



AMERICAN BENEFITS COUNCIL

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FUNDING RELIEF: FLEXIBILITY TO USE THE RELIEF WHEN IT IS NEEDED

It has become increasingly clear that different employers need funding relief in different years. Accordingly, under the proposal described below, instead of providing relief to all employers in two specific years, employers would have the ability to elect which two consecutive years to which funding relief would apply. However, such years would need to begin in 2008, 2009, 2010, or 2011.

Background

The economic downturn has had devastating effects on pension plans across the country. The market crash in late 2008 dramatically reduced pension plan assets. Although plan asset values have recovered to some extent, they are still far below early 2008 levels. Moreover, pension plans have been further battered recently by sharp declines in interest rates. The efforts to stimulate the economy through reduced interest rates can have very beneficial effects on the economy generally, but at the same time reduced interest rates significantly increase the present value of pension liabilities, creating sharply increased funding obligations.

The increased funding obligations described above threaten the economic recovery by forcing employers to divert assets away from business investments and toward pension liabilities that will not be due for many years. Moreover, without relief, these funding obligations will have very adverse effects on job creation and retention, as discussed in the American Benefits Council's recent paper: "JOBS IN PERIL: Assessing the Impact of Increases in Defined Benefit Plan Funding Obligations on Employment During an Economic Recession".

The proposals in H.R. 2989 (the bill approved by the Education and Labor Committee and originally introduced by Chairman George Miller), H.R. 3936 (introduced by Representatives Earl Pomeroy and Pat Tiberi), and H.R. 2021 (introduced by House Minority Leader John Boehner) would provide critical relief to address this crisis. This paper focuses on two critical elements of relief: the "2 and 7 proposal" and the "15-year

amortization proposal". Most specifically, this paper focuses on each employer's need to apply the relief in the two years when it is most needed.

2 and 7 proposal. In general, under the 2 and 7 proposal, the pension losses¹ that are recognized in the 2009 and 2010 plan years would be amortized over seven years, but the amortization would be delayed two years. During that two-year period, the employer would only owe interest on the pension losses. Thus, for example, the 2009 pension losses would be amortized over seven years starting in 2011, rather than in 2009. For 2009 and 2010, the employer would only owe interest on those losses.

15-year amortization proposal. In general, under the 15-year amortization proposal, an employer would have the option to amortize the 2009 and 2010 pension losses over 15 years instead of using the 2 and 7 proposal. This option would require larger payments initially than would be required under the 2 and 7 proposal, but this option would also avoid a potentially significant increase in funding obligations after the expiration of the two-year interest-only period.

Flexibility Needed

In general. As more employers make updated projections regarding funding obligations, it has become increasingly clear that different employers need funding relief in different years. Accordingly, for reasons discussed in more detail below, the proposal is to provide employers with the ability to elect to apply the funding relief described above for any two consecutive plan years as long as those plan years begin in 2008, 2009, 2010, or 2011.

Pension losses. The pension losses attributable to the 2008 market downturn can technically be recognized in 2009, 2010, and 2011 under the asset smoothing rules. Generally, most of the losses would be recognized in 2009. However, the interest rate relief granted by the IRS has generally permitted calendar year plans to defer recognition of the 2008 market losses until 2010 and 2011. However, this deferral does not apply to most non-calendar year plans, so that such plans can continue to face severe funding problems for plan years beginning in 2009.

In addition, as noted, the dramatic fall in interest rates—designed to stimulate the economy—will significantly increase pension losses in 2010 and especially in 2011. In fact, Watson Wyatt's comprehensive funding model shows that the aggregate funding obligation for 2011 will be more than four times the aggregate funding obligation for 2009.

¹ Technically, the reference to "pension losses" is a reference to the "shortfall amortization base".

Non-calendar year plans. As noted above, most non-calendar year plans did not benefit from IRS interest rate relief with respect to 2009. Moreover, some non-calendar year plans experienced losses even earlier, beginning with the plan year beginning in 2008, since the economic downturn began in 2008. We are, however, increasingly discovering that there is a wide variation in the extent to which non-calendar year plans incurred large losses for the plan year beginning in 2008.

Plans with an end-of-the-year valuation date. Smaller plans (100 or fewer participants) may determine pension funding obligations as of the last day of the plan year. For such plans, the funding issues all arise a year earlier, since they value pension assets and liabilities as of the last day of the plan year, unlike large plans that must perform such valuations as of the first day of the plan year.

Proposal

Because of the different situations described above, different employers need funding relief in different years. The Pomeroy/Tiberi bill provides certain very helpful flexibility with respect to the years to which the funding relief is available. But very recent information has indicated that more flexibility is needed. This flexibility can be designed so that no employer receives more than two years of relief, but each employer can use the relief in the years they most need it.

Under the proposal, every employer may elect two consecutive years of relief. Those two years of relief must, however be within the following range: plan years beginning in 2008, 2009, 2010, or 2011. This flexibility provides different employers with the relief suited to their own circumstances.