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STATEMENT OF NORMAN P. STEIN

ON BEHALF OF THE PENSION RIGHTS CENTER

ON DEFINED BENEFIT PENSION PLAN FUNDING

BEFORE THE

COMMITTEE ON WAYS AND MEANS

UNITED STATES HOUSE OF REPRESENTATIVES

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Thank you, Mr. Chairman and members of the committee, for inviting me here to speak to you on the important subject of defined benefit plan funding. My name is Norman Stein, and I teach at the University of Alabama School of Law, where I am privileged to be the Douglas Arant Professor of Law. I am testifying today on behalf of the Pension Rights Center. The Center is a nonprofit consumer organization that has been working since 1976 to promote and protect the retirement security of American workers and their families.

The economic crisis has hit American workers and American companies hard. We are here this morning to discuss funding standards for defined benefit pension plans both in the context of this crisis and for the longer haul.

But it is also important to note at the outset that the same economic crisis that has presented new challenges for defined benefit plans has also vividly demonstrated their enormous value to their participants. While millions of Americans have seen their 401(k) retirement savings plans plummet in value, workers and retirees covered by defined benefit plans have been able to continue their lives secure in the knowledge that they have a guaranteed source of stable retirement income to supplement Social Security.

These retirees and workers are living illustrations of what retirement experts have always known: that defined benefit plans, by shifting unacceptable risks away from individual workers and retirees, are the gold standard of retirement plans. We need to support those companies that stood against the tide and maintained active defined benefit plans for their employees. Our support for them will allow those plans to continue.

Overview of the Issues

There is currently discussion in the pension community and on Capitol Hill on the subject of whether and when to grant emergency short-term funding relief to some companies, whether temporarily to ease some of the harsh Pension Protection Act (PPA) restrictions automatically reducing participant benefit accruals if a single-employer plan's funding falls below a specified trigger point, and whether some of the more unreasonable portions of the PPA should be permanently modified or repealed. My testimony today provides our views on these questions. In addition, my testimony also touches on some issues relating to multiemployer plans and on the use of qualified defined benefit plans to unfairly provide special benefits to selected top executives through so-called Q-SERPs, or qualified supplemental executive retirement plans.

To summarize our positions:

1. We believe that Congress should make short-term emergency funding relief available for companies that continue to sponsor defined benefit plans that allow employees to continue

accruing new benefits. Such relief will allow these valuable plans to weather the economic crisis, benefiting employees and employers alike. Such relief, however, should be reserved for employers who agree to conditions to protect employees and the Pension Benefit Guaranty Corporation (PBGC). Funding relief should not be a free lunch.

2. Short-term funding relief should not be extended to companies that are sponsoring "frozen" plans – meaning those that have plans that have ceased benefit accruals for current employees. The substance of such relief would be to force the PBGC and employees to accept risky IOUs from employers. The argument that a broad grant of relief to frozen plans will preserve jobs is unsupported by facts and does not stand up to even modest scrutiny. Moreover, such plans are currently eligible for funding waivers. We would support streamlining the process for applying for funding waivers for companies that have frozen plans which we discuss below.

3. The Pension Protection Act (PPA) includes several ill-advised provisions, which should be revised or repealed. We support a permanent repeal of the mandatory freeze on benefit accruals for plans that fall below a 60% funding level. We also support a more traditional actuarial approach to pension funding, with somewhat lengthier amortization periods than mandated by the PPA for ongoing plans. And we believe that the PPA provision that treats plan termination as the date that an employer enters bankruptcy is ill-advised, upsetting reasonable expectations of plan participants (particularly in collectively bargained plans) and decreasing the likelihood that the plan will be preserved as the employer emerges from bankruptcy.

4. We support certain proposed changes to the funding and PBGC rules related to multiemployer plans, especially an increase in the PBGC guarantee levels.

5. We believe that Congress should end the ability of plan sponsors to amend qualified plans to create enhanced benefits for executives only.

Short-Term Funding Relief for Active Defined Benefit Plans

We support funding relief for companies that sponsor defined benefit pension plans under which employees continue to earn benefit accruals. We do so for two related reasons.

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 decimated the retirement prospects of so many Americans who rely primarily on their section 401(k) plans. It is appropriate, and necessary, for Congress to take action to ensure the continued existence of these plans. We fear that without funding relief, some companies will terminate or freeze their plans.

