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Pension Reform

New Legislation Likely For Defined Benefit Programs

Minimal Effect Expected for Well-Funded Pension Plans; Underfunded Plans Would Have New Requirements Intended To Lessen Risk of Failure and Bailout

Introduction

This year Congress is likely to pass amendments to both the Employee Retirement Income Security Act (ERISA) and the Internal Revenue Code (Code) addressing the problem of underfunded defined benefit pension plans. The effort to pass this legislation was begun by Representative J. J. Pickle (D-TX), Chairman of the House Ways and Means Committee's Subcommittee on Oversight. The subcommittee has already held a series of hearings on underfunding as a prelude to considering the Pension Funding Improvement Act (PFIA), H.R. 298, which was introduced by Representative Pickle early in 1993. Responding to concerns about the financial condition of the Pension Benefit Guaranty Corporation (PBGC), the Clinton Administration developed its own bill, the Retirement Protection Act (RPA), H.R. 3396, late in 1993.

There is an extremely good chance that a version of this proposed legislation will become law this year. This report summarizes why legislation on pension funding is believed to be needed. It also reviews the provisions of both the Administration's bill and the Pickle bill. Finally, it discusses the likely schedule for congressional action.

The Problem of Underfunded Pensions[1]

The proposed PBGC legislation deals mainly with single-employer, defined benefit pension plans. Under current law, these plans must purchase insurance from the PBGC to ensure that employees receive the pension benefits they have been promised. When a terminated pension plan lacks sufficient assets to pay out pension benefits, the PBGC makes up the shortfall, subject to an annual maximum pension of $29,250 per beneficiary.[2] PBGC charges each company a premium for this insurance. These premiums are meant to make PBGC self-funding. However, because the PBGC is a government corporation similar to the one that guaranteed savings and loan deposits, it ultimately is backed by taxpayers.

The majority of the 65,000 pension plans covered by the PBGC are fully funded. Total assets in these

[1]For a good explanation of how PBGC works and why reforms are thought to be needed, see Congressional Budget Office, *Controlling Losses of the Pension Benefit Guaranty Corporation,* January 1993.

[2]This cap on guaranteed benefits is adjusted annually for inflation.

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plans exceed $830 billion, while their benefit liabilities are only $780 billion. However, during 1992 the total deficit in underfunded single-employer plans insured by the PBGC increased from $38 billion to $53 billion. Forecasts show that, without further action, this deficit will grow even larger in the future. Most of the underfunding is concentrated in a few companies. For example, roughly 72 percent of all underfunding is concentrated in plans sponsored by 50 companies. Many of these are in the steel, auto, tire, and airline industries, sectors of the economy which have experienced strong competition in recent years. Underfunding in these plans is part of a broader problem of diminished profitability and shrinking workforces in the industries concerned.

The recent drop in interest rates over the last decade has also contributed to increased underfunding. This drop increased the funding requirements of most plans both by increasing the present value of future benefits and by lowering the expected return on pension assets. While lower rates may require firms to reevaluate their financial assumptions and make higher contributions over the short term, they do not necessarily contribute to the long-term problem of pension funding inadequacy.

Pension underfunding in a few of the larger plans is a cause of concern, however. First, the pension benefits are guaranteed by the PBGC and, implicitly, the U.S. taxpayer. If the PBGC is forced to pay out more in benefits than it collects in premiums from these plans, the differences must be made up either by the taxpayer or by higher premiums on all other plans. Higher premiums on fully funded plans may weaken further the pension guarantee system by causing companies to terminate their defined benefit plans and institute new defined contribution plans, which do not require PBGC insurance. This process of adverse selection would leave the PBGC with mostly weak plans to insure.

Finally, companies with underfunded pension plans operate at a labor-cost advantage relative to their competitors with fully funded plans.

Political Prospects

The fate of pension reform is likely to be affected by the politics of both private pension plans and of broader social issues. Pension reform comes under the jurisdiction of the Ways and Means and the Education and Labor Committees in the House and the Finance and the Labor and Human Resources Committees in the Senate. These committees also have primary jurisdiction over both the health care and welfare reform bills. Given the priority of these latter pieces of legislation, pension reform may not receive the close attention it needs this year even though enactment is likely.

Although concern over pension underfunding is widespread, unions and companies in those industries where the underfunded plans are concentrated generally do not favor pension reform. Because pension benefits for bargaining-unit employees can be increased only through collective bargaining, unions in highly competitive and/or declining industries have frequently sought pension increases as a substitute for largely unobtainable pay raises. This strategy is attractive for two reasons. First, an employer that is facing economic difficulty and not able to afford immediate increases in pay may agree nevertheless to increased pension benefits that do not require immediate funding. Because pension benefits are guaranteed by the federal government up to the maximum benefit set forth in the law, most workers will still receive all their benefits even if the employer never funds them. Second, union members who fear that their employer may downsize or who are near retirement age may prefer an increase in pension benefits to an increase in wages.

Pension reform, by limiting the ability of unions and employers to shift unfunded liabilities to the government, restricts the ability of workers in industries that are downsizing to continue to press for benefit increases. Like Social Security, the government's pension guarantee program has suffered from conflicting motives. Some proponents have always believed that the program should be run on an actuarially sound basis with employers required to fund fully their pension plans and pay premiums that accurately reflect the risk to the government of extending the guarantee. Others have viewed the guarantee program as a way of subsidizing workers in declining or highly competitive industries and protecting them from having to accept unemployment or reduced pay to save their companies. Also, they have been reluctant to increase premiums or to limit the extent of the guarantee if doing so would jeopardize the pensions of workers. Although they have not explicitly called for direct subsidies by taxpayers, they often have resisted the type of financial reforms that would lessen the need for such subsidies. The fate of pension reform will depend on which of these visions of the government guarantee generates the most support.

Representative Pickle has said that he believes PBGC reform is a priority issue this year, although he would have preferred to have the legislation included in last year's budget reconciliation bill[3]. The Administration, however, sided with labor unions which fought hard to prevent any changes in the law that would apply to the then-ongoing negotiations

[3]For an analysis of that bill, see *The Omnibus Budget Reconciliation Act of 1993: Will it Reduce the Deficit?*, PR-125, Manufacturers Alliance, August 1993.

between the auto workers and the Big Three car companies. Since these negotiations involved major increases in unfunded pension benefits, unions viewed the provisions of the Pickle bill as a major threat to the achievement of their bargaining strategy. Representative Pickle's determination to see reform is likely to increase now that he has announced that this will be his last year in Congress. Earlier this year, then-Chairman of the House Ways and Means Committee, Dan Rostenkowski (D-IL) listed pension reform as one of five major pieces of legislation his committee intended to report this year. Acting Chairman Sam M. Gibbons (D-FL) has affirmed this commitment.

