NRLN
NATIONAL RETIREE LEGISLATIVE NETWORK

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March 7, 2011

The Honorable Scott Brown
United States Senate
317 Russell Senate Office Building
Washington, D.C. 20510-2101

Dear Senator Brown:

One of your Massachusetts constituents has shared with me the attached Feb. 23, 2011 response she received from you. She emailed a letter to you on Feb. 4, 2011 requesting that you sponsor legislation to prevent companies from using pension plan assets for non-pension expenses, such as lump sum severance payments and paying for executives' non-qualified pensions or other deferred compensation.

I was pleased to read in your response that you are concerned about the solvency of our nation's pension systems and you believe employers should use pension dollars as intended and within the limits established by law. However, I am disappointed that you did not address your constituent's specific request to sponsor legislation to protect pension plan assets.

Much of your letter was devoted to explaining that the Pension Benefits Guarantee Corporation (PBGC) was created to protect pension benefits in private-sector traditional pension plans known as defined benefit plans. I submit to you that, when the PBGC takes over an underfunded pension plan, many plan participants find their monthly pension benefit permanently reduced by 30 percent or more. Delta Air Lines pilots and Delphi salaried retirees are just two of the unfortunate examples where retirees have lost sizable portions of their pensions under the PBGC's benefits calculation rules.

The first line of defense for protecting pensions and preventing an even larger PBGC deficit should be legislation that prevents the growing practice by companies whereby Congressional intent is circumvented when companies use pension assets for corporate purposes. It is not unreasonable to prohibit pension plan sponsors from using pension assets to make lump sum severance reversions to the corporation unless the plan has a sizable surplus and is funded at 120% or more, just as the tax laws require for transfers used to pay for retiree health costs. The approach is direct and has no impact on the federal budget.

(More)

The National Retiree Legislative Network (NRLN) has researched and written whitepapers making the case for pension asset protection and the need for PBGC reform. Attached to this letter is the Executive Summary from each of the two whitepapers. I have asked Marta Bascom, NRLN Executive Director in Washington, D.C., to contact your office to request a meeting with your staff to explain why the NRLN is seeking legislation to protect pension plan assets and PBGC reforms for the fairer treatment of retirees. Marta can be reached at 703-863-9611 or marta.bascom@linkspace.net.

I'm sure you understand that these issues are important to your constituents who are among the 44 million Americans covered by nearly 29,000 defined benefit pension plans. The NRLN looks forward to working with you on this issue.

Sincerely,

Bill Kadereit

Bill Kadereit, President
National Retiree Legislative Network

Attachments

Feb 23, 2011 05:51:32 PM, sbrown@scottbrown.senate.gov wrote:

Dear Ms. _______,

Thank you for contacting me regarding the current and future security of our nation's pension system. I appreciate hearing from you and value your input on this important issue.

I share your concern about the solvency of our nation's pension systems and believe we should take appropriate steps to ensure that retirees are able to finance a secure retirement. Likewise, I believe that employers should use pension dollars as intended and within the limits established by law. As you may be aware, the Pension Benefit Guarantee Corporation (PBGC) was created in 1974 with this purpose in mind.

Simply put, the PBGC is a federal agency created by the Employee Retirement Income Security Act of 1974 (ERISA) to protect pension benefits in private-sector traditional pension plans known as defined benefit plans. For example, if your pension plan is terminated without sufficient money to pay all benefits, the PBGC's insurance program will pay you the benefit set forth under your pension plan, up to the limits set by law. Furthermore, the PBGC is financed directly from the insurance premiums paid by companies whose plans the PBGC is designed to protect and from other assets. It is not paid for by taxes. Please know that your pension plan is insured even if your employer fails to pay the required premiums. In 2010, the PBGC negotiated with dozens of companies, both in bankruptcy and otherwise, to preserve the pension plans of their workers. As a result, 250,000 individuals will keep their pension plans who otherwise might have not.

As a husband and a father, I recognize the importance of putting money aside and supporting programs that help a family plan for a secure future. I will continue to closely monitor the PBGC’s financial condition to ensure that it is capable of meeting its intended mission. Should related legislation come before the full Senate for debate, I will keep your thoughts and concerns in mind.

Again, thank you for sharing your views with me regarding the security of our nation's pension system. If you have any additional questions or comments, please feel free to contact me or visit my website at www.scottbrown.senate.gov.

