



## AMERICAN BENEFITS COUNCIL

October 22, 2008

### 10-POINT PLAN TO HELP EMPLOYEES AND RETIREES AND TO STRENGTHEN THE ECONOMY AND THE RETIREMENT SYSTEM

The recent economic turmoil is substantially and negatively affecting virtually every aspect of our financial lives. Among the areas most adversely affected is retirement security. Employees and retirees have seen their 401(k) and other defined contribution plan savings plummet, and employers with pension plans have seen the value of their plan assets fall precipitously, creating enormous funding obligations for 2009 that are worsening the credit and liquidity crisis. We need to act now to restore retirement security, to protect jobs, and to prevent pension funding obligations from undermining companies' ability to recover.

As companies now must plan for funding requirements that were unanticipated just weeks ago, lenders are even less willing to extend credit. Companies are therefore unable to dedicate needed resources next year for job-creating business purposes to help their companies recover. This burden is placing even more pressure on companies to freeze or terminate their pension plans in order to mitigate the future impact, which further diminishes long-term retirement security. Liquidity, available credit, job creation, and retirement security are all inextricably related. Congress must act now to restore retirement security, to protect jobs, and to prevent pension funding obligations from undermining companies' ability to recover.

The American Benefits Council divides its proposals into three parts. First, we must help individuals get back on their feet economically. In developing these ideas, we built upon prior Council recommendations and also drew on key proposals offered by the presidential candidates and members of Congress. Second, we must prevent pension funding obligations from triggering a massive freeze of new benefits and widespread job loss. Third, recognizing that full economic recovery may take a while, we must begin now to lessen the impact of the downturn and better prepare for future economic uncertainties.

## HELPING INDIVIDUALS WEATHER THE STORM

- **Restore savings to those who need it most and put dollars in their pocket too.** We would expand the group of middle-income employees eligible for the Saver's Credit. This would allow middle-income employees the ability to replenish their depleted savings. And it would reward their savings with a tax credit that they could use to meet day-to-day expenses which, in turn, would assist economic recovery.
- **Protect retirees from excessive distributions that deplete their retirement savings.** Participants would have the right to be exempted from the age 70 ½ minimum distribution rules in either 2008 or 2009—and thus not be required to take any distributions—whether they are in a pension plan, a defined contribution plan (such as a 401(k) plan), or an IRA. It is important to offer individuals a choice of 2008 or 2009, since many have already taken their 2008 distributions.
- **Suspend the penalty tax on hardship distributions made in 2009.** Like both presidential candidates, we want to help individuals whose circumstances necessitate them taking a hardship withdrawal while at the same time mitigating the likelihood that they will deplete their own long-term retirement savings. In recognition of workers' need to access the money in their defined contribution plans, we would suspend the 10% penalty tax on hardship withdrawals made in 2009.

## PREVENTING FUNDING OBLIGATIONS FROM COSTING JOBS AND TRIGGERING MASSIVE BENEFIT FREEZES

The following is an internal report from the chief actuary of one defined benefit plan service provider:

“Our projections are showing DB plans due to get slaughtered in their next round of actuarial valuations. Lest we forget, asset smoothing has all but been eliminated so their unfunded liability will see a \$1 for \$1 increase for their investment losses this year....I haven't heard this consistent level of concern from plan sponsors in 20 years. Just to throw a real example out there, a large [organization] has gone from 114% funded for the 1/1/2008 year down to restricted (i.e., below 80% funded) as of yesterday....You have to assume we'll be doing a lot of freezing amendments next year.”

The benefits system has *never* seen this level of concern before. Unless something is done -- quickly -- massive funding obligations will trigger benefit freezes on an unprecedented scale. And freezing does not eliminate current funding shortfalls, so companies will be forced to direct huge resources to their plans, which will cost many jobs and prevent companies from making essential investments in their businesses.

In this regard, it is important to clarify recent reports that interest rate increases offset pension asset losses to a large extent. Those reports are based on accounting figures, not funding figures. Because plans generally use a 24-month average interest rate, the recent spike in corporate bond interest rates will do little to help the funding burden, even if the spike continues. For more on this, please see the third proposal below.

The American Benefits Council is not asking for a so-called funding holiday. And we are not asking to undo the important funding reforms contained in the Pension Protection Act (the "PPA"). On the contrary, we are confident that if the drafters of the PPA had known in advance of this crisis, they would have softened the transition from the old rules to new rules. So that is what we are suggesting below, combined with some critical clarifications of the intent of the PPA.