The bill also will have to pass the House Committee on Education and Labor—chaired by Representative William D. Ford (D-MI)—which traditionally has been more concerned with increasing the size of pension benefits and less concerned with whether these increases are funded. Judging from Representative Ford's statement when he introduced the Administration's bill, the committee recognizes that underfunded pensions are a problem. However, the labor committees in both the House and Senate can be expected to resist any efforts to limit the ability of unions to negotiate increases in private pension benefits, even if these benefit increases are unfunded and therefore represent a risk to other employers or the taxpayers. The ultimate fate of the legislation could depend upon how strongly the Administration pushes for better fiscal accountability.

The Provisions of Current Law

Funding Standard Account

Federal laws covering private defined benefit plans are needlessly complex. The Administration's bill would do little to solve this problem and in some cases would aggravate it. Instead of making one calculation of total benefits and total liabilities and then requiring employers to fund any difference over a short period of time, the law creates a number of artificial categories of assets and liabilities, each having its own amortization period. ERISA's goal of encouraging employers to fund fully their pension plans often is in conflict with the Internal Revenue Code's orientation toward raising revenue. Employers that seek to increase their contribution to a plan may find themselves paying a tax penalty and losing their tax deduction unless the higher contribution is approved by the Internal Revenue Service (IRS).

ERISA requires each defined benefit plan to maintain a funding standard account (FSA). Gains and losses to the plan are amortized in the FSA according to the schedule shown in Table 1.[4] Employer contributions and normal operating expenses show up immediately in the FSA. However, if a plan was underfunded before 1974, ERISA gives it 40 years to make up the original amount of underfunding. Only 1/40 of the original underfunding is amortized each year. Any underfunding caused by amendments to the plan adopted after 1974 (possibly because of a promised increase in benefits) are amortized over 30 years. The amortization period for shifts due to a change in actuarial assumptions is 10 years. Finally, changes due to net experience loss or gain are reflected over a five-year period. Thus, a change in liabilities can have one of at least four amortization periods, depending upon its cause.

Table 1

Unfunded liability as of January 1, 1974	40 years
Changes in unfunded liability after January 1, 1974	30 years
Net loss or gain from actuarial changes	10 years
Net experience loss or gain	5 years
Normal costs	1 year
Plan contributions	1 year

Each year, employers are required to make a contribution equal to the net deficit in the FSA. However, because pension plans are allowed to amortize losses and gains over several years, it is possible for the total amount of underfunding to increase even though such plans make the required contributions to the FSA. This is especially true in the case of employers that are giving increased pension benefits with each new collective bargaining agreement and, funding the increased liabilities over thirty years.

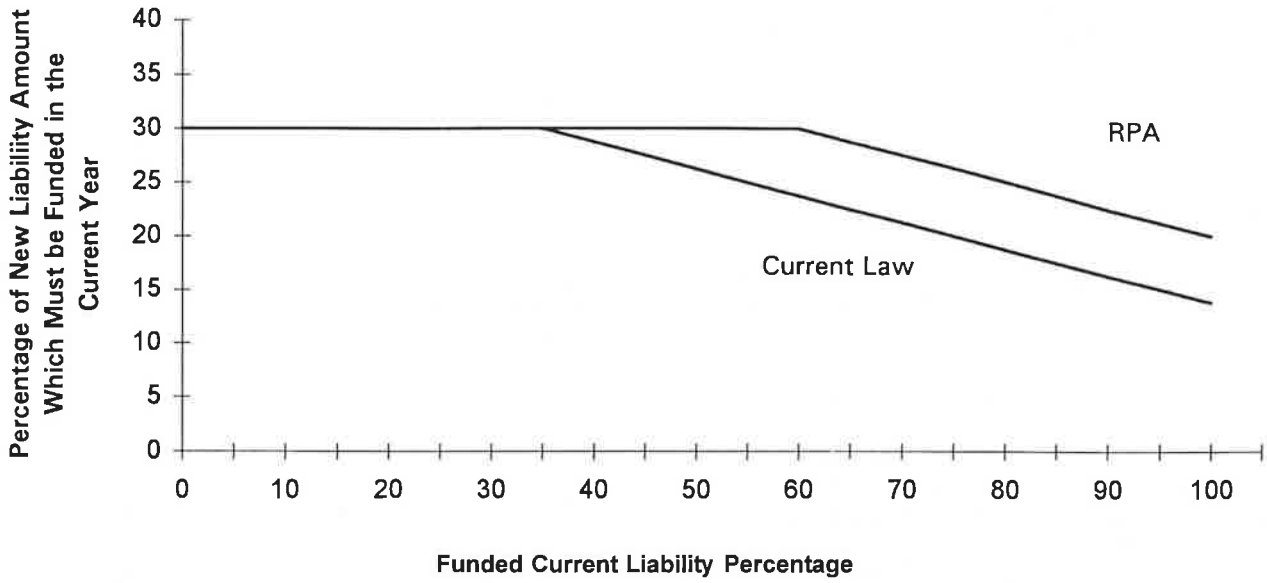
Deficit Reduction Contribution

In 1987, Congress amended the law to address underfunded plans. Rather than speed up the regular amortization periods, the new provision added yet another accounting schedule with several more amortization periods, depending upon the nature of the gain or loss involved. The law now requires companies with underfunded plans to make an additional deficit reduction contribution (DRC) each year in order to accelerate the elimination of accumulated underfunding.[5] Underfunding that existed on December 12, 1987 is amortized to the DRC over 18 years.

[4]ERISA § 320(b); Code § 412(b).

[5]ERISA § 302(d)(1), (d)(2); Code § 412 (l)(1), (l)(2). The DRC is charged as an additional amount to the FSA, thus increasing the annual FSA payment.

Chart 1
Funding Requirements for Unfunded New Liability



Any increases in underfunding since then are amortized over a variable time period which depends upon the funded current liability percentage of the plan.[6] This variable schedule and the proposed changes to it are shown in Chart 1 and discussed below. Lastly, underfunded plans are required to make a payment to cover unpredictable contingent events. The size of this payment also depends upon the current funding percentage.[7] Unfortunately, the DRC has not succeeded in eliminating the problem of underfunded plans. Both the Administration's bill and the Pickle bill attempt to correct this problem.

