calculated using the full yield curve rather than the 30-year Treasury bond rate. This change in law is phased in over 5 years.

Title IV Pension Benefit Guarantee Corporation

The flat-rate premium paid by all single-employer plans for each participant is increased from $19 to $30, but it is not indexed for inflation. Instead, the board of directors of the PBGC is instructed to recommend to Congress premium increases to address the financial health of the corporation. The bill repeals the full-funding exemption under the variable-rate premium, expanding the base of single-employer plans that pay the variable-rate premium to include all underfunded plans. Companies that terminate their defined benefit plans through the bankruptcy process will be required to pay a premium of $1000 per participant for the three years, but only after the company successfully emerges from bankruptcy. The bill also sets new, lower premium rates for new plans or very small employers.

Several sections of the Chairman's substitute are designed to cut the losses of the PBGC. In particular, the agency's guarantee is capped in bankruptcy when a company with a plan funded at less than 80% fails to make required payments into the plan. Shutdown benefits are not prohibited outright, but are treated as "ad hoc" amendments to the plan, effectively limiting the PBGC's exposure. Under current law, termination is the only tool that the PBGC can exercise when faced with a troubled pension plan. The substitute addresses this problem by granting the corporation the authority to negotiate alternative funding agreements that allow companies to keep funding their pension plans and avoiding a PBGC bailout. Conditions in the alternative funding agreement would ensure that the PBGC would not suffer further losses by participating plans, and give employees a better chance of receive their full pensions.

The bill also adopts the airline funding relief incorporated in S. 219 of the Finance Committee's bill and includes a special provision addressing the so-called "soft-freeze".

Title III Disclosures

The Chairman's substitute expands the notice and disclosure provisions of ERISA in order to achieve greater transparency and awareness of retirement security. The bill creates a new 90-day notice that informs participants and beneficiaries, unions and, in the case of multiemployer plans, contributing employers in a timely way of the true financial state of the plans for the most recent and two preceding years. Additional notices are required when benefits limitations are triggered or the company files for bankruptcy.

The substitute significantly expands participant and employer access to multiemployer plan actuarial and financial information. For the first time, contributing employers and unions will receive annual statements detailing the financial health of the plans and providing essential other information about plan practices that will help them manage their affairs and anticipate problems.

The substitute also expands the universe of underfunded or “at-risk” plans that must file extensive financial information with the PBGC that will help the agency anticipate and cope with declining plans. Employees of companies required to make the so-called “Section 4010” filings will receive special notices informing them of the financial condition of their plans.

Title VI Deduction Limits

Deduction limits would be raised for single-employer plans to 180% and for multiemployer plans to 130%.

Title VII Hybrid Plan Clarification

The substitute provides retroactive relief and prospective clarity to employers establishing hybrid pension plans. The bill clarifies that hybrid pension plans, such as cash balance and pension equity plans, are lawful and it repeals the so-called “whipsaw” rule for calculation lump sums. The substitute creates safe harbors for plans that have previously converted to hybrid designs and provided special transition protections to older workers when they did so. This retroactive relief is provided to companies that are not engaged in litigation on this issue. It also incorporates prospective conversion rules contained in the Senate Finance Committee pension legislation.

Title V Authority to Postpone Certain Deadlines

In light of the impact of Hurricane Katrina on business in affected areas, the Chairman’s substitute instructs the Secretaries of Labor and the Treasury, and the Executive Director of the PBGC to exercise their authority to postpone certain pension deadlines for up to a year.