Sincerely,
Scott P. Brown
United States Senator

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# *Back Door Reversions*:

## Draining Pension Assets for Severance and Other Corporate Purposes Threatens Retirement Security

### *Executive Summary*


The use of pension assets to make severance payments during a corporate restructuring is the largest and most widespread "back door reversion" by which some companies are seeking to circumvent the Congressional policy against reverting pension assets for corporate purposes. When pension funds were used to finance hostile takeovers and the mass layoffs that typically followed, in 1990 Congress stopped the practice by imposing a 50 percent excise tax on pension reversions. But today's "back door reversions" are more insidious. Although ERISA explicitly prohibits the use of qualified pension assets for "layoff benefits," companies can amend a plan at any time not merely to offer older workers enhanced early retirement benefits (by awarding extra years of service credit), but even to offer lump sum severance payments equal to a year's salary or more as part of a corporate restructuring.

The 2006 Pension Protection Act tightened up on this practice somewhat by requiring plan sponsors to pre-fund a plan amendment that increases benefit liabilities to the extent the plan's funding level would fall below 80 percent (after taking account of the new benefit liability). However, as the 2008 stock market meltdown demonstrated, a plan that is only 80 percent funded during a bull market could easily end up below 60 percent funded in a bear market – and in default with the PBGC if the plan sponsor declares bankruptcy. Moreover, any significant reduction below full funding not only leaves all plan participants insecure, it also reduces the ability of the plan to build a surplus that could be used to grant cost-of-living adjustments to longtime retirees, whose fixed monthly benefits erode with inflation, or to offset the cost of retiree health benefits through a Section 420 transfer.

The trend toward distressed companies using employee pension assets to pay severance costs – instead of relying on a restructuring reserve or other corporate assets – is not new to the current financial crisis. Lucent, United Airlines, AT&T, Verizon, Qwest, Federal Express, Delta and Delphi are among the other companies that have tapped pension assets to pay corporate restructuring costs. Some of these companies drained pension assets for severance payments as they spiraled downhill toward bankruptcy and an eventual taxpayer bailout courtesy of the PBGC. Other companies, left under-funded, cut other retiree benefits across the board. And some others, although their plans remained solvent, used up "surplus" assets that could have benefitted the vast majority of plan participants if used instead for cost-of-living adjustments or offset the cost of retiree health care benefits. In the current crisis, General Motors used pension assets to pay for billions in severance payments during 2008 – and ended up with such a dangerous degree of under-funding that in early 2009 the Treasury Department restricted the practice as a condition of the federal bailout loan package.

The most effective way for Congress to protect plan participants (and taxpayers) from unfunded liabilities from severance, layoff or any other benefit increase is simply to increase the target funding level threshold required for unfunded benefit increases and lump sum payouts from the 80 percent level, currently required under the PPA, to 120 percent. Severance or other benefit increases to selected individuals that are not funded should be paid out of the company's operating expenses, not from the pension trust. This would not limit the ability of plan sponsors to enhance benefits. What it does do is require companies to currently fund lump sum payouts or other benefit increases that would otherwise cause the plan to become under-funded or worsen its level of under-funding. Amendments increasing benefits that are collectively bargained or negotiated between a plan sponsor and bona fide union representatives, or in the context of a jointly-trusteed Taft-Hartley plan, should be exempted from this more restrictive funding level.

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# Pension Guarantees that Work for Retirees

*A Proposal for Commonsense PBGC reforms*

***EXECUTIVE SUMMARY***

The current economic downturn has highlighted just how vulnerable America's workers and retirees are to the threat of corporate bankruptcy and the dumping of company pension obligations onto the government's pension guarantee system. The Pension Benefit Guaranty Corporation (PBGC) took over 129 terminated plans during 2009, a 75% increase from the year before. The pace of plan terminations has only accelerated since then.

As required by ERISA, plan sponsors pay a per-participant "insurance premium" to the PBGC – a cost paid from plan assets. Although these premium payments may not reflect the long-term cost of insuring the benefits, retirees are led to believe their benefits are protected, at least up to the statutory maximum (currently $54,000 per year for a 65-year-old, but lower under age 65). Unfortunately, workers and retirees learn only after plan termination that a number of PBGC practices can leave them with benefits that are permanently reduced by 30 percent or more.

Arbitrary gaps in ERISA's benefit guarantee program are imposing unanticipated and devastating losses on tens of thousands of retirees and older workers forced into retirement by the bankruptcy of their employer. Benefits actually paid by the PBGC can be much lower than the vested benefits earned. Some limitations on PBGC's guarantee are imposed specifically by ERISA – such as the maximum annual benefit guarantee (which varies based on age). This paper focuses on one statutory and two *discretionary* policies that PBGC maintains despite the fact that it leads to unexpected and unfair benefit losses for a large number of older workers and retirees.

