



# ***Back Door Reversions:***

## **Limiting the Use of Pension Assets for Severance Will Strengthen Defined Benefit Retirement Security**

3/10/2017

### ***Executive Summary***

The use of pension assets to pay for lump sum severance payments during a corporate restructuring is a “back door reversion” that circumvents the Congressional policy against reverting pension assets to pay corporate operating expense. Severance, layoff or other lump sum benefit increases to terminating individuals should be paid out of the company’s operating expenses, not from the pension trust, unless the pension plan has a substantial surplus. Congress should require that any ad hoc plan amendment that gives a subset of participants a benefit increase payable in the form of a lump sum must be immediately funded *if* the plan’s adjusted target funding level is (a) less than 120% or (b) would be less than 120% after taking into account the cost of the amendment.

When pension funds were used to finance hostile takeovers and the mass layoffs that often resulted, Congress stopped the practice in 1990 by imposing a 50% excise tax on pension asset reversions. 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 only to offer older workers enhanced early retirement benefits (by awarding extra years of service credit), but even to offer lump sum severance payouts equal to a year’s salary or more as part of a corporate restructuring.

The 2006 Pension Protection Act limited 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%. However, as the 2008 stock market meltdown demonstrated, a plan that is 80% funded during a bull market could end up below 60% funded in a bear market – and in default with the Pension Benefit Guaranty Corporation (PBGC) if the plan sponsor declares bankruptcy. For retirees and older workers, the costs imposed by a distress termination or abandoned plan can be severe. When an under-funded plan terminates, many retirees and other plan participants (one in seven on average) suffer a *permanent loss of income* despite the partial guarantees provided by the PBGC. The permanent loss of 30% or more of an individual’s *vested but non-guaranteed benefits*, due to various PBGC limitations, can be devastating to the retirees and older workers affected, as the NRLN documents in a companion paper entitled *Pension Guarantees that Work for Retirees*.

The trend toward distressed companies using pension assets to pay severance costs – instead of relying on a restructuring reserve or other corporate assets – is not new to the recent financial downturn. Lucent, United Airlines, AT&T, Verizon, Qwest, Federal Express, Delta and Delphi are among the companies that tapped pension assets to pay corporate restructuring costs. Some companies tap their pension assets for severance payments as they spiral downhill toward bankruptcy and an eventual bailout courtesy of the PBGC. Other companies, left under-funded, cut other retiree benefits across the board. And some others, although the plans remain solvent, use up “surplus” assets that could have benefitted the vast majority of participants if used instead for cost-of-living adjustments or to pay for retiree health care benefits. For example, General Motors used pension assets to pay for nearly \$3 billion in lump-sum severance payouts 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. In 2012 it terminated its plan for management and salaried retirees entirely.

The most effective way for Congress to protect retirees and other plan participants is simply to **amend Internal Revenue Code section 436(c) [and ERISA Section 206(g)] to require that any ad hoc plan amendment that gives a subset of terminating participants a benefit increase payable in the form of a lump sum must be immediately funded if the plan’s adjusted target funding level is (a) less than 120%, or (b) would be less than 120% after taking into account the cost of the amendment.**

Severance or lump sum benefit increases to terminating employees should be treated as an operating expense, not as a qualified pension benefit. This reform does not limit the ability of plan sponsors to enhance traditional early retirement benefits (so-called “window benefits”). What it does do is require companies to 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. Ad hoc amendments increasing benefits that are collectively bargained or negotiated between a plan sponsor and bona fide union representatives should be explicitly exempted from this restriction.

In addition, plan sponsors should be given more flexibility concerning the use of surplus assets (e.g., assets greater than 120% of vested obligations). The NRLN recommends that **Congress amend ERISA to permit the reversion of any surplus assets above 120% funding for any purpose that solely benefits plan participants (including early-out payments and funding health and welfare benefits), or for reversion to the company for any purpose if 50% of the reversion amount is distributed as a one-time benefit enhancement to all vested plan participants on a pro rata basis** (e.g., a 2% monthly benefit increase). Under each of these circumstances the excise tax on pension reversions should not apply. The calculation of the 120% funding threshold should be subject to IRC Section 420(g), which requires calculation of eligible plan asset transfers using the PPA’s corporate bond market segment rates and without regard to the higher discount rates permitted under the MAP-21 funding relief enacted in 2012 (and subsequent extensions).



# ***Back Door Reversions:*** **Limiting the Use of Pension Assets for Severance Will Strengthen Defined Benefit Retirement Security**

3/10/2017

## Table of Contents

<b>I.</b>	<b>Introduction &amp; Background</b>	<b>Page 4</b>
	<b>Raiding Plans to Pay Operating Costs: The Pre-Bailout Auto Industry</b>	<b>Page 6</b>
	<b>A Broader Trend Toward Back Door Reversions</b>	<b>Page 7</b>
	<b>Strengthening Employer Incentives to Contribute and Maintain a Pension Surplus</b>	<b>Page 9</b>
<b>II.</b>	<b>The Growing Problem of Paying Severance from Pension Assets</b>	<b>Page 11</b>
	<b>Powerful Incentives to Tap the Pension Plan</b>	<b>Page 12</b>
	<b>Reducing Funding Levels Harms Retirees and Older Workers</b>	<b>Page 13</b>
	<b>Examples of Companies Making Reversions to Pay Severance</b>	<b>Page 13</b>
<b>III.</b>	<b>ERISA: The Law, the Loopholes, and How to Close Them</b>	<b>Page 18</b>
	<b>The Law and the Loopholes</b>	<b>Page 19</b>
	<b>The Stakes are High for Retirees and Taxpayers</b>	<b>Page 22</b>
	<b>The Legislative Change Needed</b>	<b>Page 23</b>
	<b>1. Amend § 436(c) to Condition Ad Hoc Lump Sums on 120% Funding</b>	<b>Page 23</b>
	<b>2. Amend § 436(d) to Condition Unfunded Lump Sums on 100% Funding</b>	<b>Page 25</b>
	<b>3. Broaden Allowable Excess Asset Reversions Above 120% Funding Levels</b>	<b>Page 26</b>
<b>IV.</b>	<b>Conclusion</b>	<b>Page 27</b>

*American Retirees Education Foundation (AREF) and National Retiree Legislative Network (NRLN) Terms of Use: This entire document is protected by U.S. copyright laws. It may not be altered or used for any commercial purpose without the written consent of the AREF and NRLN. It may be displayed, copied and distributed for non-commercial purposes providing you clearly attribute use of any part or all of it to the AREF and NRLN.*

## ***I. Introduction & Background***

The stock market crash of 2008 demonstrated just how vulnerable the nation's pension funds – and the retirement security of millions of retirees – are to market volatility. Corporate pension plans at the nation's largest companies ended that year underfunded by \$409 billion, with funding levels sufficient to cover only 75% of their projected benefit obligations. Just a year earlier, at the top of the bull market, these same S&P 1,500 pension plans were \$60 billion in surplus.<sup>1</sup> The pension underfunding induced by the market downturn also proved persistent: the aggregate deficit of plans sponsored by S&P 1,500 companies was \$408 billion as of year-end 2016.<sup>2</sup>

Conventional wisdom maintains that ERISA's funding and fiduciary requirements are designed to protect workers and retirees in such circumstances, in part by preventing companies from using pension plan assets to pay corporate operating expenses. When pension funds were used in the late 1980s to finance hostile takeovers and the mass layoffs that typically followed, Congress stopped the practice by imposing a 50% excise tax on pension reversions that are not used to provide benefits to participants.<sup>3</sup>

But today's "back door reversions" are more insidious. Although ERISA explicitly prohibits the use of pension plans 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 downsizing or restructuring. This paper describes many examples of companies that have paid for lump sum severance payments with pension assets – and how the retirees and other plan participants were harmed as a result.

The 2006 Pension Protection Act tightened up on this practice somewhat by requiring companies to pre-fund a plan amendment that increases benefit liabilities to the extent the plan's funding level would fall below 80% (after taking account of the new benefit liability). However, as the 2008 market meltdown demonstrated, a plan that is only 80% funded during a bull market can easily end up below 60% funded in a bear market – and in default with the Pension Benefit Guaranty Corporation (PBGC) if the plan sponsor declares bankruptcy.

The risk of pension underfunding is also greater than it appears since most plans are underestimating improvements in longevity among plan participants<sup>4</sup> and because "termination liability" – the actual cost of replacing a terminated plan's promised benefits with purchased annuities – is far costlier than the pension benefit obligations that companies project and report each year as an ongoing plan using ERISA's corporate bond yield curve as a discount rate.<sup>5</sup> In fact, the "funding relief" provisions Congress passed as part of the 2012 highway funding bill (MAP-21 Act) allow companies to understate actual obligations to a far greater degree by using an even higher average discount rate.<sup>6</sup> By allowing firms to reduce current contributions, funding relief further increases the risks to underfunding to retirees. Although the MAP-21 provisions allowing plan sponsors to "smooth" (average) interest rates over 25 years was intended to provide temporary relief during in the aftermath of the Great Recession, this relief (and the reduced funding levels it allows) has been extended twice by Congress until at least 2020.

For retirees and older workers, the costs imposed by a distress termination or abandoned plan can be severe. When an under-funded plan terminates, many retirees and other plan participants suffer a *permanent loss of income* despite the partial guarantees provided by the PBGC. The permanent loss of vested but *non-guaranteed* benefits, due to various PBGC limitations, can be devastating to the individuals affected, as the NRLN documents in a companion paper entitled *Pension Guarantees that Work for Retirees*.<sup>7</sup> **One in seven participants in plans taken over by PBGC lost an average 28% of their vested pension benefits**, according to the most recent data published by PBGC.<sup>8</sup> These losses most commonly impact younger and more highly-paid retirees, as well as older employees nearing retirement.

In addition, certain corporate transactions that often accompany a downsizing that depletes the pension plan to make severance payments – particularly the spin-off of under-performing subsidiaries – greatly increase the risk of distress termination and benefit losses for retirees. The strategic spin-off of an under-performing unit is a well-established tactic that holds even greater appeal when under-funded pension, health and welfare benefits can be taken off the books of the parent company. Policy changes to avoid terminations that trigger losses for both retirees and the PBGC are described in a separate NRLN paper entitled *Pension Plan Risks in Mergers, Acquisitions and Spin-Offs*.<sup>9</sup>

The concluding section of this paper recommends raising the funding level threshold for plan amendments that increase an unfunded liability for lump sum payouts to terminating employees from 80 to 120% (the same level of surplus required for section 420 transfers from surplus pension assets into a retiree health and/or life insurance benefit trust). At a minimum, no new unfunded lump sum payment obligations should be permitted if it results in the plan falling below full (100%) funding.

The risk to retirees when companies use pension assets to finance lump sum severance payments is compounded further because current law discourages surplus funding of pension plans. This occurs in two ways: First, in order to minimize corporate tax deductions for pension contributions, ERISA limits the ability of employers to accumulate a funding surplus. Second, ERISA overly restricts the ability of plan sponsors to use surplus funding in excess of a reasonable cushion (e.g., above 120%). In short, if plan sponsors could more easily accumulate and access the equivalent of a “rainy day fund” in the pension plans – to cover early-out inducements and certain other contingencies – they would have a far greater incentive to maintain fully funded plans rather than raiding under-funded plans.