The Pension Funding Improvement Act (H.R. 298)

In contrast to the RPA, the PFIA sponsored by Representative Pickle is much simpler and more direct. It would reduce significantly the complexity of current law, while at the same time strengthening the requirement that employers fully fund their pension plans.

Funding Provisions

The Pickle bill rewrites key subsections of ERISA and the Code to increase the annual contributions to underfunded plans. The bill maintains the requirement that employers fully fund the FSA. In addition, the annual payment would have to ensure that the plan does not have an "accumulated funding deficiency." This accumulated funding deficiency would be the largest of:

1. The lesser of:
   a. The balance of the FSA; or
   b. The balance of the alternative minimum FSA;
2. The underfunding reduction requirement; or
3. The solvency maintenance requirement.

The contribution would not exceed the sum of the amount needed to increase the funded liability percentage to 100 percent, including the expected increase in the current liability attributable to benefits accruing during the plan year.[8]

The bill rewrites section 412(l) of the Code and section 302(d) of ERISA to replace the DRC requirement with an underfunding reduction requirement.[9] This new requirement would apply only to plans that have a funded current liability percentage of less than 100 percent as of the first day of the plan year. For these plans, the underfunding reduction requirement would be equal to the sum of:

1. The unfunded current liability of the plan multiplied by: (a) 30 percent reduced by the product of: (i) .25 times (ii) the excess of the funded current liability percentage over 35 percent. (This is the same percentage as now required in existing law for unfunded new liability.);

[6]The funded current liability percentage is the ratio of the plan's assets to its current liability. ERISA § 302(d)(8)(B); Code § 412(l)(8)(B).

[7]To determine the unpredictable contingent event amount, see ERISA § 402(d)(5); Code § 412(l)(5).

[8]PFIA §§ 101(a), 102(a).

[9]PFIA §§ 101(b), 102(b).

2. The expected increase in the current liability attributable to benefits accruing during the plan year;
3. The amount necessary to amortize any waived funding deficiency (over a period of five years); and
4. The unpredictable contingent event amount.

The underfunding reduction requirement is thus substantially the same as the current DRC and unpredictable contingent event amounts with one exception, namely, that all past underfunding would be amortized at the same rate, regardless of whether it existed prior to 1988. The 18-year amortization period for unfunded "old" liability would be eliminated. In addition, unfunded plans would have to fund forward for the expected increase in the current liability due to benefits accruing during the coming plan year, as in the RPA.

Actuarial Assumptions

The Pickle bill contains the same limitation on interest rate assumptions as the RPA.[10] Underfunded plans could not use an interest rate greater than the four-year weighted average rate on 30-year Treasury securities. Unlike the RPA, the PFIA would not require plans to use a specific mortality table.

Solvency Maintenance Requirement

The solvency maintenance requirement would be equal to the sum of:

1. All disbursements from the plan for the plan year.
2. An amount equal to the unfunded current liability of the plan multiplied by the interest rate used by the plan to determine current liability.
3. The expected increase in the current liability attributable to benefits accruing during the plan year.
4. The amount needed to amortize any waived funding deficiency.[11]

The bill contains a phase-in rule which would limit payments under this subsection. Plans would always be required to pay the full amount of the underfunding reduction requirement. However, the need to pay any difference between this requirement and the solvency maintenance requirement would be phased in over five years. For plan years beginning in 1993,[12] the contribution would have to equal 20 percent of this difference. The percentage would be raised by an additional 20 percent in each subsequent plan year.

Disbursements from the plan would be defined as benefit payments (including purchases of annuities or payment of lump sums in satisfaction of liabilities), administrative expenses, and any other disbursements. In determining the amount attributable to annuities or the payment of lump sums, only a percentage of the total amount paid equal to the ratio of underfunding would be included. Thus, if a plan had a funding ratio of 65 percent, only 35 percent of the price of an annuity would be counted as a disbursement.

Transitional Adjustment

Employers would be allowed to elect to reduce any underfunding reduction or solvency maintenance requirement by the total amortized portion of any gain or loss from net experience or change in actuarial assumptions for plan years beginning prior to January 1, 1994 plus the amount considered contributed by the employer for the plan year.[13]

Increase in Required Funding for Benefit Increase

The Pickle bill also would limit the ability of underfunded plans to increase pension benefits by requiring them to fund immediately a greater percentage of the increase than under current law.[14]

Under current law, plans less than 60 percent funded must provide security for any benefit increases in order to maintain their status as a qualified trust.[15] The PFIA would apply this requirement to all plans that are less than 90 percent funded, taking into account the additional liabilities resulting from the benefit increase.

The bill also would increase the amount of the required security. Presently, plans that are less than 60 percent funded must provide security equal to the greater of the amount of assets needed to bring the funding level up to 60 percent or by the increased liability caused by all plan amendments adopted since December 22, 1987. Security is only required to the extent that this amount exceeds $10 million. The PFIA would require an amount of security sufficient to bring the assets up to 90 percent of the unfunded current liability. Only the first $1 million of this amount would be excused. It also would extend this requirement to multiemployer plans. The bill would extend the criminal provisions of ERISA to cover violations of this requirement.[16] These changes

[10] *Ibid.*

[11] PFIA §§ 101(c), 102(c).

[12] The PFIA was introduced at the beginning of 1993. Hence, the reference to plan years beginning in that year. Obviously, this reference is dated, and the bill, if passed, would be updated to begin the phase-in period with later plan years, possibly starting with the 1995 plan year.

[13] PFIA §§ 101(d), 102(d).

[14] PFIA §§ 201, 202.

[15] Code § 401(a)(29); ERISA § 307.

[16] PFIA § 202(d).

would be effective for plan amendments adopted after 1993.[17]

Reports by the PBGC and the Congressional Budget Office

Unlike the RPA, the Pickle bill does not raise insurance premiums. It does call, however, for separate studies by both the PBGC and the Congressional Budget Office on alternatives for increasing premiums on single-employer plans so that the assets of the PBGC program would equal its current and expected liabilities by 2002.[18] One of the alternatives presented would have to increase premiums only on underfunded plans.

The bill also would change current reporting requirements to ensure that the PBGC presents the Congress with a 30-year financial outlook rather than the five-year forecasts currently used. Whenever the forecasts show a deficit, the PBGC would be required to set forth changes in the premium schedules needed to eliminate the deficit.

