

# ***PENSION POINTERS.....***

## **PLEASE FORWARD TO THE LA FOR PENSIONS:**

In the near future your office again will be asked to take a position on pension reform. The currently pending bills are the most significant reform bills since ERISA passed in 1974. The choices made in crafting a final bill will encourage employers to establish and maintain defined benefit pension plans – or will encourage them to avoid those plans. The bills also make significant changes to rules governing defined contribution plans.

To assist you in understanding this critical legislation, we will be sending you short briefs on key issues in the bills. This brief describes the proposal in the Senate bill to look to a company's credit rating in setting a pension plan's liability. Put it in a special folder so you will have it readily available when the time comes for your office to determine whether the bill will help, or hinder, pension coverage in the future.

## ***CREDIT RATING PROPOSAL IN PENSION REFORM BILL HURTS PARTICIPANTS COMPANIES, PLANS, THE ECONOMY, AND THE PBGC***

Under the Senate bill, a plan's liability will sharply balloon if the plan is determined to be "at risk" based, in part, on a drop in the sponsoring employer's credit rating to below investment grade.

The apparent purpose of the proposal is to identify plans at high risk of terminating in an underfunded status and increase their funding level. The proposal, however, is counterproductive, flawed in several respects, ill timed, and likely to increase, not decrease, the number of underfunded terminations. Here's why:

- **The proposal assumes a cause and effect that is not now true – but more likely to be true under the proposal.**
  - Under present law, a company typically must be in bankruptcy to terminate an underfunded plan. This means that most of PBGC's claims come from poorly rated companies – it does not mean that most poorly rated companies shift liabilities to the PBGC. That simply is not the case.
  - Many, many companies dip below investment grade when they retool their business, and these companies, and their pension plans, continue to provide jobs and benefits to workers and do not pose a risk to the PBGC.
  - Under the proposal, however, precisely when the company most needs its cash to retool the business, that cash would not be available to the company. An "at risk" determination can increase plan liabilities by 10-20%, but the effect on the company's cash is far greater. For example, assume that a plan has \$9 billion of assets and \$10 billion of liabilities. If the liabilities go up by 20% to \$12 billion, the funding shortfall triples from \$1 billion to \$3 billion, and the company must contribute \$3 billion to the plan over seven years instead of \$1 billion. For some companies, this extraordinary burden will precipitate the demise of both the employer and its plans. Workers will lose both their jobs and their future pension accruals. Common sense says that PBGC claims will increase, not decrease.
  - The Senate bill recognizes the need for companies to have sufficient time to fund plans by providing commercial airlines extra time, compared to current law, to fund their plans while they retool and recover. Incongruously and inconsistently, however, a business in a different industry that also is retooling for the future would instead be subjected to harsh and inflexible new funding requirements.
- **The proposal will preclude many companies from offering pension plans, denying many workers a secure retirement benefit.**

- In today's global economy, companies often must re-invent themselves. When they do, their credit rating often drops. If they know that part of this normal business occurrence will be a precipitous increase in calls on their cash, then pension plans will not be part of the way they compensate employees, and Congress' action will weaken, rather than strengthen, the pension system.
- Many companies engage in mergers and acquisitions, but the proposal will effectively deter the purchase of a weaker company with an at risk pension plan by a stronger company. Obviously, this is not good for either company's business ventures, for the workers, for the plan, or for the PBGC.
- In some instances, entire industries are consistently rated below investment grade. A completely healthy company could be caught in the "at risk" web by this fact alone. Companies in those industries will be far less likely to sponsor any form of secure pension for their employees in the future.
- **Use of a company's credit rating to determine pension obligations, or for any other benefit purpose, is an enormous, unprecedented, and dangerous intrusion of the federal government into the marketplace.**
  - The proposal will in effect "validate" ratings produced by a limited number of credit agencies despite the fact that the current credit rating system has been under considerable unfavorable scrutiny by Congress.
  - Many companies, universities, hospitals, and other enterprises have pension plans but do not have a credit rating. In those instances, someone in the government bureaucracy will determine whether a particular enterprise is "healthy" or not. This is an extraordinary intrusion of the federal government into the marketplace, affecting these entities' financial statements and their ability to operate their enterprises.
- **What is the answer?**
  - The best barometer of the health of a pension plan is its funded status. That is the approach taken in the House bill.
- **Use of the plan's funded status as a barometer for the health of the plan is bolstered in both bills by more stringent overall funding standards and by plugging "loopholes" that can result in the rapid deterioration of a plan's funded status. For example, both bills –**
  - Set a new 100% funding target,
  - Shorten amortization periods,
  - Require credit balances to be valued according to actual gains and losses in the market,
  - Curtail either the payment or the guarantee of shut-down benefits, and
  - Limit the payment of lump sum benefits in certain circumstances.

THE CONFEREES SHOULD REJECT ANY USE OF A COMPANY'S CREDIT RATING TO DETERMINE "AT RISK" STATUS OR OTHER PENSION REQUIREMENTS. THEY SHOULD INSTEAD LOOK TO THE PLAN'S FUNDED STATUS, BACKED UP BY THE BILL'S OTHER REFORMS LISTED ABOVE.

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March 27, 2006