CALCULATION OF AT-RISK LIABILITY

Both the House and the Senate pension reform bills characterize certain plans as at-risk. Almost all of the attention regarding this issue has been focused on the “trigger” for at-risk status, in particular whether the credit rating of the plan sponsor should be used for this purpose. That remains a critical issue for companies, who strongly oppose the use of credit rating in determining the liabilities of a pension plan.

This document, however, focuses on a separate issue – the measurement of liability of an at-risk plan. The primary justification given for a higher level of liability for at-risk plans is as follows: If a plan is very underfunded or the plan sponsor is struggling, that typically coincides with a higher level of early retirements attributable to (1) increased offerings of early retirement incentives, (2) layoffs, and (3) retirements by employees concerned about future employment. In accordance with this rationale, the Senate bill requires at-risk plans to calculate liability based on the assumption that all employees who become eligible for early retirement in the current year or the next seven years retire at the earliest retirement date under the plan. The House bill requires that all participants be assumed to retire early so as to maximize the plan’s liability.

The assumptions in both bills are extremely unrealistic. We are not aware of any company currently or previously in existence – including companies in bankruptcy – where the retirement patterns even remotely resemble the assumptions required under the bills. In most cases, if anywhere close to 100% of a company’s retirement-eligible employees were to retire in a year, the company could not be expected to continue in business.

If a company is forced to liquidate, all employees currently eligible to retire would be forced to retire in that year. But in that case, all the employees who would become eligible to retire in future years would never become eligible to retire; this would significantly reduce liabilities and would fully or partially offset the increase attributable to the forced retirements.

There is no factual or conceptual support for the required assumptions contained in either bill.
bill. Those assumptions, if included in final legislation, would impose an unnecessarily harsh and inappropriate funding regime on companies struggling to recover. This consequence should be avoided in the final legislation.

**Loading factor.** The House bill also requires at-risk plans to include a loading factor in their liability based on the cost of purchasing annuities in connection with a hypothetical plan termination. The loading factor is very substantial: generally 4% of the plan’s liability plus $700 per participant. In the case of an underfunded plan that is turned over to the PBGC, however, the PBGC does not purchase annuities. Accordingly, funding this loading factor would create a surplus not needed by the PBGC to provide benefits. Struggling companies should not be forced to base their funding on this unnecessary additional element.

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