Enhanced Information Powers

Finally, the PFIA also would increase the PBGC's ability to require information from certain underfunded plans.[19] This section would apply only to plans where:

a. The underfunding of the plan exceeds $10 million;
b. The number of participants is greater than 2,000; or
c. Minimum funding waivers in excess of $1 million have been granted with respect to the plan.

All plans maintained by the same sponsor would be treated as one plan. For these plans, PBGC would have the power to require any records, documents, or other information necessary to determine the liabilities and assets of the plan or the financial condition of the sponsors or the members of the sponsor's controlled group.

The Retirement Protection Act (H.R. 3396)

The Administration's bill would accomplish several things. In addition to requiring underfunded companies to make larger contributions to their plans, the RPA would enhance the PBGC's authority to require increased funding, increase the information that plan participants receive about the funding of their plans, and increase the PBGC premiums for the most underfunded pension plans.

[17]PFIA § 203.
[18]PFIA § 301.
[19]PFIA § 302.

TITLE I

Pension Plan Funding

The bill contains several provisions that increase the amount that companies with underfunded plans must contribute to their pension funds. In general, these provisions do not affect plans that are fully funded.

Double counting.—Gains from net experience or from changes in actuarial assumptions are credited as unfunded new liability in the DRC, decreasing the required DRC contribution.[20] They are also amortized within the FSA over a five- or 10-year period.[21] Under existing law, the amortized amount in the FSA is not offset against the DRC. This results in partial double counting. For example, if a company has a net experience gain of $10 million, its DRC payment will rise.[22] In addition, it will amortize a $2 million gain in the FSA. The total contribution will include both of these amounts. The gain is thus double counted.

In the past decade, many plans experienced large gains from higher than expected returns on invested assets. These gains were amortized in the FSA, reducing annual contributions. However, because of the double counting, they also worked to reduce the DRC. As a result, some companies were not required to make any contributions, even though the total underfunding in their plans increased.

The Administration's bill eliminates this double counting.[23] The portion of any gain or loss amortized to the FSA from net experience or a change in actuarial assumptions would be balanced by an offsetting credit or charge to the DRC. The full amount of any change in underfunding will then be amortized as unfunded new liability in the DRC. The bill also subtracts from the DRC the normal cost of operating the plan, since this is already charged to the FSA.

Ironically, while the rest of the bill aims to increase payments from underfunded plans, this provision may actually decrease payments. With declining interest rates over the last few years, it is more likely that plans will experience losses rather than gains. The existing double counting would act to raise total contributions, whereas eliminating the double counting would reduce them. However, the change succeeds in separating the calculation of the two

[20]Similarly, the statutes charge losses from net experience or changes in actuarial assumptions to the DRC, thus increasing it.
[21]The amortization period for net experience gains or losses is five years, while that for changes in actuarial assumptions is 10 years (see Table 1, p. 3).
[22]Because the loss occurs after December 12, 1987, the amortized amount depends on the funded current liability ratio as shown in Chart 1, p. 4.
[23]RPA §§ 101(a)(1)(A), 121(a)(1)(A).

payments, making it easier to ensure that the DRC does what it is supposed to do: speed up contributions to underfunded plans.

The bill also increases the DRC by the "expected increase in current liability due to benefits accruing during the year."[24] This requires companies to plan forward to some extent. Finally, it changes the maximum DRC that a company is required to pay into the fund. Under current law, the DRC will not exceed the amount needed to increase the funded current liability percentage to 100 percent.[25] The proposed change would increase this limit to include the expected increase in current liability over the next year but would exclude any changes already recorded in the FSA.[26] This proposed change further separates the calculations of the FSA and the DRC, and also would require plans to anticipate any underfunding which would occur in the coming year.

Interest rate and mortality assumptions.—In order to calculate the net present value of their future liabilities, pension funds must make assumptions about future variables including interest rates and actuarial assumptions. These assumptions can significantly affect the balance between the fund's assets and its liabilities. Funds may currently choose any interest rate that lies between 90 percent and 110 percent of the four-year weighted average of the interest rates on 30-year Treasury securities.[27] Under current law, this limitation also applies to the calculation of the DRC.[28] There is no limitation in current law on actuarial assumptions.

The Administration's bill would impose tighter limits on the assumptions plans use to calculate the DRC.[29] First, the assumed interest rate must be between 90 percent and 100 percent of the four-year average on 30-year Treasury bonds. Second, the plan would be required to use the prevailing IRS Commissioner's standard actuarial table.[30] This change would be effective for plan years beginning after December 31, 1994. This change would not affect the assumptions used to calculate the FSA. As a result, plans that are fully funded would not be affected by the change.

Plans that currently use an assumed interest rate between 100 percent and 110 percent of the four-year average or that use mortality tables that differ from the GAM 83, might experience a change in their underfunding. Any increase in liability due solely to the mandated use of the lower interest rate and specified mortality assumptions[31] would be treated as unfunded old liability and amortized in the DRC over 12 years.[32]

Other actuarial assumptions.—The RPA also would restrict the ability of underfunded plans to change other actuarial assumptions without the prior approval of the Secretary of the Treasury.[33] However, prior approval would be required ***only*** if all of the following conditions are met: (1) the plan is underfunded; (2) the aggregate unfunded vested benefits at the close of the preceding plan year of all unfunded plans within the employer's controlled group exceed $50 million;[34] and (3) the change in assumptions decreases the unfunded current liability of the plan either by: (a) $50 million or by (b) $5 million or more and is at least 5 percent of the plan's current liability before the change.[35]

Thus an unfunded plan with current liabilities of over $1 billion would need approval for any changes that decreased the estimated underfunding by at least $50 million. Plans with underfunding of between $100 million and $1 billion would need approval for any changes which decreased their liabilities by at least 5 percent. The change would not affect plans with liabilities under $100 million unless the change increases underfunding by at least $5 million.

This requirement would be effective for all plan years beginning after the date of the bill's introduction.[36] However, in one of many retroactive provisions, the bill also provides that assumption changes made in plan years beginning after December 31, 1992 that would have required approval under the new law would not be effective for plan years beginning after December 31, 1994, unless approved by the Treasury Secretary. As a result, plans that recently adopted changes to their actuarial assumptions may find that they would need approval to maintain those assumptions, even though the changes were consistent with existing law at the time they were made. The bill does not provide the Secretary of the

[24]RPA §§ 101(a)(2), 121(a)(2).

[25]ERISA § 302(d)(1); Code § 412(l)(1).

[26]RPA §§ 101(a)(1)(B), 121(a)(1)(B).

[27]ERISA § 302(b)(5); Code § 412(b)(5).