The final section of this paper therefore recommends that ERISA be amended to permit the reversion of any surplus above 120% for any purpose that solely benefits plan participants (including early-out payments and paying health and welfare benefits), or for reversion to the company for any purpose *if* 50% of the reversion amount is distributed as a one-time benefit enhancement to all vested plan participants on a *pro rata* basis (e.g., a 2% monthly cost-of-living increase). Under each of these circumstances the excise tax on pension reversions should not apply. Moreover, to ensure the plan is fully funded on a termination basis, the 120% funding level should be calculated without using the pension

“stabilization” relief enacted in 2012, as required under Section 420(g) for transfers to pay for retiree health and life insurance benefits.<sup>10</sup>

### ***Raiding Plans to Pay Operating Costs: The Pre-Bailout Auto Industry***

The auto industry provides a recent and glaring example of how the current ambiguity in ERISA invites abusive “backdoor reversions.” In November 2008, soon after the severity of the financial crisis became clear, the PBGC sent urgent Letters of Inquiry to Detroit’s distressed Big Three. The PBGC demanded details about the automakers’ plans to tap their remaining island of solvency – their pension funds – to cover the cost of billions of dollars in severance and early retirement buyout payments. By January 2009 the automakers’ pension under-funding had deteriorated to the point that the Treasury Department’s bailout loan program included restrictions on GM’s ability to continue to use pension assets to pay for lump-sum severance payments to terminating workers.<sup>11</sup> GM used \$2.9 billion in pension assets to make lump sum severance payments during 2008 – and ended the year with a projected \$12.4 billion deficit in its pension plans (\$20 billion by PBGC calculations).<sup>12</sup>

In 2008, the *Detroit Free Press* reported an admission by GM and Chrysler that for the first time in their history, the companies were using pension assets to fund lump sum severance payments, ranging from \$45,000 to \$62,500, that would be paid in addition to workers’ accrued retirement benefit. The PBGC estimated that Chrysler’s \$9 billion pension deficit left its plans 34% under-funded. Although Ford had no public comment, its annual 10-K filing with the SEC indicated that the company charged \$2.44 billion to its U.S. pension plans in 2007 for “amendments” and “separation programs” related to restructuring.<sup>13</sup> After taking billions out of its pension funds to pay for restructuring, Ford reported in a January, 2009 earnings release that the stock market downturn had left the company with a \$4.1 billion pension deficit at year-end 2008.<sup>14</sup>

“We’re taking advantage of the overfunded status [of the pension plan], and it certainly helps with regard to not having to tap into corporate cash,” GM Spokesman Dan Flores told the *Free Press* in March, 2008, before the stock market meltdown. “However, they [workers] choose to take it [the severance], whether it is in cash or annuity or a rollover, it is coming out of the pension fund,” he explained.<sup>15</sup>

A sad irony, of course, is that the catalyzing scandal that led to the enactment of ERISA and the creation of the PBGC was the 1963 bankruptcy of the Studebaker auto company in South Bend, Indiana, which left 4,000 workers with only 15% of their promised pensions and another 2,900 with zero. As it spiraled down, Studebaker drained its already under-funded pension assets attempting to offset other costs and remain in business.<sup>16</sup> Was this history repeating itself?

In his November 28, 2008 letter to General Motors, the PBGC Executive Director stated that “GM’s public statements suggest that the present value of these new [attrition program] obligations, including lump sums, exceeds \$5 billion.”<sup>17</sup> In his letter to Ford’s CFO, PBGC’s Millard noted:

By their very nature, benefits under these new attrition programs are not pre-funded, were not taken into account in previous funding determinations, may increase future funding requirements and may not be fully guaranteed under ERISA. These factors increase the risk of loss to plan participants and to the PBGC in the event of plan failure.<sup>18</sup>

Millard later told the *Wall Street Journal* that “we see a continued use of the pension plans for other corporate purposes, including restructuring, and we worry that if it continues, the scenario could be much worse.” The PBGC is concerned that “with each passing year, the cost of funding buyouts will pose a greater threat to the pension funds.”<sup>19</sup> A default by the Big Three alone could have more than tripled the agency’s deficit, which was already a projected at \$11.2 billion before the 2008 market crash.

According to the PBGC, the three automakers were \$41 billion underfunded at year-end 2008 and had enough money in their pension funds to cover only 76% of their pension obligations. PBGC Executive Director Charles E.F. Millard warned that as many as 1.3 million workers and retirees could see their pension benefits slashed if the companies defaulted and the plans were taken over by the PBGC.<sup>20</sup> “I’ve got a retiree club that’s absolutely sick about it,” Paul Heller, a GM salaried retiree, told the *Detroit Free Press*. “They [management] robbed it blind to pay off the people to get them to leave.”<sup>21</sup>

GM reported in SEC filings that its pension plans were overfunded by \$18.8 billion at the end of 2007. However, the combination of withdrawing billions for severance payments and the market downturn more than erased the surplus and left its plan underfunded by \$12.4 billion, or about 80% funded overall.<sup>22</sup> Moreover, unlike the traditional extra age and service credits (“window benefits”) that have long been used to encourage early retirement by increasing a worker’s monthly benefit, the cost of which is spread over the individual’s life expectancy, the depletion of GM’s pension fund for lump sum severance payments was large and immediate.

### ***A Broader Trend Toward Back Door Reversions***

Unfortunately, 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 2008 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 – in some cases doing so on the way to bankruptcy and/or a federal pension bailout courtesy of the PBGC.

For example, in 2001 and 2002 a struggling **Lucent Technologies** charged \$2.2 billion in “termination benefits” to its various employee pension plans through a combination of lump sum payments and age and service credits. As the *Wall Street Journal* reported: “Lucent used its pension fund for severance... Doing so raised Lucent’s pension liability by \$1.95 billion.”<sup>23</sup> Although Lucent’s pension plans were substantially overfunded at the outset, the combination of severance payments and the stock market downturn left the management and salaried workers’ plan with a \$2.6 billion deficit by 2003.<sup>24</sup> In early 2003 Lucent eliminated its traditional death benefit, which was paid from pension fund

assets, effectively cutting benefits in its rank-and-file management and salaried workers plan by \$400 million. (See the further discussion of Lucent below, on page 16.)

Emboldened by the government's failure to put reasonable limits on the ability of companies to shift corporate restructuring costs onto the pension plans, pension consultants and lobbyists have been pushing other strategies to get access to pension plan assets. While the use of pension assets to pay for corporate restructuring is the largest and most widespread "back door reversion," there are a number of other means by which some companies are seeking to circumvent the Congressional policy against reversions:

- ***Qserp Transfers:*** As the *Wall Street Journal* revealed in 2008, a growing number of companies are abusing an ERISA tax loophole to "move hundreds of millions of dollars in obligations for executive benefits into rank-and-file pension plans. This lets companies capture tax breaks for pensions of regular workers and use them to pay for executives' supplemental benefits and compensation."<sup>25</sup> For example, **CenturyLink, Inc.** in three consecutive years (2005, 2006 and 2007) transferred unfunded obligations from its very generous nonqualified Supplemental Plan for senior executives to its rank-and-file Qualified Plan, according to the company's 2012 proxy statement. These "enhanced annuities" are now funded as obligations of the company's under-funded qualified plan and will be paid out to the senior executives on top of their qualified benefits and in the form of a lump sum if they so choose.<sup>26</sup>
- ***Section 420(h) End Runs:*** In 2008, while it was raiding its pension assets to pay restructuring costs, General Motors also engineered a brazen abuse of the one major exception that Congress created to the excise tax on pension asset reversions, so that companies more than 120% funded could transfer the surplus to offset company expenditures on retiree health benefits. GM announced that it would cancel retiree health coverage (for retirees 65 and older) and, as of January 1, 2009, partially compensate retirees by raising their pension benefit by \$300 per month. This maneuver cost the GM plan \$8.7 billion in new liabilities – and accounted for the majority of the plan's reported \$12.4 billion shortfall as of year-end 2008.<sup>27</sup> Since GM's management did this as two separate transactions, it appears technically legal. Nevertheless, the effect was to use pension plan assets to pay for retiree health care obligations, while avoiding the "maintenance of benefit" conditions imposed on similar multi-year transfers under the 2006 Pension Protection Act amendments to ERISA Section 420(h).
- ***Selling Pension Plan Assets to Hedge Funds:*** In late 2007, at the top of the last bull market, Wall Street firms sought regulatory approval for an idea in financial engineering first proposed by Bear Stearns: Corporations that froze their pension plans (so that no new benefit liabilities accrued) would sell the assets to hedge funds and other investment firms, which would pay a premium for the option value of "running the money" more aggressively than stodgy old pension plan administrators would believe is prudent.<sup>28</sup> Although the Bush Treasury Department ruled in 2008 that selling plan assets and liabilities to an investment firm with no employment relationship to plan participants would violate current law, it suggested how Congress could amend ERISA to allow the practice.<sup>29</sup>

This white paper focuses on the abuse of pension trusts to pay lump-sum severance costs because that is by far the largest and most immediate threat to the retirement security of millions of retirees.

### *Strengthening Employer Incentives to Fully Fund Pension Promises*

As we'll see in the next section, the risk of loss to retirees and taxpayers that results from companies using pension assets to finance lump sum severance payments varies enormously depending on how well funded the plan is prior to the 'back door reversion.' During the economic downturn of 2001-2002, the use of pension assets for early-out payments at **Verizon and AT&T** – which had surpluses exceeding 120% at the time – had no immediate negative impact, whereas the same behavior at struggling companies with under-funded plans (**Delphi, United Airlines and Delta Air Lines**) led to huge permanent losses for retirees when the companies later went bankrupt and their distressed plans were taken over by the PBGC.

Thus, although the NRLN believes that lump sum severance payments are an operating expense that should not drain pension assets, it also recognizes that the risks from this practice are substantially mitigated when plans are well-funded. Unfortunately, however, ERISA's funding rules discourage well-funded plans.

Since enacting ERISA in 1974, Congress has alternated between strengthening the pension system by encouraging employer contributions – and then weakening the system by trying to raise revenue by limiting tax-deductible contributions. During ERISA's first decade, when defined benefit (DB) plans covered the largest share of the workforce in history, there were few limits on the ability of employers to make contributions and to build up what frequently became substantial surpluses, at least during bull markets. Then, as part of a 1986 deficit reduction bill, Congress enacted what the American Benefits Council (and other industry advocates) characterized as “short-sighted, revenue-driven restrictions that lowered the maximum tax-deductible contribution, imposed a significant excise tax on contributions that were not tax-deductible, and placed heavy penalties on employer withdrawals of surplus assets.”<sup>30</sup>

Perversely, this policy discouraged plan sponsors from contributing a surplus during 'good times' – and required them to more quickly make up the under-funding that follows a market downturn during 'bad times.' The result is that pension plans are chronically underfunded, industry is left scrambling to convince Congress to enact year-to-year “funding relief” bills after severe market downturns, and companies are left with yet another reason to freeze or terminate their DB pension plans. In addition, more companies than necessary dump larger pension deficits than necessary on the PBGC (and taxpayers) when they go bankrupt or need to shed liabilities to emerge from bankruptcy.

