



PENSION & BENEFITS



REPORTER

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Counterpoint: Retirement Security and Defined Benefit Plan Funding

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A top legislative priority for the business community is to secure legislation that will defer their pension plan funding obligations. As part of its tax extender bill, the Senate has already passed some provisions that would extend generous funding relief to almost all sponsors of defined benefit plans, including those employers that have frozen their defined benefit plans. Moreover, the Senate provisions do not provide adequate safeguards to protect employees against the risk of ultimate plan insolvency.

The House has a chance to pass a stronger bill that would better protect the interests of workers and retirees. The Pension Rights Center urges the House to pass, and defend in conference, an alternative version of funding relief—one that would provide adequate protections for plan participants and that would strengthen the defined benefit system.

The question of funding relief should be inseparable from the question of the retirement security of American workers. This article is written from that perspective. We believe that the primary beneficiaries of funding relief should be those plans that truly need the re-

lief and are still enabling to their workers to accrue benefits.

We also assume a point that some advocates for broad and unrestricted funding relief seem to have a difficult time conceding: funding relief, like lunch, is not free. It is essentially a forced extension of unsecured and low-cost credit from plan participants to the plan sponsor.

Funding relief could add to Pension Benefit Guaranty Corporation liabilities and could also result in some plan participants losing benefits. Properly designed funding relief should both minimize those costs and reward continued defined benefit plan sponsorship.

This article has four parts:

- Part I outlines participant protections to funding relief that we presented on behalf of the Pension Rights Center in congressional testimony. It is based on protecting and preserving defined benefit plans. While the provisions passed in the Senate as part of the tax bill and the proposals now being considered by the House of Representatives do not go this far, these protections represent what we believe is the right position in regard to funding relief. In a perfect world, funding relief would only be extended to companies that have stood by their defined benefit plans at a time when many firms were abandoning them, and would include provisions that promote participant interests.

- Part II disputes the idea that broad funding relief in its current form is a sensible jobs protection measure. It is not and treating it as if it were will have steep costs to participants and the PBGC.

- Part III discusses compromise provisions that we believe must be included in a reasonable funding bill. While such a bill would be, from a worker's perspective, imperfect, it would provide a workable approach to ex-

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tending funding relief to plan sponsors while minimizing the harm to participants.

- Part IV makes suggestions about how to improve pension policy in the future.

See also a counterpoint BNA Insights article representing the views of the American Benefits Council.

I. Targeted Relief and Participant Protections

In our view, there are two related rationales for funding relief.

First, as the economic recession has reminded us, defined benefit plans are the best retirement vehicles for assuring a secure source of income in retirement. Such plans provide retirees with a guaranteed stream of income for life and are not subject to the kind of catastrophic failure that has diminished the financial security of so many Americans who rely primarily on their tax code Section 401(k) plans to fund their retirement.

It is appropriate and necessary for Congress to take action to ensure the continued existence of these plans. Without funding relief, some companies will be forced to freeze or terminate their defined benefit plans.

Second, the companies who stood by their defined benefit programs while other abandoned them deserve support from Congress.

If the above are the rationales for funding relief, such relief should be reserved to sponsors of active plans, that is, plans in which employees are continuing to accrue new benefits. Active plans are true economic partnerships between the plan sponsor and the plan participants, and funding relief provides both shared benefit and shared risk.

While there are different approaches that relief might take, the most straightforward is to permit plan sponsors an extended amortization period for losses attributable to the recession. Because the risk of employer default would be borne by employees, it is appropriate that relief be conditioned on the employer's commitment to maintain the plan during the extended amortization period.

As for frozen plans, our starting position – and we still believe the most eminently reasonable one – is that companies can make use of an expedited version of the waiver process that already is in place under current law. Congress could set up a temporary funding review board and require that waivers be ruled in an expedited manner.

Executive Compensation Plan Amendments. In addition, funding relief should be conditioned on the plan sponsor amending executive deferred compensation plans that involve segregation of company assets in such vehicles as a rabbi trust. Contributions to these plans, no less than contributions to qualified plans, result in fewer operating assets to the company. Moreover, payments from executive compensation plans strip the company of assets that could help fund the company's qualified plan.

Thus, funding relief should be conditioned on companies amending "funded" executive deferred compensation plans so that they cannot receive new funding, and amending all executive deferred compensation plans so that payment of any future accrued benefits (or at least a portion of them) is deferred until such time as the qualified plan has reached certain funding benchmarks. This does not limit the ability of companies to award

generous deferred executive compensation: it simply affects the timing of when such benefits can be paid.