[28]ERISA § 302(d)(7)(C); Code § 412(l)(7)(C).

[29]RPA §§ 101(a)(6), 121(a)(6).

[30]This actuarial table, described in section 807(d)(5)(A) of the Code, is currently the GAM 83 mortality table.

[31]The increased liability attributed to the change in assumptions is calculated in the following manner. First, the current liability for the 1995 plan year is calculated using the new assumptions imposed by the change. Then the liability for 1995 is recalculated using the same percentage of the four-year average weight and the same mortality tables as were used for the 1993 year. The increased liability attributed to the change is the difference between these two figures. RPA §§ 101(a)(6), 121(a)(6).

[32]RPA §§ 101(a)(3), 121(a)(3).

[33]RPA §§ 102, 122.

[34]In making this determination, employers cannot use overfunding in some plans to offset underfunding in others.

[35]RPA §§ 102(a), 122(a), 201(a).

[36]RPA §§ 102(b), 122(b).

Treasury with any guidelines for granting such approval.

Unfunded new liability amount.—Current law defines "unfunded new liability" as the total "unfunded current liability"[37] without regard to: (1) the unamortized portion of the unfunded liability that existed on December 12, 1987; (2) the unamortized portion of any change in liability caused by an increase in existing benefits since 1987; and (3) the unpredictable contingent event liability.[38] The unfunded new liability can be viewed as the difference between the amount of assets in a plan and the amount of assets that the law requires it to have. Because the law allows plans to amortize increases in pension benefits over several years, it is possible for a plan's unfunded new liability amount to be zero and still be in a position where its assets are less than the present value of all the pension benefits it has promised.

Employers must contribute a certain percentage of the total unfunded new liability to their plan each year as part of the DRC. This percentage depends upon the funded current liability percentage and rises with it. The greater a plan's underfunding, the greater the portion of its unfunded new liability it must contribute. In general, the funding requirements are steepest for plans with less than 35 percent funding and decline as the funded current liability percentage rises.[39] Fully funded plans are required to contribute an amount equal to 13.75 percent of any new liability in the first year. The Administration's bill would increase this percentage for all plans that have a funded current liability percentage of over 35 percent.[40] All plans with a funded current liability percentage of 60 percent or less would have to contribute the maximum 30 percent of the unfunded current liability to their plan. The funding requirements for all plans with percentages over 60 percent would increase by 6.25 percentage points from current law. Chart 1 on page 4 shows the new funding percentages as a function of the funded current liability for both existing law and the RPA.

Unpredictable contingent event amount.—Employers must also make an annual payment to cover unpredictable contingent events.[41] The RPA would change the law so that the unpredictable contingent event amount that is added to the DRC is at least as much as if it were treated as unfunded new liability. The RPA also would cap payments of the unpredictable contingent event amount so that the present value of the total unpredictable contingent event amounts attributable to an unpredictable contingent event does not exceed the amount that would be required to cover the increase in liabilities if the event ever occurred.[42]

This particular provision of the bill exemplifies the Administration's approach of adding an additional layer of complexity onto already complex legislation. Although the change may be technically exact and logically neat, it is doubtful whether this logical perfection justifies the increased complexity. Rather than simplifying the law by treating the liability for unpredictable contingent events the same as all other liabilities, the bill retains the separation but requires accountants to make yet another calculation in order to determine the correct contribution.

Transition rule for increased funding.—The Administration's goal of reducing unfunded liabilities is weakened by the bill's elective transition rule that limits the size of the additional contribution required elsewhere.[43] Although the transition rule ensures that a company's contribution will be at least as large as under current law, it offsets much of the progress made in other portions of the bill. One reason why the Administration proposed a higher funding standard but then added a generous transition period is to ensure that companies did not face ***sudden*** increases in their required contributions. Another reason has to do with the pay-as-you-go budget laws. Under current law, any bill that would increase the budgetary deficit in any year must be paid for by raising revenue or cutting other programs. Requiring companies to make larger contributions to their pension plans increases the tax deductions they can claim. This in turn reduces the government's tax revenues over the short term. By minimizing the amount of these deductions, the transition rules reduce the offsetting tax increases that must be contained in other parts of the bill.

Rather than set up one simple funding scale that applies to all plans, the transition rule varies according to the ratio of the plan's assets to its liabilities. The result is yet another calculation, this one varying each year depending upon the plan's initial funded current liability percentage for the first plan year beginning after December 31, 1994, and a variable schedule listed in the bill. While difficult to decipher, let alone describe, the transition rule would require a fund that is only 50 percent funded to increase this ratio to 74 percent by 2001.

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[37]The unfunded current liability is the total liability to all participants and beneficiaries minus the value of the plans assets. ERISA §§ 302(d)(7)(A), (d)(8)(A); Code §§ 412(l)(7)(A), (l)(8)(A).

[38]ERISA § 302(d)(4); Code § 412(l)(4).

[39]ERISA § 302(d)(4); Code § 412(l)(4).

[40]RPA §§ 101(a)(4), 121(a)(4).

[41]ERISA § 302(d)(1)(B); Code § 412(l)(1)(B).

[42]RPA §§ 101(a)(5), 121(a)(5).

[43]RPA §§ 101(a)(7), 121(a)(7).

Three-Year Solvency Requirement

The Administration's bill would also add an additional requirement that all underfunded plans have liquid assets equal to three years worth of disbursements.[44] Plans would be required generally to have liquid assets[45] equal to three times the amount of adjusted disbursements over the last 12 months. This provision is intended to prevent insiders with advance knowledge of a plan's probable termination from converting their pensions into lump-sum distributions, thereby reducing the funds available to other beneficiaries.

Employers that fail to make a quarterly solvency payment would be charged interest at the same rate as that which applies to missed regular quarterly payments.[46] In addition, a new excise tax of 10 percent per quarter on outstanding quarterly payments would be assessed. The excise tax would rise to 100 percent if the solvency payment is not paid within one year.

If the required payment is not made, the plan may not pay participants and beneficiaries any benefits in excess of the monthly amount they would receive under a single life annuity. This prohibition would apply only to participants and beneficiaries whose annuity starting date occurs while the quarterly payment is outstanding.[47] The Secretary of the Treasury may specify other types of payments to be included in this prohibition. As a result, beneficiaries who might otherwise be entitled to a lump-sum distribution would have to settle for annuity payments until the plan had fulfilled the new solvency requirements.[48] The bill contains a civil penalty for each payment in violation of this section.