The Pension Protection Act (PPA) of 2006 addressed this issue to a substantial degree, providing that an employer can deduct contributions up to full funding as well as a “cushion amount” as much as 50% above present value of the plan's current benefit obligations. This increased the deduction limit in Internal Revenue Code Section 404

from 100% of current unfunded liability to 150%.<sup>31</sup> The PPA also eliminated the 10% excise tax on *non-deductible* contributions to single-employer plans above this limit.<sup>32</sup>

Another issue that impacts a firm's willingness to fully fund a plan – and to accumulate a surplus during bull markets – is the plan sponsor's degree of flexibility concerning the use of surplus assets (e.g., assets greater than 120% of vested obligations). Although the ultimate ownership of plan assets has been an issue of considerable controversy, under ERISA the assets in an ongoing pension trust must be managed for the “exclusive benefit” of plan participants. At the same time, there is growing support for the notion that to the extent a plan reaches a funding level in excess of 120%, it is reasonable to give employers more options to redeploy the “surplus” assets provided that retirees and other plan participants benefit to some significant degree.

Under current law, with the exception of retiree health and group life insurance benefits described just below, employers may withdraw assets from a pension plan only after terminating the plan and providing for the payment of all accrued (vested) benefits. Any surplus remaining is subject to both corporate income tax (currently up to 35% at the federal level) and a 50% excise tax. The excise tax rate is reduced to 20% if the company transfers at least 20% of the reversion amount to plan participants on a *pro rata* basis by increasing their defined benefit amount, or instead transfers at least 25% of the reversion amount into participants' 401(k) or other defined contribution (DC) account. In practice, the combination of the excise tax and the requirement of plan termination have made reversions both rare and unappealing to both employers and retirees.

The exception to this virtual prohibition on reversions is a so-called “section 420 transfer,” which is named for the ERISA tax code section authorizing it. Under Internal Revenue Code section 420(h), a company may transfer pension assets on a tax-free basis into a separate account dedicated to paying retiree medical expenses that would otherwise be an operating expense. In 2012, along with funding relief provisions, Congress added retiree group life insurance benefits as an allowable use of a section 420 transfer. The PPA also expanded section 420(h) to permit firms to transfer assets in excess of 120 % of pension liabilities to cover retiree medical benefits for up to 10 years. “This ‘big bang’ 420 transfer can utilize a very significant portion of any surplus and enhance corporate cash flow,” according to a Towers Perrin white paper. Thus, even a true “surplus” can usually be used to benefit the majority of participants and not only a small group.

In the final section of this paper, **the NRLN recommends that lump sum severance payments be given the same treatment as section 420 transfers that pay for retiree health and life insurance benefits.** In addition, the NRLN recommends that excess asset reversions be permitted for plans funded at more than 120% of their liabilities, with no excise tax imposed and no requirement that the plan be terminated, *but only if 50% of the reversion amount is transferred to participants* in the form of a one-time, *pro rata* benefit improvement. In practice this would give companies the choice to use all of the excess assets (above 120% funding) to fund a non-pension benefit for plan participants (e.g., retiree health or early-out payments) *or* to use 50% to enhance pension benefits, while retaining 50% as operating income. In addition, **like current Section 420 transfers, the 120% excess funding threshold should be subject to Section 420(g)** and calculated using the Pension Protection Act's corporate bond yield curve and without

regard to the higher discount rates allowed under the pension funding relief provisions initially enacted as part of the MAP-21 Act in July 2012 (and discussed further below).<sup>33</sup>

Although any reversion increases risk for retirees, using a portion of a reversion to improve benefits could help mitigate the virtual absence of cost of living increases in recent years. Increasingly, retirees are living longer on fixed incomes that decline in purchasing power each year due to inflation – particularly health care cost inflation, which has increased faster than general price inflation for many years. Even a one-time cost-of-living adjustment can help offset this steady decline in the real economic value of the defined benefit.

## ***II. The Growing Problem of Paying Severance from Pension Assets***

It's critical to keep in mind that pension plan assets represent the financial obligations of plan sponsors to their workers and retirees for earned benefits. Plan sponsors are required by ERISA to pre-fund pension promises in a legally-separate trust and to manage the assets for the “exclusive benefit” of plan participants. Although a fully-funded pension plan can be terminated – and any surplus reverted after the purchase of annuities to guarantee the payment of vested benefits for all participants – prior to termination even surplus assets in a plan frozen to new benefit accruals cannot be used to pay for corporate operating expenses.

Traditionally, large firms, particularly in cyclical manufacturing industries, maintain a restructuring reserve to pay layoff benefits and severance during hard times. Many firms also establish separate severance plans that are governed by ERISA, but not subject to funding, vesting and anti-cutback rules. In both cases, restructuring reserves and severance plans use *general* corporate assets to make severance payments – not DB pension plan assets. However, thanks to ERISA's ambiguity and lax regulatory enforcement, an increasing number of distressed firms, as well as firms wanting to offset current operating expense to bolster short-term earnings reports, are substituting pension fund assets for general assets when it comes time to finance a corporate downsizing. “There's a trend toward using pension assets for that purpose [severance],” Bob Walter, a principal at Buck Consultants told *Pensions & Investments* magazine. “We've seen quite a bit of it among our clients and other organizations.” He noted that although the tax code and old IRS regulations suggest that severance should not be paid from pension assets, “that can be worked around by listing severance as ‘supplemental pension credits,’ ‘transitional pension credits’ or ‘shutdown benefits,’” according to *P&I*.<sup>34</sup>

### ***Powerful Incentives to Tap the Pension Plan***

It is widely recognized that companies use severance pay to encourage older, more expensive workers to leave the payroll, particularly when layoffs are inevitable. In exchange for a buyout, older workers in particular are typically required to sign a waiver of claims under the Age Discrimination in Employment Act (ADEA). To pay these separation costs, plan sponsors have powerful incentives to tap pension assets, rather than corporate assets, whenever possible. A Towers Perrin white paper (“Managing Pension Surplus: A New Playbook for a New Era”) makes this explicit:

Pension surplus can be used to enhance retirement benefits for existing participants in lieu of other reward elements, such as ... severance and retiree medical benefits. While the value of the additional pension benefits would reduce the surplus, using excess surplus to fund additional retirement plan benefits can ... free up working capital for use elsewhere in the organization.<sup>35</sup>

Towers Perrin also advises clients that paying severance and other ancillary benefit payments from qualified pension assets “provide distinct tax advantages, such as the ability to roll over certain [lump sum] distributions to IRAs.”<sup>36</sup> Indeed, GM cited the fact that many older workers objected to paying income tax on their lump sum severance payments as one motivation for making the payments from the pension trust.<sup>37</sup> Under the tax code, income taxes on lump sum pension payouts can be deferred by rolling it over into an Individual Retirement Account, whereas the same payment from corporate assets would be treated as ordinary income. Pension payouts also escape payroll taxes, both FICA (Social Security and Medicare) and FUTA (federal and state unemployment taxes), which saves the company more than 8% of the payout compared to using corporate assets.

Finally, and most worrisome, the strongest incentive to pay attrition costs from pension assets occurs at companies in financial distress. As GM and Chrysler spokesmen conceded, before 2008 the big automakers never resorted to charging billions of dollars in restructuring costs to their pension trusts. But as bank robber Willy Sutton famously stated, that’s where the money is. Similarly, other massive “back door reversions” to offset severance costs occurred primarily at companies – such as Lucent, Delta, Delphi, United Airlines and Consolidated Freightways – during times they were in a downward spiral. As the NRLN describes in a separate white paper on *Pension Plan Risks in Mergers, Acquisitions and Spin-Offs*,<sup>38</sup> companies that are downsizing, with under-funded pension plans, are also more likely to engage in financial engineering – such as spin-offs, split-ups and mergers – that lead to distress terminations, particularly since the PBGC lacks the regulatory tools to protect retirees.

## ***Reducing Funding Levels Harms Retirees and Older Workers***

While some workers might benefit in the short run from a lump sum severance payout, a far larger number of plan participants could in the longer term lose future benefit accruals and/or lose vested benefits entirely if they exceeded the level guaranteed by PBGC.

Retirees are, of course, the primary victims of “backdoor reversions” that diminish plan assets. A downward spiral into bankruptcy is the worst-case scenario. Since PBGC only insures benefits up to a maximum \$64,400 at the normal retirement age of 65 (in 2017) – and applies a number of other limitations on the vested benefits it actually guarantees – a default termination results in a permanent loss of earned benefits for many retirees. But even if a company and its pension plan avoid or survive bankruptcy after reducing plan assets to pay for severance benefits, it becomes far more vulnerable to a market downturn – and may react by cutting benefits for retirees and other participants.

As described just below, this is exactly what happened at Lucent Technologies and at Qwest Communications. In both cases, the companies were downsizing after the tech stock bubble burst in 2000; they used huge withdrawals of pension assets to pay lump sum severance benefits; and then, determined to avoid making pension contributions for the first time in many years, they cut whatever pension benefits they believed they legally could (both companies eliminated the retiree death benefit that had long been paid from pension fund assets).

Even if a plan is fully-funded – and severance payments are made using “surplus” assets – there is risk to the plan and harm to retirees. As any actuary will concur, a “fully funded” plan today – particularly during good economic times – could just as easily have large unfunded obligations tomorrow if either financial markets *or* the plan sponsor’s own business prospects worsen. Moreover, what ERISA deems to be full funding is *not* remotely enough assets to cover all obligations on a termination basis. The PBGC’s consistent experience is that at termination plans prove to be at least 20% less-well-funded than they appear under ERISA’s rules for ongoing plans. Both the PBGC and the GAO have for years recommended that Congress base minimum funding rules on plan termination liabilities rather than on projections of benefit obligations and returns on investments that are based on higher assumed interest (discount) rates.<sup>39</sup>

## ***Examples of Companies Making Reversions to Pay Severance***

Even before the severe 2008 downturn pushed the Big Three automakers to use pension assets to pay billions of dollars in restructuring costs, some other major U.S. firms were pushing the envelope of what’s allowable since at least the stock market downturn of 2000-01. As the company examples below indicate, the circumstances vary considerably and fall into one of three categories.

Most troubling are companies such as GM, Delphi, United Airlines and Delta Air Lines that began siphoning off pension assets to pay for downsizing in desperation. These companies were in a downward spiral and – in the case of United Airlines, Delta, Consolidated Freightways, Bethlehem Steel and Polaroid – left the PBGC, retirees and other plan participants holding the tab for larger liabilities and diminished assets. In all

of these cases large numbers of early retirees and high-wage retirees lost earned benefits, since PBGC guarantees on average only 80% of the vested benefits that plans would have paid had they not defaulted.<sup>40</sup>

A second set of companies, such as Lucent Technologies and Qwest Communications, spiraled dangerously close to bankruptcy but managed to find a way up (both were ultimately acquired by stronger companies). These two companies are instructive because of the direct damage to non-represented retirees. After paying out more than \$2 billion and \$400 million, respectively, in pension assets for severance payments after the market downturn of 2001-2002, the Lucent and Qwest plans turned from surplus to deficit – and management at both companies, rather than make a contribution to the plan, reacted by cutting the death benefit and life insurance that retirees had considered an earned benefit and had counted on for decades to support surviving dependents.