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

The type of relief we favor is to permit an extended amortization period for losses attributable to the recession. The risk of employer default would be borne by employees, so it is appropriate that relief be conditioned on certain commitments to employees. Thus, we support conditioning funding relief to companies with ongoing plans that:

(i) agree that plan participants will continue to receive benefit accruals until the end of the amortization of the recessionary investment losses;

(ii) agree to amend their plan to prohibit reversions of "excess" assets if the plan becomes overfunded in the future; and

(iii) have secured the consent of any unions whose members are participants in the plan.

We also support a tiered approach to funding relief for employers who have frozen the plan for new entrants or who have engaged in a soft freeze.[1] These plans should be allowed to amortize only a portion of the recessionary losses or be permitted to amortize them over a shorter period of time than would otherwise be available.

In addition, funding relief should be conditioned on the company 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. We thus would recommend conditioning funding relief on companies amending "funded" executive deferred compensation plans so that they cannot receive new funding, and amending all executive deferred compensation plans so that they cannot pay benefits until the company has fully funded its qualified plan.

Companies With Frozen Plans Should Receive No Additional Funding Relief

Funding relief is not free: it is essentially an unsecured debt forced upon participants and the PBGC. If the plan is not eventually brought up to fully funded status, it is the participants and PBGC (and perhaps taxpayers) who will bear the financial burden of funding "relief." Thus, we do not believe that emergency funding relief should be made available to plans in which employees are no longer earning new benefits.

Some have argued that extending relief to such plans will save jobs, but the factual predicate for this argument is weak. There is nothing in any of the many proposals we have seen that would ensure that the funding relief – the money saved by not being used for pensions – would be used for creating and preserving jobs. The money could be used for any purpose, including moving jobs overseas, automation, or executive compensation.

We believe that the best argument for granting funding relief is not to save jobs – which is a rhetorical argument not supported by the weight of evidence – but instead (as we argued above) because targeted funding relief would serve a constructive societal purpose in preserving pension plans which provide secure and adequate retirement income to working men and women. Also, pension plans invest company contributions (and interest) in the capital markets, creating long-term investment capital that ultimately is an effective way to expand the economy and ensure the preservation and creation of jobs.

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[1] A soft freeze occurs when a benefit formula that is amended to deny credit for future years of service continues to reflect future increases in compensation.

It should also be noted that there are provisions in current law that allow employers to request a funding waiver if they can show temporary substantial business hardship and that failure to grant a waiver would be adverse to the interests of plan participants. Moreover, frozen plans have already benefited from generous funding relief provided by the Internal Revenue Service and Congress.

We would support providing the IRS with resources to streamline the process to review waiver requests, perhaps by setting up a special temporary funding review board and requiring that a waiver be ruled upon within 60 days of request. A company with a frozen plan that wants further funding relief could qualify for that relief by unfreezing the plan and accepting the conditions we described above.

Repeal Certain Pension Protection Act Provisions

- Repeal the PPA provision mandating the automatic freeze of benefit accruals in single-employer plans that are less than 60 percent funded. Plan participants should not be penalized because employers have not funded the plan. Alternatively, the PPA provision should be a temporary suspension of benefit accruals rather than a freeze, with the accruals resuming once a plan has attained a specified funding level. (There should be relief from the freeze provision during the current recession if Congress does not want to consider permanently amending the Pension Protection Act at this time.)
- Repeal 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 effectively cuts workers benefits by not counting additional accruals under the plan.
- Modify the PPA to allow ongoing plans at least ten years to amortize unfunded liabilities.

- ***Protections for Employees in Multiemployer Plans***

    - Raise the benefit amount guaranteed by the PBGC to at least $20,000 for a full career worker.
    - If multiemployer plans in the future find their way out of the current crisis and become overfunded by a significant amount, Congress should explore ways to reinstate subsidized early retirement benefits (and subsidized survivors benefits) that may have been eliminated under the "Red Zone" (critical status) provisions of the PPA.

Eliminate Q-SERPs

Two years ago, the *Wall Street Journal* revealed a practice in which benefits in qualified plans were amended to provide increased benefits for a few executives. The enhanced benefit formulas for a privileged few were known as 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 ERISA to ensure that Q-SERP benefits receive the lowest priority if the plan terminates.

Conclusion

The economic meltdown of the last year has shown the tremendous value of defined benefit plans to employees and retirees. Congressional response to the economic crisis should be to help ensure the survival of existing defined benefit plans and to stand by those companies that stood by their defined benefit plans in an era when too many companies abandoned them.