Amendment to Full-Funding Definition

As mentioned above, the RPA also amends the definition of full funding to include the expected increase in current liability due to benefits accruing during the plan year.[49] This change is effective for plan years beginning after December 31, 1994.

Recognition of Collectively Bargained Changes

Under current law, collectively bargained changes in pension benefits must be recognized only when a formal amendment to the plan is adopted, unless employers choose to recognize them immediately. In the case of collective bargaining contracts where benefit increases will occur in later years, this can produce a long delay between the time changes are agreed upon and the time they are recognized as liabilities. The Administration's bill would require employers to recognize immediately any benefit increases that have been agreed upon, even though the pension plan has not been formally amended.[50] The change would affect collective bargaining agreements that take effect on or after January 1, 1995. This provision would be of limited help since employers are still not allowed to recognize anticipated increases in pension benefits until they are actually negotiated. For example, both the unions and the auto industry anticipate that there will be another increase in benefits during the next pattern bargaining contract scheduled for 1996. However, current law does not allow the companies to begin funding this anticipated increase in liabilities until a contract is actually signed.

Termination of Quarterly Contribution Requirements

The RPA also contains a section which should significantly reduce the administrative requirements of fully funded plans. The bill would end the current requirement for quarterly payments for all plans in which the funded current liability percentage is 100 percent or greater.[51] These plans would only be required to make whatever annual payment is needed to maintain full funding. The change is effective for plan years beginning after the date of the bill's enactment into law.

Change in Excise Taxes

Tax law impedes the full funding of defined benefit plans. Any payments in excess of the required amounts are generally not tax deductible and may be subject to an excise tax of 10 percent. This removes any incentive to address underfunding faster than the law requires.

The RPA would remove the excise tax in two minor instances.[52] First, the tax would not apply to contributions to a terminating plan to the extent that they do not cause the plan's assets to exceed its liabilities, provided the plan has 100 or fewer participants. Note that the contributions would still not be deductible. Plans with more than 100 participants currently may deduct this contribution. This change

[44]RPA §§ 101(a)(8), 121(a)(8).

[45]"Liquid assets" means cash, marketable securities, and such other assets as specified by the Secretary of the Treasury. RPA §§ 101(a)(8)(A)(iv), 121(a)(8)(A)(iv).

[46]RPA § 101(a)(8)(B).

[47]RPA § 101(a)(8)(C).

[48]A plan which fails to pay distributions as the result of this prohibition does not violate the qualification requirements of ERISA and continues to constitute a qualified trust under the Code.

[49]RPA §§ 101(a)(9), 121(a)(9).

[50]RPA §§ 103, 123.

[51]RPA §§ 104, 124.

[52]RPA § 105.

would be effective for taxable years ending on or after the date of the bill's enactment into law.

Second, the excise tax would not apply to excess contributions that are nondeductible solely because they violate the combined contribution limits for companies that have both a defined benefit plan and a defined contribution plan under 401(k) or 401(m) of the Code. This exception does not apply to amounts that exceed 6 percent of compensation or to plans with fewer than 100 participants. This change is effective for taxable years ending on or after December 31, 1992.

TITLE II

Amendments to Title IV of ERISA

Reportable events.—The Administration's bill broadens the requirements for reporting events that could affect a plan's underfunding in several ways. Under current law, the plan administrator must notify the PBGC of certain events, called reportable events, within 30 days ***after*** they occur. First, the bill extends the duty to notify the PBGC of reportable events to include the contributing sponsor as well as the plan administrator. Under current law, contributing sponsors must notify the plan administrator of a reportable event. The administrator would then notify the PBGC. The change requires the contributing sponsor to make the report directly to the PBGC.[53]

Second, the bill specifies several new events for which the contributing sponsor must give the PBGC at least 30 days ***advance*** notice. This notice is required only if the aggregate unfunded vested benefits at the close of the preceding plan year of all plans maintained by the sponsor or its controlled group (taking into account only those plans with unfunded vested benefits) exceed $50 million. These new events include:

- The withdrawal of the sponsor from the controlled group;
- The liquidation of the contributing sponsor or a member of the controlled group;
- The declaration by a contributing sponsor or a member of the controlled group of an extraordinary dividend or the redemption, in any 12-month period, of at least 10 percent of the total combined voting power or of the combined value of all classes of stock of the controlled group; and
- The transfer, within any 12-month period, of at least 3 percent of the plan's benefit liabilities to a person outside the controlled group.

The PBGC has the power to promulgate regulations adding other events to this reporting requirement if it feels the events may indicate the need to terminate the pension plan. It may also waive the reporting requirement for certain sponsors.

Any advance notice given to the PBGC would be exempt from public disclosure requirements except as it is relevant to administrative or judicial proceedings or congressional requests. These changes in the reporting requirements would apply to events occurring 60 days or more after the date of enactment of the bill into law.

Alternative to involuntary termination.—Present law limits the PBGC's ability to protect underfunded plans. If the PBGC learns of an event that might endanger future funding, it has only one real remedy, that is, to terminate the plan. Termination may ensure that no member of the controlled group escapes responsibility for funding the plan. It is a drastic step, however, aimed at cutting the plan's losses rather than eliminating them. It places immediate pressure on the contributing employer to make up the full amount of the underfunding. In cases where the employer is experiencing economic hardship, this may place the PBGC in the position of having to choose either pension benefits or jobs. The Administration bill strengthens the PBGC's hand by giving it several powers short of termination.[54] These new powers would apply only if the events concerned would reduce the total revenues, total operating income, or total assets of the controlled group by more than 10 percent over a 12-month period.

Under the bill, whenever the PBGC determines that the occurrence of one of the events for which advance notice is required would increase unreasonably the possible long-run loss to the PBGC with respect to a plan, it could institute proceedings in a federal district court. The court would be authorized to grant such equitable and legal relief as needed to protect the PBGC's interests without interfering unreasonably with the business of the contributing sponsor or members of the controlled group.

After it receives advance notice, the PBGC has 30 days in which it can either file a legal action or request additional information or documentary material on the event. If it requests additional information, the deadline for bringing legal action is postponed until 20 days after the PBGC has received all of the additional information it requested.

A company may go ahead with the event prior to the expiration of the time period for filing a suit, provided it gives the PBGC notice of its intention to do so. In that case, or in a case where a company fails to give the PBGC advance notice when required

[53]RPA § 201(a).

[54]RPA § 202.

to or fails to provide the PBGC with additional information when requested to do so, the time period for filing an action is extended to the normal period governing the PBGC causes of action.[55]

This section of the bill applies to all events occurring at least 60 days after the bill's passage into law. The additional remedies available to the PBGC do not affect its ability to terminate the plan.