Companies such as Verizon and AT&T represent a third, more benign scenario, yet still a negative one for retirement security. These companies used surplus pension assets to pay downsizing costs. However, as explained just above, a plan that is “fully-funded” today (at or just above 100% of its projected benefit obligation using the higher funding relief “stabilization” rates adopted in July 2012), may be substantially under-funded within months if the markets head south. As we’ve seen, Ford and GM tapped billions in “surplus” pension assets to pay severance costs during 2007 and early 2008 – only to end up with large pension shortfalls by the end of 2008. Moreover, even if plan sponsors legally have discretion over the use of plan “surplus,” their fiduciary duty – and federal policy – ought to steer them toward tapping that surplus for a purpose that benefits participants, such as granting an occasional cost-of-living adjustment to longtime retirees, or making a section 420(h) transfer to offset corporate costs for retiree health benefits. These uses of plan assets are clearly within the legislative intent of Congress, whereas using the pension plan as a corporate restructuring reserve is not.

Finally, policymakers should be aware that it is nearly impossible for the typical retiree, or even most reporters, to figure out what share of a company’s restructuring costs are drawn from pension plan assets. In some cases, such as at AT&T in 2002, it comes to light because a union (in that case CWA) is in a position to find out and blows the whistle in public. However, as best we can tell lump sum severance payouts are not clearly disclosed in Form 5500 filings at the Department of Labor (which, in any event, are filed far too long afterward); and even SEC filings rarely make clear distinctions about the source of the funds used to pay severance.

The companies below typically did disclose using pension assets for severance payouts in Notes to Consolidated Financial Statements in their Annual Reports filed on Form 10-K (and available to the public through the SEC’s free EDGAR system online). But for many other companies, particularly those that later declared bankruptcy and dumped their pension liabilities onto the PBGC, there was little clear disclosure even in SEC filings. Certainly, plan participants should be informed – and Congress should seriously consider a requirement to add a disclosure of such payments to the Summary Plan Document that is required to be sent periodically to participants.

### **United Airlines**

United is an example of a company that amended its pension plan to pay substantial amounts for severance payments just prior to bankruptcy – and, ultimately, cost its employees and retirees more than \$3 billion in lost, uninsured benefits when it turned its grossly under-funded plan over to the PBGC. Reeling from the travel slump after 9/11, during 2002 United increased its pension obligations by \$544 million to help fund buyouts for terminating workers, according to SEC filings. Combined with lower investment returns and lower interest rates (which raise projected benefit obligations), United’s pension plan ended 2002 under-funded by \$4.7 billion.<sup>41</sup> United declared bankruptcy in December 2002.

According to Bradley Belt, then PBGC Executive Director, United continued to increase benefits for separation payments in 2002, just prior to declaring bankruptcy, even though the financial health of the company and its pension plans had been steadily deteriorating since 2000.<sup>42</sup> In 2005 “the bankrupt airline dumped nearly \$10 billion in pension obligations on the federal government, making it the largest corporate pension default in U.S. history,” the *New York Times* reported.<sup>43</sup>

While the carrier was able to emerge from bankruptcy by terminating plans that covered 120,000 active and retired workers, by then its plan was \$9.8 billion under-funded on a termination basis. Because of its guarantee limits, the PBGC covered only \$6.6 billion of participants’ vested benefits, meaning that United’s retirees ultimately paid the price. Indeed, one of the most devastating reductions in benefits occurs in the airline industry because pilots at that time had to retire at age 60 and at that age the PBGC paid only 72% of the benefit due at ‘normal’ retirement age (age 65).

### **Lucent Technologies**

Lucent provides a striking example of how using pension assets to fund severance payouts, coinciding with a stock market downturn, pushed a distressed company to cut benefits soon after for *all* non-represented retirees. In 2001 and 2002 Lucent charged \$2.2 billion in “termination benefits” to its rank-and-file pension plans. Although Lucent’s plans (both management and non-management) reported a cumulative \$20 billion surplus at the beginning of this period, by 2002 the management plan had become under-funded due to the combination of the attrition costs, 401(h) transfers for health care payments, and the dot.com stock market downturn.<sup>44</sup>

With the company in a downward spiral – and its pension plans suddenly under-funded – Lucent in 2003 decided to avoid making a contribution by cutting the group life insurance “death benefit” that for decades had provided one year’s pay to retirees’ surviving spouses and dependent children. This cut benefits for rank-and-file management and salaried workers plan by \$400 million. In March 2003 retirees received the following explanation from Lucent CEO Pat Russo:

[W]e have made the very difficult decision to eliminate the death benefit for management retirees...Eliminating the death benefit reduces the management pension plan’s funding obligations by about \$400 million... **Most important, it**

**reduces the likelihood that we would have to make a contribution in the near future.**<sup>45</sup>

In a separate communication to the Lucent Retirees Organization, Lucent Board member Henry Schacht acknowledged that \$567 million in lump sum severance payments were paid from the pension trusts.<sup>46</sup> Assuming that two-thirds of this \$567 million was applied to management, because of their generally higher salaries, the management plan was depleted by roughly the same \$400 million amount the company saved by eliminating the pension death benefit.

The company also teetered on bankruptcy during this period, shedding 80% of its active workforce. Its stock price fell from \$82 to less than \$1 in late 2002. Ultimately, the stock market recovered and struggling Lucent was acquired by Alcatel, a French conglomerate. However, had Lucent declared bankruptcy and dumped its pension plan on the PBGC, both retirees and taxpayers would have been the losers.

### **Qwest Communications**

The Labor Department conducted a nearly three-year investigation in connection with Qwest paying more than \$400 million of severance benefits from rank-and-file pension plan assets between 2000 and 2003. Although a Labor Department investigator told a Qwest official that the company would likely be charged with violations of ERISA, no charges were ultimately filed, according to the *Rocky Mountain News*.<sup>47</sup> Qwest reportedly tapped pension assets for as much as \$480 million in severance payments to more than 12,000 employees, including top managers, between August 2000 and June 2003 as part of a downsizing.

Although Qwest reported a \$4.1 billion pension surplus at the end of 2000, by year-end 2002 Qwest's pension plan was underfunded by \$314 million. The struggling company later threatened to reduce its pension obligations by cutting retirees' death benefit and also reduced life insurance obligations from one year's pay to a flat \$10,000. The company had not given longtime retirees a COLA since 1996.<sup>48</sup> Qwest merged into CenturyLink in 2010.

### **Delphi Corporation**

At Delphi Corporation, the bankrupt auto parts supplier spun-off by General Motors, the PBGC's controversial 2009 decision to terminate the pension plan for the company's 75,000 active and retired salaried workers left a large portion of the participants with a permanent loss of between 20 and 40% of their vested benefits (with some losing more than 40%).<sup>49</sup> A survey of Delphi plan participants showed that nearly 1,300 (77%) of those responding reported losing at least 20% of their vested benefits.<sup>50</sup> Lump sum severance payments were the primary cause of the plan's severe under-funding. Delphi charged \$1.9 billion in lump sum severance and other "special attrition program" costs to its pension plan in 2006, a period when the bankrupt company claimed it could not afford to make contributions.<sup>51</sup>

By late 2008, Delphi's salaried plan was roughly \$2.5 billion under-funded on a termination basis, according to the PBGC.<sup>52</sup> In other words, **75% of Delphi's projected pension deficit was attributable to management using pension assets to finance the operating cost of its "attrition program."** At that time, just prior to the stock market meltdown, PBGC Executive Director Millard warned that due to the company's diminished pension assets and failure to make contributions "the hit to the PBGC could well be in excess of \$2.5 billion."<sup>53</sup> In February, 2009, a U.S. bankruptcy judge also granted Delphi's request to cancel retiree health care and life insurance benefits earned over decades by 15,000 salaried retirees, losses that came on top of the permanent reductions in earned pension benefits.<sup>54</sup>

### **Delta Air Lines**

Shortly after the terrorist attacks of 2001, already struggling Delta Airlines implemented a mass layoff affecting nearly 12,000 employees. According to Delta SEC filings, in 2001 alone the company used pension plan assets to pay out \$185 million in "special termination benefits" and adopted enhanced early retirement benefit amendments that increased plan liabilities by an additional \$262 million.<sup>55</sup> In January 2007, Delta turned its Pilots' pension plan over to the PBGC. The plan was underfunded by about \$3 billion, with \$1.7 billion in assets and \$4.7 billion in benefit obligations (35% funded). As a result, Delta pilots lost more than 30% of their pension benefits on average, due to PBGC limits on insured benefits. The PBGC became liable for about \$920 million, its sixth-largest loss up to that time.<sup>56</sup>

### **AT&T Inc.**

In March 2002, after harsh public criticism from a union representing 28,000 of its workers, AT&T said it would not in fact use the \$4 billion surplus in the company's pension plan for represented employees to make severance payments to thousands of employees expected to be laid off. Ralph Maly, Vice President of the Communications Workers of America (CWA), called AT&T's plan to use pension surplus for severance "a raid on our members' pension fund, enabling the company to push downsizing costs onto the workers."<sup>57</sup> The company backed down and negotiations over the layoffs proceeded.

What CWA did not mention, or perhaps did not know, was that AT&T had already taken more than \$1 billion from the pension plans for its management and salaried employees to pay severance over the preceding two years. Buried in a footnote to its financial statements in SEC filings, AT&T reported that in October 2000:

[W]e implemented a voluntary enhanced pension and retirement program (EPR) to reduce the number of management employees... Enhanced pension benefits related to this program were recognized as an expense of \$1.1 billion in 2000.... We anticipate additional lump sum payments will be made in 2002 in connection with the force reductions...<sup>58</sup>

### **Anheuser-Busch**

Within weeks after announcing it had agreed to be acquired by InBev SA, the Belgian-based beer maker, Anheuser-Busch revealed an “enhanced retirement program” in 2008 that paid 1,300 workers 55 and older an early retirement buyout that included a severance payout worth up to 12 months’ salary. The company said the enhanced retirement and severance costs would cost between \$400 and \$525 million, with at least two-thirds paid from the company’s pension plan, according to news reports and a preliminary SEC filing.<sup>59</sup> The following year InBev SA announced it would freeze the salaried pension plan, effective January 1, 2012, which means participants no longer accrue benefits in the plan after that date.

### **Verizon Communications**

Verizon Communications reported that up to \$2 billion was removed from its pension fund for severances in 2002: “Total pension, benefit and other costs related to severances were \$2,010 million . . . in 2002, primarily in connection with the separation of approximately 8,000 employees.”<sup>60</sup> Although Verizon’s pension plan maintained a surplus until the 2008 market crash, retirees have long complained that the company has not granted a cost-of-living adjustment to longtime retirees for more than decade.