First, while ERISA imposes limitations on benefit guarantees, ***the largest loss of earned benefits suffered by most retirees after a plan termination is caused by the PBGC's decision to value the future cost of benefits using an unrealistically low interest rate assumption.*** The lower the interest rate, the greater the estimated present value of future benefit obligations. But while other qualified pension plans are required, pursuant to the Pension Protection Act of 2006, to calculate their funded status based on the AA corporate bond yield curve prescribed by the Treasury Department, the PBGC uses a much lower discount rate (currently under 5%) that is derived from the prices charged by private insurance companies for fixed and deferred annuities.

***The government is confusing and misleading 44 million insured plan participants*** by requiring companies to send them year after year an Annual Funding Notice that discloses a funding level and projected benefit obligation that are substantially rosier than what the PBGC later calculates as "termination liability." In other words, the PBGC chooses to use a different – and far more conservative – interest rate assumption in valuing benefit obligations than a plan sponsor is required to use under ERISA's minimum funding rules. And because the PBGC assumes a much lower discount rate on future benefit obligations (recently under 5%), it allocates plan assets *as if* it will not be offsetting a substantial portion of future benefit costs by investing the plan assets, just as other plan sponsors offset future costs with expected market rates of return on investment.

As a result, the assets recovered from a terminated plan cover the inflated "present value" of guaranteed and non-guaranteed benefit obligations to a much lesser degree than if the PBGC assumed that plan assets would earn a long-term average market rate of return (typically 6% to 8%). Because the present value of benefit liabilities are exaggerated, plan assets rarely cover even most of the non-guaranteed vested benefits, such as benefit increases within five years of termination. This results in unnecessarily large and permanent losses for participants. ***Congress should require PBGC to use the same corporate bond yield curve and other assumptions as plan sponsors for the purpose of allocating plan assets to pay non-guaranteed benefits.***

The second discretionary PBGC policy that unnecessarily reduces benefits for a subset of retirees is flatly contrary to the plain language of ERISA. One of the statutory limitations on guaranteed benefits is the five-year phase-in of "any increase in the amount of benefits under a plan *resulting from a plan amendment.*" If such a benefit increase becomes effective within one year of the plan termination date, it is not guaranteed at all; if the amendment made the benefit increase effective more than one year prior to termination, the guarantee phases in 20% per year.

Despite the statutory definition of the five-year phase-in as "resulting from a plan amendment," the PBGC has determined that the annual statutory inflation adjustment of the maximum annual compensation that can be considered in calculating a benefit (the IRC Section 401(a)(17) limit) and the maximum annual benefit payable by a qualified plan (the IRC Section 415(b)(1)(A) limit) is a benefit increase subject to the five-year phase in. As a result, older workers or retirees whose accrued monthly benefit simply adjusted automatically in line with the statutory inflation adjustment suffer a disproportionate loss of benefits. Although vested, these benefits are rarely paid because the portion not guaranteed under the five-year phase-in is moved to a low Priority Category (PC-5), at which point there are rarely plan assets remaining to pay these "non-guaranteed" claims. ***The PBGC should change this policy or Congress should clarify that a benefit increase triggered by a federal statute is not subject to the five-year phase-in limitation.***

A third indefensible gap in ERISA's guarantee system is the statutory three-year 'lookback' that PBGC applies to determine what benefits are eligible for payment under Priority Category 3. On the date of plan termination (or bankruptcy filing, whichever is earlier), if a plan participant has not been retired (in "pay status") or eligible to retire for at least three years, then no portion of his or her benefit is eligible for PC-3 prioritization. The guaranteed portion of the benefit will still be paid (under PC-4), but the *non-guaranteed* portion will almost always be unfunded and lost forever. Since all of the non-guaranteed benefits of recent retirees are demoted to PC-5, this group takes a big reduction whether they have been retired for 1 month or nearly three years. ***Congress should amend Section 4044(a)(3) so that the benefits of all plan participants who are already retired, or eligible to retire, on the date of plan termination are protected equally.***

Finally, the paper addresses the growing concern about the PBGC's ability to deter plan terminations by, or recover assets from, foreign-owned or foreign-based plan sponsors. Actually collecting on a liability in practice requires that foreign entities have sufficient assets within the jurisdiction of U.S. courts. Because of this increased risk, PBGC should add foreign ownership, and proposed sales or spin-offs to foreign owners, to the list of transactions triggering an Advance Notice of Reportable Events, as well as special scrutiny under the PBGC's Early Warning Program. In addition, ***Congress should to clarify that the PBGC has the authority to enforce a lien against all U.S.-based assets of a foreign plan sponsor and require that plan fiduciaries – particularly a plan's "named fiduciary"– be U.S. citizens subject to the jurisdiction of U.S. courts***.

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