Companies that receive funding relief should similarly be subject to rules that would prevent them from stripping out firm assets through extraordinarily large payments to shareholders or excessive immediate compensation to executives during a period when the plan sponsor contends it has insufficient assets to fund its defined benefit plan.

A funding relief bill should also repeal two provisions in the Pension Protection Act (PPA) that unfairly upset reasonable participant expectations about their plan benefits:

- The PPA provision mandating the automatic freeze of benefit accruals in single-employer plans that are less than 60 percent funded. Congress should suspend this rule during any period of funding relief, so that the plan receiving relief remains a partnership between employer and employee

- The PPA provision that allows the PBGC to set the date of a distress termination as the date the plan sponsor filed bankruptcy rather than the date the plan is officially terminated by the bankruptcy court. When the PBGC uses the earlier date, the agency retroactively cuts worker benefits by not counting additional accruals under the plan.

Finally, a funding relief bill should also prohibit Qualified Supplemental Executive Retirement Plans (Q-SERPs). These provisions were an inequitable use of plan assets and may have contributed, at least at the margins, to the current funding problems of some plans.

Congress should eliminate Q-SERPs and should also adjust the plan asset allocations in Title IV of the Employee Retirement Income Security Act to ensure that existing Q-SERP benefits receive the lowest payment priority if the plan terminates.

II. Pension Relief is Not Primarily a Jobs Bill

The business community has advocated for across-the-board funding relief, which would extend to sponsors of frozen defined benefit plans as well as active plans as a costless measure to save jobs. The theory here sounds straightforward but is in fact flawed.

Companies claim that employers are going to cut jobs if they are forced to make contributions to their defined benefit plans in accordance with the PPA rules. To prevent this, they argue that funding relief should allow all companies to amortize recession-related investment loss over an extended time period and without any meaningful conditions. Moreover, the argument continues, such relief is virtually costless, because it does not excuse funding, but merely defers it. Plans will ultimately be brought to full-funded status.

There are numerous problems with this argument. Let's start with the second claim: that funding relief is costless. It is not. Some firms that receive funding relief will still fail, leaving in their wake plans with fewer assets than they would have had if their sponsors' funding obligations had not been deferred.

In addition, no one advocating broad funding relief has suggested that the relief should be limited to companies with strong credit ratings (and even here, we should keep in mind that today's superstar firm might be tomorrow's Enron). Nor has anyone argued that deferred funding obligations should result in a higher

bankruptcy priority. If funding relief were truly free, Congress could at no risk guarantee funding obligations that it permits to be deferred (Where are the TARP funds when we need them?).

The fact that no one in Congress has talked seriously about this “option” suggests that no one in Congress really believes that funding relief is free — or will not have adverse effects for some plan participants and the PBGC.

Job Creation Argument Flawed. The business community argues that across-the-board funding relief is needed to save jobs. However, neither bill requires or even encourages companies to use freed up funds to preserve jobs. If they were serious about jobs, they would include such provisions. Instead, companies are free to use the cash flow to increase executive compensation, to make extraordinary payments to shareholders, to engage in job-eliminating mergers or acquisitions, automation, or even to move operations overseas.

In March, the *Wall Street Journal* reported that many large companies are holding large amounts of cash (“With Fistfuls of Cash, Firms on Hunt,” March 4, 2010). What is the justification for extending funding relief to such companies?

In contrast, money contributed to plans will be invested in the economy and allocated through the capital markets. Isn’t that a better way of allocating capital than in effect providing unsecured loans to any company that happens to have a defined benefit plan? In the long run, won’t allowing market allocations of capital create more jobs than funding relief? This may be especially true given reports that the credit markets have been especially tight for start-up firms, which may be strong creators of new jobs.

For many weak firms, funding relief will only put off the firm’s ultimate failure, and any jobs that are preserved in the short run will be lost in the long run.

In short, across-the-board funding relief is an irrational response to the very real need for job preservation and creation. It is a blunt instrument focused not on jobs but on providing additional cash flow for any employer with a defined benefit plan.

In some and perhaps most cases, it will do nothing to save jobs, in other cases it will save jobs only temporarily, and in still other cases it will cost rather than save jobs. What is more likely, though, is that it will lead to harm of workers, retirees, and the PBGC.

III. What are Possible Compromises?

While we still believe that the most responsible approach to funding relief is the one we advocated in Part I – which boils down to relief for ongoing plans and use of the current waiver process for frozen plans – we believe that a reasonable compromise funding bill remains possible. So what are the ideas that all stakeholders should be able to accept that could lead to a funding relief package in the next few weeks?