### ***III. ERISA: The Law, the Loopholes, and How to Close Them***

ERISA was never intended to permit the use of pension assets, in place of corporate assets, to finance lump sum severance payments (“layoff benefits”). Yet, particularly during financially hard times, some large and distressed companies have become increasingly bold in exploiting loopholes that allow plan amendments that increase payouts for selected subgroups of plan participants. As *Wall Street Journal* reporters Ellen Schultze and Theo Francis revealed in a profile of Lucent Technologies,<sup>61</sup> some companies have been skirting the traditional mechanism of a corporate restructuring reserve, or of a separately constituted ERISA welfare plan for severance benefits, to instead draw down billions of dollars in qualified pension assets to make lump sum severance payments. In a separate page one investigative report, Schultz and Francis exposed how other companies, such as CenturyLink and Intel, exploit the ambiguity of ERISA to adopt plan amendments that transfer liabilities for supplemental, nonqualified senior executive (SERP) liabilities onto the rank-and-file (tax-qualified) plan whenever the non-discrimination formula can be manipulated to arguably permit it.<sup>62</sup>

This section explores both the legal loophole and the practices of a sample of distressed companies in more detail.

#### ***The Law and the Loopholes***

Top ERISA regulators at both Treasury and the Department of Labor, interviewed for this paper, agreed that although Congress clearly did not intend to allow companies to adopt ad hoc, unfunded plan amendments to finance severance payments – and particularly not lump sum payouts unrelated to the plan’s accrued benefit formulas – neither does ERISA specifically prohibit the practice. Plan amendments that increase benefits are allowed at any time, limited mainly by the funding rules (e.g., under PPA, an amendment that would diminish plan funding below 80% must be funded to that level) and anti-discrimination

tests (to prevent grossly disproportionate payouts to the most highly-compensated employees).

The use of plan assets to finance restructuring costs have become more common only since a 1999 U.S. Supreme Court decision that weakened ERISA's fiduciary safeguards concerning the allowable uses of plan assets. In *Hughes Aircraft Company v. Jacobson* the Supreme Court reversed the Ninth Circuit Court of Appeals, ruling that Hughes Aircraft, the plan sponsor, did not violate ERISA when it amended its pension plan to divert surplus pension assets to fund an early retirement program and a new pension benefit structure for its employees.<sup>63</sup> Plan participants argued that Hughes violated its fiduciary duties under ERISA, which requires that plan assets be managed for the "exclusive benefit" of plan participants. The key holding made by the Court was that the plan sponsor was not acting in a fiduciary role. The Supreme Court stated that "as long as an amendment does not violate a specific provision of ERISA, the act of amending a pension plan does not trigger ERISA's fiduciary provisions."<sup>64</sup>

Subsequently, corporate ERISA lawyers have used the *Hughes* rationale to justify their position that a plan sponsor's use of surplus pension assets to fund severance or special retirement payments is lawful except as specifically limited by ERISA. In fact, this was the sole legal basis relied on by Qwest, in response to the Department of Labor investigation noted above, after it used its pension *surplus* to pay special termination payments to thousands of employees during 2000 through 2003. Of course, as described in the company examples above, today some firms are diverting pension assets to fund severance and early-out payments even when the plan is not fully funded.

The Treasury regulations governing ERISA appear to prohibit the use of ad hoc amendments to pay severance – or any other "layoff benefit" – from qualified plan assets. The problem of large ad hoc, unfunded severance payments was questioned in a 2007 Notice and request for comment issued by the Treasury and IRS, but it never resulted in a final clarifying regulatory change.<sup>65</sup> The 2007 IRS Notice begins by citing the applicable ERISA tax code regulations that describe the nature of the benefits permitted to be provided in qualified DB plans under Section 401(a):

Under § 1.01.1-1(b)(1)(i), a qualified pension plan must be established and maintained by an employer primarily to provide systematically for the payment of definitely determinable benefits for employees over a period of years, usually for life, after retirement.

. . . A qualified defined benefit plan . . . also may provide certain non-retirement benefits, such as disability benefits and incidental death benefits. ***Under § 1.401-1(b)(1)(i), a qualified pension plan is not permitted to provide for the payment of benefits not customarily included in a pension plan, such as layoff benefits.***<sup>66</sup>

Indeed, these ERISA regulations governing the tax qualification of defined-benefit pension plans emphasize that permissible benefits should be retirement-type benefits that are "definitely determinable" and therefore subject to adequate pre-funding. The text of the Section 401(a) regulation described in the Treasury Notice likewise states:

However, a plan is not a pension plan if it provides for the payment of benefits not customarily included in a pension plan *such as layoff benefits* or benefits for sickness, accident, hospitalization, or medical expense...<sup>67</sup>

This does not preclude employers from establishing a *separate* welfare plan to pay severance or layoff benefits or, alternatively, pre-funding promises to pay plant shutdown benefits as an ancillary benefit within a pension plan. Indeed, existing interpretations make it clear that lump sum severance benefits are not qualified pension plan benefits.

First, ERISA regulations promulgated by the Department of Labor specify ‘safe harbor’ rules for the creation of a separate welfare plan to provide severance-type benefits that are not subject to ERISA pre-funding, vesting and anti-cutback requirements. Under Labor Code regulation § 2510-3.2(b), governing “severance pay plans,” an employer can establish such a plan – and not fund it – provided, among other criteria, that its purpose is the “payment of severance benefits on account of the termination of an employee’s service” and “not contingent, directly or indirectly, on the employee’s retiring.”<sup>68</sup> This regulation itself suggests that DOL believed severance benefits could not be funded using a qualified defined-benefit pension plan.

Second, under I.R.C. Section 411(d), ERISA’s anti-cutback rules, a qualified pension plan can provide certain specified ancillary benefits that are not retirement-type benefits, and therefore “are not protected from reduction or elimination under § 411(d)(6)(B).”<sup>69</sup> The corresponding Treasury regulation defines the term “ancillary benefit” as including:

**(6) a plant shutdown benefit or other similar benefit** in a defined benefit plan that does not continue past retirement age and does not affect the payment of the accrued benefit, but only to the extent that such plan shutdown benefit or other similar benefit is permitted in a qualified pension plan.<sup>70</sup>

Neither of these two permissible alternatives contemplates draining DB plan assets by means of the sort of ad hoc, lump sum severance-type benefits that companies such as Lucent, Qwest, GM and Chrysler have adopted by plan amendment. Moreover, the availability of these alternatives support the argument that the use of qualified pension assets to make ad hoc lump sum severance payments is inconsistent with ERISA’s intent.

Senior regulatory counsels at Treasury, the PBGC and the Department of Labor maintain that ERISA regulations are very unclear about the extent to which benefits conditioned on the termination of employment can be paid from qualified pension plan assets. Plan sponsors argue that while the prohibition on “lay-off benefits” might conceivably limit a plan from promising severance payouts entirely unrelated to retirement, “plant shutdown” benefits are permitted and nothing in ERISA explicitly limits a plan amendment that increases benefits and is not characterized as being solely contingent on non-retirement termination of service.

Nevertheless, it’s clear that some companies are abusing ERISA’s lack of clarity on this issue – and thereby endangering the benefit security of all other plan participants. In its Notice 2007-14, the Treasury Department stated that it has:

become concerned that certain qualified defined benefit plans may include nontraditional benefits that are not subject to the protections of § 411 and other qualification rules of § 401(a). Examples include (1) **benefits that are payable only upon the involuntary termination of an employee** or in other limited circumstances that are unrelated to retirement; . . .<sup>71</sup>

The Treasury Notice seemed particularly concerned about limiting severance payments contingent on involuntary termination:

Benefits payable only upon an employee's involuntary separation from service . . . may not be among the type of benefits that are intended to receive the tax benefits generally applicable to qualified plan benefits.<sup>72</sup>

Despite the apparent intent of the law to limit the payment of ad hoc severance or lay-off benefits from qualified pension plan assets, since ERISA's adoption there has been relatively little controversy around the practice of companies using *surplus* plan assets to offer "window benefits," in the context of a voluntary buyout. Traditional "window" benefit programs have allowed older workers to qualify for immediate payment of early retirement benefits – or to enhance the formula for early retirement benefits – if they voluntarily choose to retire by a certain date (i.e., within the "window"). While these traditional "window" benefits would diminish plan over-funding, they were typically modest enhancements of the monthly annuity – not large lump sum payouts unrelated to the annuity – and also were not offered by underfunded plans.

Far more troubling, at least to the PBGC and to retiree advocates, is the sort of practice described above whereby lump sum liabilities for corporate restructuring costs – or for executive Qserp benefits – are transferred to rank-and-file plans that are not even "fully" funded. At a minimum, it is this practice that the reforms proposed below address. (Note, as explained above, even a plan fully funded on a going-forward basis is likely to be underfunded on a termination basis – and in any event subject to downdrafts in financial markets.)

### ***The Stakes are High for Retirees and Taxpayers***

Ultimately, the primary danger of giving plan sponsors unlimited discretion to adopt *ad hoc* plan amendments to pay severance or related restructuring costs from pension plan assets is underfunding. A virtual blank check to diminish plan funding levels to offset what should be a corporate operating expense is a "moral hazard" with a two-fold impact:

First, it endangers the benefit security of all plan participants, including those who receive the lump sum or other buyout bonus (since their own retirement security is tied to adequate funding of their far larger pension benefit). In the worst-case scenario, if the company is distressed and later slides into bankruptcy, many early retirees and higher-income and/or long-service retirees could lose a substantial portion of their vested benefits not guaranteed by PBGC. Because the PBGC chooses to use a very low insurance industry discount rate to calculate the present value of plan liabilities – but ignores the fact the agency will be receiving much higher average returns from investing

the plan's assets – in addition to other statutory limitations on benefits insured, roughly one in seven participants lose an average 30% of their vested benefits, compounding the damage done to retirees and older workers by the distress termination itself.<sup>73</sup>

Even in the most benign scenario, where a financially healthy company uses up the plan's "surplus" – and funding levels end up at 90 to 100% – retirees are still harmed. A subsequent market downturn can more easily push funding levels down to dangerous levels. Recall that the 2008-09 market crash by itself pushed S&P 1500 firms with DB plans from an average funding level of 104% to 75%. Moreover, even if the plan is left fully funded, the surplus is no longer available to help the company fund its retiree health benefit promises (under Section 420) and/or to pay periodic COLAs that can help offset the inflation's diminution of real benefit levels, a problem that is growing worse as retirees live longer on average.

Second, the "moral hazard" endangers taxpayers and the stability of the federal pension guarantee system. Even before the 2008 stock market crash, taxpayers were on the hook for a PBGC actuarial deficit that exceeded \$11 billion, a projection that rose to a record \$26 billion by November 2011 due to higher levels of underfunding and record-low interest rates (since a low discount rate balloons the present value of long-term liabilities). When the agency sent its formal Letters of Inquiry to the Big Three automakers, described above, it warned that the failure of General Motors by itself could double the PBGC's deficit due to the combined impact of the market downturn, the apparent \$5 billion cost to the automaker's pension plans to pay for severance, and the questionable quality of the plans' assets (which included considerable GM stock).<sup>74</sup>

### ***The Legislative Changes Needed***

Unfortunately, there is no very narrowly-tailored amendment to ERISA that would be an effective means to prevent only plan amendments that fund severance benefits. Amendments to pay severance-type benefits can easily be characterized as a plain-vanilla (albeit selectively-paid) benefit increase; and can take different forms. Therefore, the most straightforward remedy is to focus on the greatest harm, which is an ad hoc and unfunded increase in plan liability from **lump sum payouts** that leave a plan less than fully funded. The Pension Protection Act mitigated the risk of new, unfunded liabilities by amending Internal Revenue Code Section 436 to tighten the funding-based limits on increases in benefit liabilities for plans less than 80% funded, as well as on the payment of plant shutdown and other "contingent event" ancillary benefits. However, we believe that Congress must go further.