Additional information requirements.—The Administration bill also would increase the reporting requirements for underfunded plans.[56] The information requirements would apply to the contributing sponsors and all members of the controlled group if the aggregate unfunded vested benefits of all plans maintained by the group (counting only those plans that are underfunded) exceed $50 million or if a lien may be placed on the plan's assets or if minimum funding waivers of over $1 million have been granted and any portion thereof are still outstanding.

Such companies must provide the PBGC with annual financial statements, together with any other records or documents that the PBGC may later require by regulation. Any information furnished under this section is exempt from disclosure to the public (except in the context of an administrative or judicial hearing), but not from disclosure to the Congress. This provision would be effective upon enactment of the bill into law.

Liability upon liquidation.—Under current law, the PBGC cannot state a claim against a company which enters bankruptcy proceedings unless it terminates the pension plan. The liability for future contributions rests with any remaining members of the controlled group. In cases where the principal contributor enters bankruptcy, the assets of the remaining members may not be sufficient to protect the plan's beneficiaries. Furthermore, unless the PBGC terminates the plan, it must forego the possibility of receiving any assets from the bankrupt company.

Under the Administration's bill, if one or more of the members of the controlled group, including the contributing sponsor, liquidated all or substantially all of their assets, they would still be liable for the amount of any underfunding as if the plan had terminated.[57] Either the plan itself or the PBGC could assert a claim in bankruptcy proceedings. Any proceeds which the PBGC receives from asserting such a claim would be turned over to the plan. The bill also authorizes the PBGC to promulgate regulations under which a plan could assign its claim against the bankrupt to another member of the controlled group, provided the plan receives any recoveries. This provision applies to bankruptcies commencing on or after the bill's enactment.

Enforcement of minimum funding requirements.—Under current law, only the Secretary of Labor has the authority to enforce the funding requirements of ERISA. The IRS has the authority to enforce the corresponding requirements in the Code. The RPA gives the PBGC the authority to enforce both of these provisions by initiating a legal action on its own.[58] This expansion of legal authority would apply only to plans that are subject to the imposition of a lien and would cover all payments required after the bill's enactment.

Remedies for noncompliance with standard termination.—Under current law, if a single-employer plan wrongfully terminates without providing sufficient funding, the PBGC may nullify the termination. Such a reversal may be extremely complicated and confusing to plan beneficiaries, however. The RPA would give the PBGC the additional option of going through with the termination and using other legal remedies against the employer to ensure proper funding.[59] Specifically, the law allows the PBGC to issue a notice of noncompliance if it determines that a plan will not be able to meet its benefit liabilities. Under current law, this notice prevents the plan from terminating. However, the bill also would allow the PBGC to refrain from issuing a notice in cases where the plan administrator has not complied with the requirements for termination if the PBGC determined that preventing the termination would be inconsistent with the interests of the plan participants and beneficiaries. This provision applies to any proposed terminations for which the PBGC has not issued a final notice of noncompliance as of the date of the bill's enactment.

Prohibition on benefit increases.—The RPA would restrict the ability of bankrupt companies to increase the pension benefits of an underfunded plan by providing that any benefit increases cannot become effective until after the company's reorganization plan takes effect.[60] The Secretary of the Treasury has the authority to approve certain *de minimis* increases in the liabilities. The prohibition does not apply to amendments negotiated prior to the time the employer entered bankruptcy. Thus, unions negotiating with a financially troubled firm still have an incentive to demand generous benefit increases in lieu of wages, knowing that the federal government guarantees the

[55]Under § 4003(e)(6) of ERISA, the time period within which the PBGC can bring an action is generally limited to the greater of: (1) six years after the event that gives rise to the cause of action or (2) three years after the PBGC had or should have had actual knowledge of the cause of action.

[56]RPA § 203.

[57]RPA § 204.

[58]RPA § 205.

[59]RPA § 206.

[60]RPA § 207.

pension benefits even though the company may fail. The prohibition would not apply to amendments that do not increase the plan's underfunding.

Failure to adhere to this prohibition would cause the plan to lose its status as a qualified trust under the Code. The prohibition applies to plan amendments adopted on or after the date of the bill's enactment.

Substantial owner benefits.—The RPA simplifies the phase-in provisions for substantial owners (a person who owns more than 10 percent of the business).[61] Under current law, the PBGC guarantee is phased in over 5 years for plan beneficiaries whose ownership of the company is less than 10 percent. The RPA would apply this shorter phase-in period to all beneficiaries whose ownership is less than 50 percent. For "majority" owners (defined as those owning at least 50 percent), the bill would change the guarantee provisions to depend upon the number of years the plan has been in effect rather than the number of years the specific owner has been a participant. The PBGC would guarantee 1/30 of the benefits for every year the plan has been in effect. Each individual owner would still be subject to the five-year phase-in rule.

The bill also would make a minor change in the allocation of assets from an underfunded plan. The change would give beneficiaries who are not majority owners a slightly higher preference in the distribution of assets from an underfunded pension plan. The amendment is effective for all terminations for which a notice of termination is filed or for which the PBGC initiates termination proceedings on or after the date of the bill's enactment.

Phaseout of variable rate premium cap.—Every defined benefit plan must purchase insurance from the PBGC. The PBGC currently charges fully funded plans a premium of $19 per participant. An additional $9 per participant is charged for every $1,000 of underfunding, however, the additional premium is capped at $53 per participant. Thus, once a plan's underfunding hits $6,000 per participant, further underfunding does not increase that plan's premiums even though it increases the insurance risk to the PBGC.

Most of the PBGC's risk exposure comes from underfunded plans. According to the PBGC, plans that would be affected by this change account for 80 percent of total pension underfunding, but currently pay only 25 percent of the PBGC's premiums. Over 70 percent of all premiums come from corporations paying the flat rate of $19 per participant. Thus, even though seriously underfunded plans create most of the insurance risk faced by the government guarantee, they pay only a fraction of the premiums meant to cover this risk.

The RPA would gradually remove the cap on additional premiums.[62] Affected plans would have to pay 20 percent of the increase for the first plan year beginning on or after July 1, 1994. The following year they would have to pay 60 percent of the proposed increase in premiums in excess of $53. For plan years beginning on or after July 1, 1996 the full uncapped premium would be due.

TITLE III

Participant Services

The RPA would make several changes to the services a plan provides to its participants. Some of these changes would affect fully funded plans as well.