Although the proposals below generally do not modify the benefit restriction rules directly, they would have a very significant effect on the application of those rules, enabling participants across the country to receive earned benefits.

- **Permit pension plans to smooth out unexpected asset losses, as clearly intended by Congress in 2006.** In the PPA, Congress permitted pension plans to recognize unexpected asset gains and losses over 24 months. The Treasury Department misinterpreted Congress' intent and has effectively applied a mark-to-market rule to pension plans, which will cause unmanageable burdens for companies in 2009. As noted above, if companies are required to take into account all 2008 losses, many will cease benefit accruals for all employees and will have enormous trouble recovering from the economic downturn. The proposal would allow all plans to use smoothing for 2009 and subsequent years. Moreover, for unexpected gains and losses recognized as of the valuation dates in 2009 and 2010, the smoothing period would be extended to 36 months. In light of many plan losses of approximately 20% or 30% for 2008, smoothing—which in the long-term neither overstates nor understates asset values—is critical.
- **Permit full asset smoothing.** Also, the PPA only allowed unexpected gains and losses to be smoothed out to a very limited extent, so that the smoothed value must stay within 10% of the fair market value of the assets. In light of the dramatic reduction in the market this year, the 10% limit is strikingly insufficient to provide meaningful relief. Accordingly, it is critical that we let asset smoothing apply without percentage limitations in 2009 and 2010. Such

smoothing would be applied for all purposes, including the determination of the variable rate premium payable to the PBGC (for which no smoothing is permitted today).

- **Transition to the new funding rules.** Before the PPA, the “funding target” for pension plans was 90% funded. Under the PPA, the 90% figure was phased up to 100%; in 2008 and 2009, the phase-in levels are 92% and 94% funded, respectively. So if a plan is 92% funded in 2008, there is no shortfall to fund. But if a plan is 91% funded, its funding obligation is based on a 9% shortfall, not a 1% shortfall. In other words, the transition relief is only available to plans at or above the phase-in level. With a huge number of plans falling below 92% funded next year, it is critical that (1) the phase-in level stay at 92% for another year, and (2) the transition relief be available to plans below the phase-in level, as well as above. The 92% phase-in level for 2009 would apply for all purposes for which the same phase-in structure applies, including the benefit restrictions.
- **Permit all new funding elections for 2009 or 2010 to avoid benefit restrictions and keep plans viable.** Generally, funding methods, such as which type of yield curve to use, must remain consistent, absent IRS approval. Given the enormous changes over the past several months, companies need to reassess their funding methods to find those best suited to keeping their plans alive. So for 2009 and 2010, under this proposal, funding methods can be changed without IRS approval. *This proposal (which is a clarification with respect to 2009), along with the smoothing changes above, will provide a large number of plans with the ability to avoid having to apply the PPA’s benefit restrictions solely by reason of the 2008 market downturn.* For example, employers using the 24-month yield curve average for 2008 could switch to the spot yield curve for 2009 to take advantage of the recent spike in interest rates. *Without such a change, the recent spike in corporate bond rates will provide little help with respect to funding obligations and benefit restrictions.*
- **Relief from 2008 plan losses and reduce plan freezes.** Under the PPA, plan losses generally must be amortized over seven years. For losses that arose in 2008 and are recognized in 2009, the amortization period would be extended so that such losses are amortized over 10 years. In addition, 2008 losses can trigger benefit restrictions for 2009. Such benefit restrictions can be avoided through employer contributions, but employers are discouraged from making such contributions by a rule prohibiting those contributions from being taken into account for minimum funding purposes. Under the proposal, that prohibition would be made inapplicable for 2009. Furthermore, plans would be permitted to amortize 2009 normal cost over two years. This would help reduce freeze activity in 2009.

## PLAN FOR THE FUTURE

- **Enhance financial education.** Plan participants have questions about what the current economic situation means for their long-term retirement security. The Department of Labor (“DOL”) should publish a model notice that employers could choose to provide to employees and retirees regarding such things as diversification, retirement income needs, and the importance of continuing to save. In addition, the Department of Education should come up with a five-year plan to enhance financial literacy through incorporating financial education into school curriculums.
- **Increase the start-up credit for small business retirement plans.** Under current law, small employers are eligible for a tax credit of 50% of the cost of starting a new retirement plan, up to a maximum of \$500 per year for three years. For 2009 and 2010, the 50% should be increased to at least 75% and the \$500 maximum should be increased to \$2,000. It is critical that during this crisis we continue to plan for the future by encouraging more employers to adopt plans for their employees.