#### ***1. Amend § 436(c) to Condition New Lump Sum Payouts on 120% Funding***

Congress should amend Internal Revenue Code section 436(c) [and ERISA section 206(g)] **to require that any ad hoc plan amendment that gives a subset of participants a benefit increase payable in the form of a lump sum must be immediately funded if the plan's adjusted target funding level is (a) less than 120% or (b) would be less than 120% after taking into account the cost of the amendment.**

A 120% threshold is justified considering that during both the 2001-02 and 2008-09 bear markets, pension funding levels dropped by 20 to 30 percentage points, on average. A 120% threshold is also consistent with Code Section 420(h) transfers, which allow plan sponsors to use surplus pension plan assets to fund retiree health and life insurance benefits only to the extent the plan is funded at 120% or more.

Legislative language implementing this reform was introduced in the U.S. House on a bipartisan basis in October 2009 as Section 111 in H.R. 3936, the pension plan funding relief legislation sponsored by Congressmen Earl Pomeroy (D-ND) and Pat Tiberi (R-OH).<sup>75</sup> Their provision mirrored the current Section 436(c) limit on unfunded benefit increases by plans funded below 80%, but it applied specifically to “ad hoc amendments” that increase benefits paid in lump sum to subsets of participants who are terminating employment unless the plan has a substantial surplus. The Pomeroy/Tiberi provision, although not included in the final funding relief legislation, proposed adding the following new subsection (3) to the Section 436(c) limitations:

(c) LIMITATIONS ON PLAN AMENDMENTS INCREASING LIABILITY FOR BENEFITS.—

(1) IN GENERAL. [no change]

(2) EXEMPTION. [no change]

(3) **SPECIAL LIMITATIONS ON AD HOC AMENDMENTS.**—

(A) IN GENERAL. No ad hoc amendment to a defined benefit plan which is a single employer plan which has the effect of increasing liabilities of the plan by reason of increases in benefits, establishment of new benefits, changing the rate of benefit accrual, or changing the rate at which benefits become nonforfeitable may take effect during any plan year if the adjusted funding target attainment percentage for such plan year is—

(i) **less than 120%**, or

(ii) would be **less than 120%** taking into account such amendment.

(B) EXEMPTION. Subparagraph (A) shall cease to apply with respect to any plan year . . . upon payment by the plan sponsor of a contribution (in addition to any minimally required contribution under section 430) equal to—

(i) in the case of paragraph (A)(i), the amount of the increase in the funding target of the plan . . . attributable to the amendment, and

(ii) in the case of paragraph (A)(ii), the amount sufficient to result in an adjusted funding target attainment percentage of 120%.

. . . .

(D) AD HOC AMENDMENT.— For purposes of this paragraph, the term ‘ad hoc amendment’ means an amendment to a plan which—

(i) increases the nonforfeitable benefits payable to one or more participants,

(ii) applies only to a subset of the employees otherwise eligible to accrue benefits under the plan,

(iii) applies by its terms only to employees who, during a limited period of time, terminate employment, and

(iv) provides that the increase described in clause (i) is payable in the form of a **prohibited payment** (as defined in subsection (d)(5)).

The term “prohibited payment” in proposed subsection (D)(iv) immediately above refers to payments in the form of a lump sum. It’s important to note that the Pomeroy/Tiberi provision above does not in any way limit the ability of plan sponsors to enhance traditional early retirement benefits. It also does not limit the ability of plan sponsors to use funding in excess of 120% to pay lump sum benefit enhancements. Indeed, it does not even overturn the Supreme Court’s *Hughes Aircraft* precedent that has emboldened plan sponsors to divert surplus plan assets to pay severance and other restructuring costs. **What it does do is limit ad hoc amendments granting lump sum benefit increases that are not funded if the plan does not have a substantial surplus (above 120%).**

Another important feature of the Pomeroy/Tiberi provision was its **explicit exemption for pension plans that are subject to collective bargaining**. Collectively-bargained plans – whether they are single-employer or multiemployer (jointly-trusted) plans – should be exempt. The language in the Pomeroy/Tiberi H.R. 3936 stated:

Paragraph (3) shall not apply to any amendment of a plan maintained pursuant to one or more collective bargaining agreements between employee representatives and one or more employers.

This exception gives employers and unions more flexibility with respect to collectively bargained plans since participants are represented and the employer’s discretion (and conflict of interest) is at least mitigated. Indeed, when Congress struck the balance it did in selecting the 80% target funding threshold, it was thinking primarily of the situation where unions negotiate – or at least strongly influence – buyout provisions. Non-represented retirees and workers, however, have no input into or protection against the use of pension assets to pay for lump sum benefit increases that worsen under-funding.

For example, in 2002 when AT&T moved to fund \$4 billion in severance payments for thousands of employees from pension plan assets, the Communications Workers of America publicly attacked the idea and forced AT&T to back off. AT&T’s plan to use the company’s pension surplus for severance was “a raid on our members’ pension fund,” argued Ralph Maly, the union’s vice president for communications and technologies.<sup>76</sup>

Congress adopted this same exemption for bargained benefits in the multi-year Section 420(h) transfer provision in the Pension Protection Act of 2006. Section 420(a) provides that if there is a qualified transfer of any excess pension assets from a defined benefit plan to a health benefits account which is part of such a plan, to avoid being treated as a reversion, the minimum cost requirements of §420(c)(3) must be satisfied. Under §420(c)(3)(D), the cost maintenance period is five (5) taxable years beginning with the year in which the qualified transfer occurs. However, the PPA exempted multiemployer plans entirely from this provision; and included an exception for collectively-bargained single-employer plans that allow the “minimum cost requirements” to be determined by bargaining between the plan sponsor and bona fide labor union representatives.

A parallel situation pertains to Section 436(b), which limits the ability of plans to pay plant “shutdown benefits and other unpredictable contingent event benefits” (which are ancillary, non-vested benefits) if that would result in the plan’s target funding level falling below 60%.<sup>77</sup> Industrial unions in the auto and steel industries in particular fought to retain this low 60% threshold during the legislative debates over the PPA. However, where plan participants are non-represented, a company’s ability to define and pay “shutdown” or other “unpredictable contingent event benefits” under § 436(b) could easily become an end-around the limitations proposed above on unfunded benefit increases.

## ***2. Amend § 436(d) to Condition Unfunded Lump Sum Payouts on 100% Funding***

In addition to increasing the funding target attainment thresholds in §436(c) to full funding, as described just above, **Congress should consider amending § 436(d) to prohibit any unfunded lump sum payouts at a time when the plan’s funding level is below 100%**. This approach has generally been supported by the PBGC, since the agency believes that lump sum payments, whether intended to provide additional severance benefits or simply as an alternative form of payment to a monthly life annuity, accelerate under-funding and can even result in a “run” on the plan (as occurred with the Delta Air Lines pilots pension plan). Because the PBGC did not guarantee the full amount of the monthly annuity benefit accrued by many pilots in Delta’s plan, signs of the company’s financial distress caused many pilots to rush to withdraw their vested benefits in a lump sum. The plan lost liquidity and had to close.

A smaller but equally dramatic example is Kaiser Aluminum. As the company teetered on bankruptcy in 2002, departing salaried employees took lump sum payouts so quickly that it set off the equivalent of a bank run. By the time the company stopped the practice, the plan had only 21 cents left for each dollar it owed in benefits – and with the company declaring bankruptcy, the remaining participants and their obligations were defaulted to the PBGC.<sup>78</sup>

According to PBGC officials, simply prohibiting lump sum payments, particularly from plans that are not fully funded, would greatly mitigate the problem of companies funding attrition programs from plan assets. Although this reform would certainly deter plan sponsors from using pension assets to pay severance benefits, prohibiting unfunded lump sum payments would still allow companies to adopt a more traditional “window benefit” that provides an equivalent economic value to the laid-off or retiring worker through an increase in his or her accrued life annuity formula. The mitigating factor for these traditional “window benefits” is that the costs are amortized over the lifespan of the retirees who accept them.

## ***3. Broadening Allowable Excess Asset Reversions Above 120% Funding Levels***

Finally, the NRLN recommends that **excess asset reversions be permitted for plans funded at more than 120% of their liabilities** – with no excise tax imposed and no requirement that the plan be terminated – **but only if 50% of the reversion amount is**

**transferred to participants in the form of a one-time, pro rata benefit improvement.**

In practice this would give companies the choice to use all of the excess assets (above 120% funding) to fund a non-pension benefit for plan participants (e.g., retiree health or early-out payments) *or* to use 50% to enhance pension benefits, while retaining 50% as operating income.

Although any reversion increases risk for retirees, using a portion of a reversion to improve benefits could help to mitigate somewhat the lack of cost of living increases (COLAs) over the past decade at most large companies. Since plan sponsors would have this option only when the plan is more than 120% funded – and because participants would share directly in any reversion – the original purpose of the 50% excise tax on reversions would be served, while benefitting retirement security.

To ensure reversions are limited to plans with a substantial funding cushion, **these excess asset reversions should be subject to the same limitation that governs Section 420(h) transfers to pay for retiree health and term life insurance benefits.** The pension funding relief enacted in July 2012 (the MAP-21 Act) added Section 420(g), which requires that the surplus funding level that allows transfers of pension assets to fund retiree health and life insurance benefits, under Section 420(h), must be calculated based on the average corporate bond segment rates established by the Pension Protection Act of 2006 – and without using the pension “stabilization” relief enacted as part of MAP-21.<sup>79</sup> The stabilization provisions in MAP-21 allow plan sponsors to use higher interest rates in valuing their liabilities, which substantially lowers the estimate of plan liabilities and, in turn, lowers minimum required contributions. However, the 2012 law requires employers to use the pre-MAP-21 (lower) segment rates to calculate funding for the purpose of transferring surplus assets to pay for retiree health and term life insurance benefits under Section 420.

#### **IV. CONCLUSION**

The use of pension assets to make lump sum severance payments during a corporate restructuring is the largest and most widespread “back door reversion” that allow some companies circumvent the Congressional policy against reverting pension assets for corporate purposes. 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 age and 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. However, as the 2008 stock market meltdown demonstrated, a plan that is only 80% funded during a bull market could easily end up below 60% funded in a bear market – and terminated and taken over by the PBGC if the plan sponsor declares bankruptcy. Moreover, any significant reduction below full funding reduces the ability of the plan to build a surplus that can finance cost-of-living adjustments for longtime retirees, whose fixed monthly benefits erode with inflation, or to offset the cost of retiree health benefits through a Section 420(h) transfer. Severance or other lump sum benefit increases to terminating employees are an operating expense that should not be funded from the pension trust.

