

DEWINE-MIKULSKI AMENDMENT

The DeWine-Mikulski amendment has two components: a smoothing component and a credit-rating component. As explained in more detail below, the amendment would apply the HELP bill rules with respect to asset and interest rate smoothing and with respect to the determination of a plan's at-risk status (i.e., the credit rating issue).

Smoothing. Under current law, a company's funding obligation to its defined benefit plan is based on the plan's unfunded liabilities. A plan's unfunded liabilities are, in turn, based on a measurement of the plan's assets and liabilities.

Under current law, for purposes of determining a plan's assets, investment gains and losses can generally be smoothed over five years, so that fluctuations in market values do not cause sharp and unforeseeable changes in a company's funding obligation.

For purposes of determining a plan's liabilities, an interest rate is necessary to determine the present value of the plan's projected benefit payments. In 2005, this interest rate is the long-term corporate bond rate. That rate is averaged over four years, with more weight given to the more recent years. Again, this interest rate smoothing is important in ensuring that companies' funding obligations are predictable.

The HELP bill would have limited smoothing of assets and interest rates to three years, as opposed to five years and four years, respectively, under current law.

On the other hand, the merged HELP-Finance bill limits smoothing to one year with respect to both assets and liabilities. Companies need more predictability than that to make business plans. In most industries, it is critical to make long-term plans well beyond one year. In fact, one of the biggest reasons that companies have been leaving the defined benefit plan system is the unpredictability of funding obligations. If this problem is exacerbated by one-year smoothing, there could be a mass exodus from the system. That would do great harm to the retirement security of millions of Americans.

The DeWine-Mikulski amendment would provide for three-year smoothing of assets and interest rates, as under the HELP bill. Some have argued that less smoothing or no smoothing is necessary to achieve accuracy. That is not correct. Spot valuations of assets and interest rates are accurate, but only on that day. And no plan transaction occurs on that day. Even under the merged HELP-Finance bill, the one-year smoothing period ends up to 20½ months before the date of a corresponding plan transaction. A 20½-month old valuation is not accurate. In fact, longer smoothing periods can often be better predictors of future valuations.

In short, the amendment would provide businesses with critical predictability and would prevent a sharp decline in defined benefit plans.

Credit rating. Under all the bills under consideration, additional funding obligations apply with respect to plans that are determined to be “at-risk”. An at-risk plan has an increased risk of plan termination. The additional funding obligations apply because plan termination generally triggers larger plan benefits in some respects.

The HELP bill bases at-risk status on a plan’s funded status, i.e., whether a plan is below 60% funded. The best indicator of risk is a poorly funded plan.

The HELP-Finance bill bases at-risk status in large part on a company’s credit rating. This is counterproductive and troubling. It is troubling for the Federal government to rate the viability of companies either indirectly in the case of public companies (via the credit rating agencies, which have their own problems) or directly in the case of private companies. Moreover, it is severely counterproductive to impose enormous additional funding burdens on companies experiencing a business downturn. These additional burdens will clearly undermine struggling companies’ ability to recover, which is bad for the employees, the company, the economy, and the PBGC.

The DeWine-Mikulski amendment would apply the HELP bill provisions regarding a plan’s at-risk status. This amendment would properly measure plan risk and would avoid undermining struggling companies’ ability to recover.