1. A funding relief package should distinguish between active and frozen plans. Those with active plans should be entitled to more extended funding relief than those with frozen plans. Longer-term funding relief—a 15-year amortization period for such liabilities—should be available only to plans in which employees are continuing to accrue meaningful benefits and will continue to do so through the period of

funding relief. Short-term funding relief—allowing recession-based plan liability increases to be paid over nine years, with the first two years’ interest only—would be available for all plans, whether frozen or not. This is a compromise between the positions outlined in Parts I and II of this essay.

2. Relief would be conditioned on cash-flow matching requirements. Plan sponsors who elect to use funding relief would be required to make contributions to the plan to the extent they use cash on hand to pay excessive compensation to employees or to make excessive payments to shareholders in the form of extraordinary dividends or stock buybacks. The matching requirement would be capped so that no plan sponsor would be in a worse position on an aggregate basis than if they had not elected funding relief.

The most controversial aspect of these ideas is the cash-flow matching contribution requirement, particularly for extraordinary dividends and stock buybacks. Two related arguments have been raised against these “matching contribution” requirements: first, the government should not be dictating to businesses about dividend policy or stock redemptions; and second, that this might be a case of allowing the camel’s nose under the tent, with more governmental interference in core business decisions to come (I’ve heard the camel-nose metaphor engaged by a couple of opponents of cash-flow matching requirements.)

Certainly the first answer to these arguments is that funding relief is elective and thus so too are the cash-flow matching requirements. No one is forcing any company to elect funding relief. Moreover, the matching rules are not a prohibition on dividends. They merely say to a company that elects funding relief that, if you can afford to make unusually large payments to shareholders, then you can also afford to make some of the plan contributions that you would have made had you not elected to defer them. Finally, corporate assets paid to shareholders rather than invested in the business are no longer available to bring the plan up to fully funded status. Certainly we don’t want firms to strip assets out of a firm.

The debate should be on two questions: how to define extraordinary payments (for no one is arguing that corporations should not be able to pay ordinary dividends to shareholders) and on the duration of the matching obligation.

It should certainly be possible to devise a satisfactory definition that does not impinge on the ability of corporations to pay ordinary dividends or to redeem some stock, but that which prevents an unscrupulous firm from asset stripping. And it should also be possible to reach compromises on the duration of the matching rules.

Here we would like to make one observation: the bill that was reported out of the Senate Finance Committee would not require matching contributions unless and to the extent that annual payments to shareholders exceeded income for the year. This would be a meaningful, even if somewhat modest, trigger for the matching contribution requirement.

The bill, however, used an EBITDA (earnings before interest, taxes, depreciation, and amortization) definition of income, which could result in a license for some heavily leveraged companies to strip the corporation of assets, leaving its carcass to its secured creditors and its pension liabilities to its participants and the PBGC. The

primary purpose of the cash-flow rules is to guard against just this sort of abuse and the definition of income needs to be calibrated to accomplish this end. EBITDA does not.

In any event, Congress has offered a reasonable structure for a funding relief bill. The devil may be in the details, but this is a devil that can be harnessed.

3. Active plans should not suspend benefits during the period of extended funding relief. As argued previously, because pension funding relief places the risk of employer default onto employees, it is appropriate that relief be conditioned on the employer's commitment to maintain the plan during the extended amortization period.

4. A funding relief package should include provisions to eliminate Q-SERPs. As noted above, Q-SERPs are an inequitable use of plan assets that could potentially contribute to a plan's underfunding.

IV. Charting the Future

A pension-relief bill is the proverbial "Dutch boy" plugging holes in the dike. It is a short-term solution for

one small part of the long-term problem of the retirement insecurity that this nation faces. It is hardly a secret that many Americans are not saving for retirement, and those who are saving are often doing so in deeply-flawed do-it-yourself savings arrangements, rather than true retirement plans.

It is certainly time to start looking at broader issues of retirement security that are challenging this country. Are there ways to encourage traditional or new forms of defined benefit plans? How do we make 401(k) plans as secure and transparent as possible, while recognizing that they are only supplemental savings plans? How do we expand coverage for today's workforce?

While we contemplate short-term measures that can help today's generation of workers, it is also time to look forward. Simply passing funding relief or making changes to 401(k) plans will not lead to adequacy or security for tomorrow's generation of workers.

What we need for tomorrow are new ideas, which with Social Security, will provide universal, secure and adequate retirement income. That task will require political, social and economic ingenuity. It is time to put our shoulders to the wheel and take on that challenge.