The most effective way for Congress to protect plan participants (and taxpayers) from unfunded liabilities due to lump sum severance or layoff or payouts is simply to **amend ERISA code Section 436(c) to require that any ad hoc plan amendment that gives a subset of participants a benefit increase payable in the form of a lump sum must be immediately funded if the plan’s adjusted target funding level is (a) less than 120%, or (b) would be less than 120% after taking into account the cost of the amendment.**

This limitation on ad hoc lump sum payouts would not limit the ability of plan sponsors to enhance early retirement 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, would be exempted from this more restrictive funding level.

Finally, the NRLN recommends that **ERISA should be amended to permit the reversion of any surplus assets above 120% funding for any purpose that solely benefits plan participants** (including early-out payments and funding health and welfare benefits), **or for reversion to the company for any purpose if 50% of the reversion amount is distributed as a one-time benefit enhancement to all vested plan participants** on a *pro rata* basis (e.g., a 2% monthly benefit increase). Under each of these circumstances the excise tax on pension reversions should not apply. In addition, the calculation of the 120% funding threshold should be subject to Section 420(g), which requires calculation of eligible plan asset transfers using the PPA’s corporate bond market segment rates and without regard to the higher discount rates permitted under the MAP-21 funding relief provisions enacted in 2012.

---

## ENDNOTES

<sup>1</sup> David S. Hilzenrath, “Stock Losses Leave Pensions Underfunded by \$400 Billion,” *Washington Post*, January 7, 2009. See also Mark Anson, “One-Two Punch to Pension Funds,” *Pensions & Investments*, Jan. 22, 2009, noting that the 100 largest U.S. pension plans were 77.2% funded at year-end 2008.

<sup>2</sup> Mercer, “S&P Pension Funded Status Recovers to 2015 Levels,” Press Release, Jan. 5, 2017, available at <https://www.mercer.com/newsroom/december-2016-pension-funding.html>. The 423 defined-benefit plan sponsors in the S&P 1,500 hit an all-time high of \$557 billion in under-funding at the end of 2012. Mercer, “S&P 1500 Plan Sponsors Finish 2012 with Highest Year-End Deficit Ever,” Press Release, Jan. 3, 2013, available at <http://www.mercer.com/press-releases/1499735>

<sup>3</sup> The minimum excise tax on reversions went from 10% in 1986, to 15% in 1988, to 20% in 1990. The excise tax rate is increased to 50% when the plan sponsor keeps the surplus rather than uses it to provide benefits to employees through a new plan or by increasing benefits under the terminated plan. See *Internal Revenue Code* § 4980(a) and § 4980(d).

<sup>4</sup> See Cecilia Valente, “Longer Life Spans Strain Pension Needs,” Bloomberg.com, Jan. 23, 2009, available at <http://www.reuters.com/article/pensionsNews/idUSLNE50M00I20090123>. A Hewitt Associates study found that longer life spans could add up to 15% to the estimated pension liabilities currently anticipated by most defined benefit plans.

<sup>5</sup> ERISA permits plan sponsors to use a higher market rate of interest to project the present value of vested pension obligations, whereas the insurance industry and the PBGC use a much lower interest rate to calculate the cost of replacing these promised benefits with fixed annuities. The lower the discount rate the higher the present value of future benefit obligations.

<sup>6</sup> Conference Report to Accompany the Moving Ahead for Progress in the 21<sup>st</sup> Century Act (Map-21) Act (H.R. 4348), Public Law 112-141 (enacted July 6, 2012), Section 40211(A)(2)(D). The funding

---

“stabilization” provisions in the Act allow plan sponsors to use higher interest rates in valuing their liabilities, which substantially lowers projected liabilities and, in turn, lowers the employer’s minimum required contributions. Although the MAP-21 provisions allowing plan sponsors to “smooth” (average) interest rates over 25 years was intended to provide temporary relief during in the aftermath of the Great Recesssion, this relief (and the reduced funding levels it allows) has been extended twice by Congress until at least 2020.

<sup>7</sup> National Retirees Legislative Network, “Pension Guarantees that Work for Retirees: A Proposal for Commonsense PBGC Reforms,” White Paper Series (*updated* December, 2012).

<sup>8</sup> “PBGC’s Guarantee Limits: An Update,” Pension Benefit Guarantee Corporation, September 2008, available at <http://www.pbgc.gov/docs/guaranteelimits.pdf>. One out of seven participants lost an average 28% of their vested benefits during the decade prior to 2008. PBGC failed to update this data during the Obama administration, although PBGC staff said an update will be published during 2017.

<sup>9</sup> National Retirees Legislative Network and American Retirees Education Foundation, “Pension Plan Risks in Mergers, Acquisitions and Spin-Offs,” White Paper Series (*updated* November, 2016), available at <https://goo.gl/WSqU6>.

<sup>10</sup> The Moving Ahead for Progress in the 21<sup>st</sup> Century Act (Map-21) Act (H.R. 4348), Public Law 112-141 (enacted July 6, 2012), Section 40211(A)(2)(D). *See also* Internal Revenue Service, “Guidance on Pension Funding Stabilization under the Moving Ahead for Progress in the 21st Century Act (MAP-21),” Notice 2012-61 (Sept. 11, 2012), available at <http://www.irs.gov/pub/irs-drop/n-12-61.pdf>. MAP-21’s funding “stabilization” provisions allow plan sponsors to use higher interest rates in valuing their liabilities, which substantially lowers projected liabilities and, in turn, lowers the employer’s minimum required contributions. However, the law requires employers to use the pre-MAP-21 (lower) segment rates to calculate funding for the purpose of transferring surplus assets to pay for retiree health and term life insurance benefits under Section 420.

<sup>11</sup> John D. Stoll and Jeff Bennett, “GM, Chrysler Offer New Buyouts,” *The Wall Street Journal*, Feb. 4, 2009.

<sup>12</sup> Tim Higgins, “Questions Arise from GM’s Use of Pension for Buyouts, VEBA Trust,” *Detroit Free Press*, March 1, 2009.

<sup>13</sup> Ford Motor Company, Annual Report on SEC Form 10-K for FY ending Dec. 31, 2007, Note 24 to Consolidated Financial Statements (“Retirement Benefits”), filed Feb. 27, 2008.

<sup>14</sup> Keith Naughton, “Ford May Need to Put \$4 Billion Into Pension, Spurring Aid Bid,” *Bloomberg.com*, Feb. 6, 2009; available at [www.bloomber.com/apps/news?pid=newsarchive&sid=aDEsmY5awSrw](http://www.bloomber.com/apps/news?pid=newsarchive&sid=aDEsmY5awSrw).

<sup>15</sup> Tim Higgins, “Pension Funds Used for Retirement Offers, Unusual Move Irks UAW Members,” *Detroit Free Press*, March 22, 2008.

<sup>16</sup> *See* James A. Wooten, “‘The Most Glorious Story of Failure in Business,’ The Studebaker-Packard Corporation and the Origins of ERISA,” *Buffalo Law Review*, vol. 40 (Buffalo, NY: 2001), at 731.

<sup>17</sup> Letter from PBGC Executive Director to Federick A Henderson, President and CFO, General Motors Corporation, November 26, 2008. Letters available on request from PBGC.

<sup>18</sup> Letter from PBGC Executive Director to Alan Mulally, President and CEO, Ford Motor Company, November 26, 2008. *See also* Letter from PBGC Executive Director to Robert L. Nardelli, Chairman and CEO, Chrysler LLC, November 26, 2008.

<sup>19</sup> John D. Stoll, “Pension Agency Sounds Alarm on Big Three,” *Wall Street Journal*, November 28, 2008.

<sup>20</sup> John D. Stoll, “Agency Raises Concerns About Car Makers’ Pensions,” *The Wall Street Journal*, Jan. 9, 2009. Ford Motor Co. reported in its fourth quarter financial disclosures to the SEC that it may need to contribute up to \$4 billion by 2010 to cover its year-end 2008 shortfall, a deficit the PBGC estimates is far larger when measured on a termination basis. *See* Keith Naughton, “Ford May Need to Put \$4 billion Into Pension, Spurring Aid Bid,” *Bloomberg.com*, Feb. 6, 2009.

<sup>21</sup> Tim Higgins, “Questions Arise from GM’s Use of Pension for Buyouts, VEBA Trust,” *Detroit Free Press*, March 1, 2009.

<sup>22</sup> Naughton, *supra* note 11.

<sup>23</sup> Ellen E. Schultz and Theo Francies, “Fringe Benefits: How Lucent’s Retiree Programs Cost it Zero, Even Yielded Profit; Trusts Paid the Tab – A Handy Tool for Downsizing,” *The Wall Street Journal*, March 29, 2004, page A1.

<sup>24</sup> Lucent Technologies Inc., Annual Report on Form 10-K for 2002, Note 12 to Consolidated Financial Statements, December 12, 2002 (available on SEC’s free EDGAR system).

