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DEFINED BENEFIT PENSION PLANS: A SIX-POINT PLAN TO ADDRESS THE ACCELERATED EXODUS

Unfortunately, defined benefit pension plans have been in decline for many years. There are many reasons for the long-term decline, including, for example, funding and accounting volatility, competitive pressures, employee preferences, and workforce changes. However, recently, the decline has markedly accelerated in a new way due to intensified pressures, with employers understandably exiting the system with respect to part or all of their plans. On behalf of pension plan sponsors – both those that continue to maintain an active plan and those that previously maintained an active plan -- the American Benefits Council offers this six-point plan to respond to these pressures.

Importantly, this six-point plan is perfectly suited for the lame duck session: (1) the plan raises tens of billions of dollars of revenue, and (2) the plan helps create jobs by preventing unnecessary diversion of critical company assets and by stimulating business expansion.

(1) FUNDING STABILIZATION NEEDS TO BE MADE PERMANENT.

Business essentials: Business needs predictability and stability. If costs can unexpectedly fluctuate by hundreds of millions of dollars per year, that can cripple a business' ability to make plans. Just as importantly, businesses cannot be subject to costs that are structurally designed to increase during economic downturns, thus impeding recovery.

Funding volatility: The artificial decreases in interest rates over the last several years have created enormous increases in funding obligations, triggered by the Federal Reserve Board's efforts to combat the economic downturn through lower interest rates. The funding stabilization legislation adopted in MAP-21 provided critical short-term help, but the effect of that stabilization phases out, and some companies are exiting the pension system to prepare for the return of those enormous obligations.

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Solution: The funding stabilization rules in effect in 2012 need to be made permanent. This alone would raise tens of billions of dollars and create tremendous job growth.

(2) ACCOUNTING STANDARDS NEED TO BE STABILIZED.

Business essentials: For many legacy companies, pension plan liability is disproportionately large compared to the size of the business. In this context especially, businesses need predictability and stability with respect to accounting standards.

Accounting volatility: The same artificial decreases in interest rates noted above for funding purposes have created very large pension plan liabilities on company balance sheets, far in excess of any reasonable long-term valuation of those liabilities. Because of this, interest rates fluctuations can, in many cases, be the single most powerful driver of company equity on its balance sheet, obscuring actual business results. This inappropriate result is a key factor in the accelerated exodus from the pension system.

Solution: The interest rates used to measure pension obligations need to be reformed to avoid artificial distortions caused by short-term non-market forces, such as the Federal Reserve Board's actions to reduce interest rates. This can be achieved by stabilizing accounting interest rates in a manner similar to the stabilization of interest rates applicable for funding purposes.

(3) PBGC PREMIUMS NEED TO BE BASED ON STABLE LONG-TERM ASSESSMENTS OF NEED.

Business essentials: In these challenging economic times, companies have to scrutinize every significant cost.

Skyrocketing costs: Under the new PBGC premium structure, large companies can incur annual premium costs of tens of millions of dollars. To the extent that a plan sponsor exits the pension system in favor of an enhanced 401(k) plan, those annual costs disappear. Moreover, PBGC has been repeatedly asking for higher premiums based on a deficit that is entirely attributable to today's artificial low interest rates. PBGC's demands for higher premiums will likely only intensify as higher premiums and funding and accounting volatility continue to cause companies to exit the pension system (at least in part), thus shrinking the PBGC's premium base. This is a serious challenge, both for companies that still have an active plan and fear being among the "last plans standing" and, of course, for the PBGC itself.

Solution: The PBGC premium structure needs to be stabilized. The need for premium adjustments cannot be based on short-term artificial fluctuations in interest rates. PBGC's liabilities need to be measured based on stable interest rates that are

representative of the extremely long period over which benefits are paid by the PBGC. Once this is done, Congress needs to reevaluate the premium issue, including how to adjust the current premium levels and rules to reflect both the real nature of the PBGC's financial condition and a more accurate measure of a pension plan's funded status for purposes of the variable rate premium.

(4) BUSINESSES SHOULD NOT BE PREVENTED FROM ENGAGING IN HELPFUL TRANSACTIONS BY PBGC

Business essentials: Companies are constantly entering into transactions to expand or contract components of their businesses in order to achieve greater efficiencies and prospects for growth.

Very large toll charges on transactions: The PBGC consistently uses statutory powers designed for entirely different purposes to require companies engaging in business transactions to make enormous additional contributions to their plans. Some companies refrain from needed transactions simply because they cannot afford the costs imposed by PBGC. For a few companies, in fact, this issue is even more important than the other critical issues listed above.

Solution: PBGC's power to impose costs on business transactions needs to be conformed to Congress' original intent. For example, Congress authorized PBGC to require security from pension plan sponsors that shut down a major facility and trigger a very large layoff. However, PBGC has routinely and openly used this statutory authority to impose significant costs on sales of business units and other transactions where no one loses his or her job. This has to stop.

(5) WE NEED TO CONTINUE WORKING WITH CONGRESS, TREASURY AND THE IRS TO PREVENT TESTING RULES FROM ENCOURAGING PENSION PLAN CLOSURES.

Business essentials: When businesses must reluctantly close pension plans, they need flexibility to preserve the pension plan for existing employees, who may have been counting on continued pension benefits.

IRS testing rules: In many cases, IRS testing rules have the effect of forcing companies to close down the pension plan completely. This happens because after many years, the group of employees grandfathered under the pension plan becomes too highly compensated, due to turnover and increased seniority, thus violating technical rules designed for very different situations. This is clearly a bad result for workers.

Constructive work on solutions: In 2012, Congressman Richard Neal (D-MA) introduced a bill to address this issue. In a prior Congress, now-Senators Rob Portman

(R-OH) and Ben Cardin (D-MD) introduced bills that would also have addressed this problem. Very constructive discussions have also begun with the Treasury Department to avoid forced closures of plans.

(6) WORKABLE RULES FOR HYBRID PENSION PLANS ARE CRITICAL.

Business essentials: Hybrid pension plans, such as cash balance plans and pension equity plans, have been the sole source of significant growth during the long decline of the defined benefit plan system. This is obviously a good development for workers as well.

Clear, workable final regulations would provide effective means of transition to compliance: Any direct or indirect application of the rules on a retroactive basis would be a very serious problem. For example, pending issuance of the final regulations, plan sponsors needed to make reasonable judgments as to how comply with the new statutory requirements. The regulations should make it clear that such reasonable judgments may constitute compliance for the period between the statutory effective date and the regulatory effective date; otherwise, following the regulations could viewed as the only way to ensure compliance retroactively.

Solution: Continued work with Treasury and the IRS. There has been a constructive ongoing dialogue with Treasury and the IRS on these issues.