- 
- <sup>25</sup> Ellen E. Schultz and Theo Francis, “Companies Tap Pension Plans to Fund Executive Benefits; Little-Known Move Uses Tax Break Meant for Rank and File,” *The Wall Street Journal*, August 4, 2008, page A1. Schultz explores the abuses of Qserp transfers in greater detail in her 2011 book *Retirement Heist*.
- <sup>26</sup> CenturyLink, Inc., Definitive Proxy Statement (DEF 14A), filed with the Securities and Exchange Commission on April 11, 2012, at page 54.
- <sup>27</sup> Tim Higgins, “Questions Arise from GM’s Use of Pension for Buyouts, VEBA Trust,” *Detroit Free Press*, March 1, 2009.
- <sup>28</sup> See Doug Halonen, “Ex-PBGC Chief Seeking Frozen Plans,” *Pensions & Investments*, October 29, 2007, available at <http://www.pionline.com/article/20071029/PRINTSUB/71025021>.
- <sup>29</sup> Internal Revenue Service, Revenue Ruling 2008-45 (August 6, 2008), available at <http://www.treasury.gov/press-center/press-releases/Documents/hp1110revrul200845.pdf>. “A transfer of a tax-qualified pension plan from an employer to an unrelated taxpayer when the transfer is not connected with a transfer of significant business assets, operations, or employees, is not permissible under current law,” the Treasury Department stated in an August 6, 2008 news release announcing the IRS revenue ruling; available at <http://www.treasury.gov/press-center/press-releases/Pages/hp1110.aspx>. See also Doug Halonen, “Treasury, IRS: Pension Plan Liability Buyouts Illegal,” *Workforce Management*, August 7, 2008.
- <sup>30</sup> American Benefits Council, “Pensions on the Precipice: The Multiple Threats Facing Our Nation’s Defined Benefit Pension System,” May 2004, at p. 19.
- <sup>31</sup> See I.R.C. Section 404(o). In practice the deduction limit is somewhat higher, since under Section 404(o)(3), the 50% “cushion amount” can include both “50 percent of the funding target for the plan year” and the amount by which this funding target would be higher taking into account, e.g., “increases in compensation which is expected to occur in succeeding plan years.”
- <sup>32</sup> See I.R.C. Section 4972(c)(7).
- <sup>33</sup> The Moving Ahead for Progress in the 21<sup>st</sup> Century Act (Map-21) Act (H.R. 4348), Public Law 112-141 (enacted July 6, 2012), Section 40211(A)(2)(D).
- <sup>34</sup> Chris Clair, “Surplus Assets Issue Surfaces Over Layoffs; AT&T Says it Never Planned to Use Excess for Severance Pay Despite Charges of Union; Communications Workers of America Cries Foul,” *Pensions & Investments*, March 4, 2002.
- <sup>35</sup> Towers Perrin, “Managing Pension Surplus: A New Playbook for a New Era,” white paper, August 2008, at page 6.
- <sup>36</sup> *Id.*
- <sup>37</sup> Tim Higgins, “Pension Funds Used for Retirement Offers, Unusual Move Irks UAW Members,” *Detroit Free Press*, March 22, 2008.
- <sup>38</sup> National Retirees Legislative Network, “Pension Plan Risks in Mergers, Acquisitions and Spin-Offs,” *supra* note 9.
- <sup>39</sup> *Id.* and David Walker, “Single-Employer Pension Insurance Program Faces Significant Long-Term Risks,” Testimony before the House Committee on Education and the Workforce, September 4, 2003, at 33-34.
- <sup>40</sup> For detail on how PBGC policies reduce the actual guarantee of vested benefits to an increasing number of retirees and older workers, see NRLN, “Pension Guarantees that Work for Retirees,” *supra* note 6.
- <sup>41</sup> United Airlines, Annual Report on SEC Form 10-K for FY ending December 31, 2002, at Note 20 to Consolidated Financial Statements (filed March 2003).
- <sup>42</sup> Rachel Beck, “Pension Systems in Need of Major Overhaul,” *The New York Times*, June 17, 2005.
- <sup>43</sup> *Id.*
- <sup>44</sup> Lucent Technologies Inc., Annual Report on SEC Form 10-K for FY ended Sep. 30, 2002, Note 12 to Consolidated Financial Statements, filed December 12, 2002 (available on SEC’s free EDGAR system).
- <sup>45</sup> Patricia Russo, Chairman & CEO of Lucent Technologies, Letter “To Retirees” dated March 5, 2003. See also Lucent Technologies, Inc., Annual Report filing on Form 10-K, for the Fiscal Year ended Sep. 30, 2005, filed Dec 10, 2005.
- <sup>46</sup> Schacht wrote: “First, as disclosed in our Fiscal 2001 Annual report, Lucent booked \$2.1 billion in ‘termination benefits,’ \$1.954 billion for pension and \$197 million for postretirement health and group life. . . . In addition, of the \$2.1 billion stated, approximately 27% was drawn . . . to fund lump sum payments to employees upon their termination.”
- <sup>47</sup> Jeff Smith, “Feds Took a Look at Qwest; Labor Dept. Probed Severance Payments Out of Pension Fund,” *Rocky Mountain News*, July 8, 2005.

---

<sup>48</sup> The 1996 COLA was a graded increase that depended on how long a person had been retired. The relatively small number who retired prior to 1969 received a 12% increase. All persons who retired since the break-up of AT&T (after January 1984) received less than 3%. See *Jarvis v. U S WEST*, Case No. 97-N-2189 (D. Colo). See also Janet Forgive, “Getting Shareholder Approval of Severance Packages Would Hurt Recruiting, Firm Says,” *Rocky Mountain News*, March 17, 2001.

<sup>49</sup> The PBGC left the hourly workers’ plan intact after Delphi’s former parent, General Motors, then under the control of its majority owner, the U.S. Department of the Treasury, decided to make good on an agreement to contribute only to the solvency of the collectively-bargained plans. During 2012 Congress continued its bipartisan investigation into the legality and motives of the Obama Administration’s role in the differential treatment of the hourly and salaried plan participants.

<sup>50</sup> Delphi Salaried Retirees’ Association, 2010 Survey of 6,700 participants in the Delphi Retirement Program for Salaried Employees. Significantly, 73% of the 1,703 respondents were under the age of 65 at the time of plan termination, with 44% between age 60 and 64. The PBGC’s maximum benefit guarantee – \$54,000 for a retiree who is age 65 at plan termination – is reduced substantially for each year under age 65 at the time of termination.

<sup>51</sup> Delphi Corporation, Annual Report filed on SEC Form 10-K for FY ending 12/31/06, Note 17 to Consolidated Financial Statements (filed Feb. 27, 2007).

<sup>52</sup> Mary Williams Walsh, “U.S. is Pressuring Delphi Over Pension Obligations,” August 15, 2008.

<sup>53</sup> *Id.*

<sup>54</sup> David Shepardson, “Judge Grants Delphi Request to End Benefits for 15,000 Retirees,” *Detroit News*, Feb. 24, 2009; Thomas Hartley, “Judge Says Delphi Can Cancel Retiree Benefits,” *The Business Journal of Milwaukee*, Feb. 25, 2009.

<sup>55</sup> Delta Air Lines Inc., Annual Report on SEC Form 10-K for FY ending 12/31/01, Note 12 to Consolidated Financial Statements (filed March 28, 2002).

<sup>56</sup> Gerry Geisel, “PBGC Takes Over Delta Pilots Pension Plan,” *Workforce Management*, January 5, 2007.

<sup>57</sup> Chris Clair, “Surplus Assets Issue Surfaces Over Layoffs; AT&T Says it Never Planned to Use Excess for Severance Pay Despite Charges of Union; Communications Workers of America Cries Foul,” *Pensions & Investments*, March 4, 2002.

<sup>58</sup> AT&T Inc., Annual Report on SEC Form 10-K for FY ending 12/31/01, Note 11 to Consolidated Financial Statements (filed Feb. 28, 2002).

<sup>59</sup> Associated Press, “Anheuser-Busch Ups Retirement Plan for Key Workers,” August 12, 2008. See also Anheuser-Busch, SEC 10-Q for quarter ending Sep. 30, 2008 (filed Nov. 6, 2008).

<sup>60</sup> Verizon Communications Inc., Annual Report on SEC Form 10-K for FY ending 12/31/03, at page 75.

<sup>61</sup> Ellen E. Schultz and Theo Francis, “Fringe Benefits: How Lucent’s Retiree Programs Cost it Zero, Even Yielded Profit; Trusts Paid the Tab – A Handy Tool for Downsizing,” *The Wall Street Journal*, March 29, 2004, page A1.

<sup>62</sup> Ellen E. Schultz and Theo Francis, “Companies Tap Pension Plans to Fund Executive Benefits; Little-Known Move Uses Tax Break Meant for Rank and File,” *The Wall Street Journal*, August 4, 2008, page A1; Schultz and Francis, “Fringe Benefits: How Lucent’s Retiree Programs Cost it Zero, Even Yielded Profit; Trusts Paid the Tab – A Handy Tool for Downsizing,” *The Wall Street Journal*, March 29, 2004, page A1.

<sup>63</sup> *Hughes Aircraft Company v. Jacobson*, 525 U.S. 432, 119 S.Ct. 755 (1999).

<sup>64</sup> 119 S.Ct. 763-64. See also *Lockheed Corp. v. Spink*, 517 U.S. 882, 891 (1996) (holding that “the act of amending a pension plan does not trigger ERISA’s fiduciary provisions”).

<sup>65</sup> U.S. Department of Treasury and Internal Revenue Service, Notice 2007-14, “Description of Benefits Permitted to be Provided in Qualified Defined Benefit Plans,” Internal Revenue Bulletin 2007-7 (Feb. 12, 2007), at 2, available at <https://goo.gl/cRC4sw>.

<sup>66</sup> *Id.*

<sup>67</sup> Internal Revenue Code Regulation § 1.401-1(b)(1)(i).

<sup>68</sup> Labor Code Regulation § 2510.3-2(b)(1). See also § 2510.3-1(a)(3), defining “employee welfare benefit plans,” which provides that: “Thus, the effect of section 3(1)(B) of the Act is to include within the definition of ‘welfare plans’ those plans which provide holiday and severance benefits, and benefits which are similar (for example, benefits which are in substance severance benefits, although not so characterized.”

<sup>69</sup> Treasury Notice 2007-14, *supra* note 16, at 3.

<sup>70</sup> I.R.C. Regulation § 1.411(d)-3(g)(2).

<sup>71</sup> Treasury Notice 2007-1, *supra* note 16 at 6.

---

<sup>72</sup> *Id.* At 7.

<sup>73</sup> For an explanation of how the PBGC uses its discretion to undermine the recovery of vested benefits by the participants of bankrupt plans, *see* National Retirees Legislative Network, “Pension Guarantees that Work for Retirees: A Proposal for Commonsense PBGC Reforms,” *supra* note 5, at pp. 9-16.

<sup>74</sup> John D. Stoll, “Pension Agency Sounds Alarm on Big Three,” *Wall Street Journal*, November 28, 2008.

<sup>75</sup> A section-by-section summary of H.R. 3936, the Pomeroy/Tiberi “Preserve Benefits and Jobs Act of 2009,” is accessible at [http://www.appwp.org/documents/dbfunding\\_pbj-sectionxsection102709.pdf](http://www.appwp.org/documents/dbfunding_pbj-sectionxsection102709.pdf).

<sup>76</sup> Chris Clair, “Surplus Assets Issue Surfaces Over Layoffs; AT&T Says it Never Planned to Use Excess for Severance Pay Despite Charges of Union; Communications Workers of America Cries Foul,” *Pensions & Investments*, March 4, 2002. *See also* Chris Clair, “Using Pension Surplus to Pay Severance Scrutinized,” *Business Insurance* (March 10, 2002), available at <https://goo.gl/Z0sl1p>.

<sup>77</sup> I.R.C. Section 436(b) provides in relevant part:

(b) FUNDING-BASED LIMITATION ON SHUTDOWN BENEFITS AND OTHER UNPREDICTABLE CONTINGENT EVENT BENEFITS UNDER SINGLE-EMPLOYER PLANS.—

(1) IN GENERAL. If a participant of a defined benefit plan, which is a single employer plan, is entitled to an unpredictable contingent event benefit payable with respect to any event occurring during the plan year, the plan shall provide that such benefit may not be provided if the adjusted funding target attainment percentage for such plan year—

(A) is **less than 60%**, or

(B) would be **less than 60%** taking into account such occurrence.

(2) EXEMPTION. Paragraph (1) shall cease to apply with respect to any plan year . . . upon payment by the plan sponsor of a contribution (in addition to any minimally required contribution under section 430) equal to—

(A) in the case of paragraph (1)(A), the amount of the increase in the funding target of the plan . . . attributable to the occurrence referred to in paragraph (1), and

(B) in the case of paragraph (1)(B), the amount sufficient to result in a funding target attainment percentage of **60%**.

<sup>78</sup> Mary Williams Walsh, “U.S. Cancels Pension Plan at Kaiser,” *The New York Times*, Dec. 18, 2003.

<sup>79</sup> The Moving Ahead for Progress in the 21<sup>st</sup> Century Act (Map-21) Act (H.R. 4348), Public Law 112-141 (enacted July 6, 2012), Section 40211(A)(2)(D). *See also* Internal Revenue Service, “Guidance on Pension Funding Stabilization under the Moving Ahead for Progress in the 21st Century Act (MAP-21),” Notice 2012-61 (Sept. 11, 2012), available at <http://www.irs.gov/pub/irs-drop/n-12-61.pdf>.