Disclosure.—The bill would require plan administrators of underfunded plans to notify plan participants and beneficiaries in clear language of the plan's funding status and the limits of the PBGC guarantee of unfunded benefits.[63] This requirement would apply to all plans that are required to pay the variable rate premium. The specific notice requirements would be spelled out by the PBGC in regulations and would probably include safe harbor language.

Missing participants.—Plan administrators are sometimes unable to find participants at the time a plan is terminated. Difficulty tracking participants can occur because the participant moves, changes names, or for other reasons. In these cases, the plan administrator is required to purchase an annuity from an insurer to provide the participant's benefits. Where only a small benefit is involved, the funds may be deposited in an interest-bearing account in a federally insured institution until the participant is found.

Administrators often have trouble finding a third party willing to offer an annuity or account to an unknown and possibly untraceable person. The RPA would simplify the administrator's task by requiring it to transfer the funds to the PBGC, together with all information on the participant.[64] Information on the participant would have to be provided to the PBGC even should an annuity be purchased. The PBGC would also regulate the scope of the "diligent search" that plan administrators must make before they declare a participant missing. This provision would be effective upon the issuance of final regulations by the PBGC.

[61]RPA § 208.

[62]RPA § 209.

[63]RPA § 301.

[64]RPA § 302.

Maximum guarantee of disability benefits.—In certain cases, the PBGC also guarantees total and permanent disability benefits, provided the total benefits do not exceed the statutory cap. However, if the disability benefit is converted to a normal or early retirement benefit, the insurance limit will depend upon the participant's age at the time of conversion. In some cases, this can lead to a lowering of the maximum benefit the PBGC will insure.

The RPA would change the law to ensure that benefits going to a participant who meets the standards for receiving Social Security benefits on account of his total and permanent disability are insured in the same amount as if the participant was 65.[65] The maximum insured amount would not change merely because the disability payment is converted into an early or normal retirement benefit. This section would be effective for terminated plans with respect to which a notice of termination or proceeding to terminate is filed on or after the date of the bill's enactment.

TITLE IV

Other Provisions

ERISA citation.—The RPA would update Section 404(g) of the Code to refer to ERISA as amended by the RPA.[66]

Definition of contributing sponsor.—The RPA would update the statutory definition of a contributing sponsor.[67] The definition is intended to identify the entity responsible for making contributions to the plan in the normal course of business. A contributing sponsor is currently defined as the person responsible for meeting its funding requirements. Originally this applied only to the person maintaining the plan. Later amendments extended this liability for maintaining the plan to the entire controlled group, which unintentionally broadened the definition of the contributing sponsor. The RPA would amend the definition so that once again it would apply only to the entity that would normally make contributions.

Recovery ratio.—When a plan terminates without sufficient assets to cover its liabilities, the PBGC attempts to recover additional assets from the employer. As explained above, the PBGC guarantees pension benefits only up to a certain level. In some cases this results in participants receiving fewer benefits than they were entitled to under the pension plan. The law requires the PBGC to pay these participants a portion of these unguaranteed benefits based on its success in recovering additional funds from the employer. Where the amount of unfunded unguaranteed benefits exceeds $20 million the percentage is based on the PBGC's actual recoveries from that employer. Where the amount is less than $20 million the percentage is based on the PBGC's average recovery rate for the last five years. This averaging was introduced to avoid delaying payments to plan participants until court cases were resolved, while still holding down the PBGC's liabilities.

The RPA would eliminate the averaging provision and base all percentages on the PBGC's actual recovery rate for that plan.[68] Experience has shown that in most cases, the PBGC is able to reach a settlement with the employer before the final benefits are determined. This proposed change is expected to increase the amount of benefits participants are able to recover. Under the averaging method, the average recovery rate was strongly influenced by a few large plans with substantial underfunding. In most cases, actual recoveries are higher than this average.

Distress termination criteria for banking institutions.—A contributing sponsor or controlled group member can qualify for distress termination only if it meets one of several tests. One of these tests applies to firms liquidating under Title 11 of the United States Code or under a similar law of a state or local government. The RPA would extend this qualification to employers undergoing liquidation under other federal bankruptcy laws such as Title 12 for FDIC-insured institutions.[69] This change is retroactively effective for all notices of intent to terminate filed on or after January 1, 1986.

Single-sum distributions.—Current law places a ceiling on the interest rate assumptions plans can use when making lump sum distributions by tying the ceiling to rate assumptions used by the PBGC. However, the law does not specify which mortality tables a plan should use. The Administration's bill would change both the interest rate and mortality table provisions for calculating a lump sum distribution.[70] The interest rate would equal the current rate on 30-year Treasury bonds. The mortality table would be the one specified in the Code to determine the reserves for group annuity contracts (currently GAM 83). This change generally would not take effect until plan years beginning in 2000. A plan could be amended, however, to use them earlier.

In addition, the bill would amend the assumptions plans must use in determining the maximum benefits under section 415 of the Code. Section 415 limits the annual benefit of any pension paid out from a qualified plan to the lesser of $90,000 (adjusted

[65]RPA § 303.
[66]RPA § 401.
[67]RPA § 402.
[68]RPA § 403.
[69]RPA § 404.
[70]RPA § 405.

annually for inflation) or 100 percent of the participant's annual compensation for his three highest years. This provision generally would apply to the calculation of benefits other than a life annuity. Current law requires plans to use an interest rate equal to the greater of 5 percent or the rate specified in the plan. The RPA would change this to read the greater of the rate on 30-year Treasury bonds or the rate specified in the plan. The bill also would require plans to use the standard mortality table discussed above. Plans would be allowed, but not required, to pay out the accrued benefit as of the last day before the 1995 plan year even though it is higher than the amount permitted under the changed rules.

Lien for missed minimum funding contributions.—Under present law the PBGC must wait 60 days before it can perfect a statutory lien against the assets of a plan sponsor that fails to make the minimum contribution required by law. The lien is available only if the missed payment exceeds $1 million, and then only for the excess over $1 million. The amended law would allow PBGC to perfect a lien immediately for the full amount of the missed payment.[71] This change would apply to all payments due after the date of enactment.

Rounding rules for COLAs.—The dollar limitations contained in ERISA are adjusted annually for cost of living increases. In order to reduce complexity and administrative expenses, the bill would round down the final adjusted COLA calculation so that increases would occur in certain minimum increments.[72] Because the final calculation is always rounded down, and never up, this provision would reduce significantly the amount of benefits retirees would receive. If administrative complexity and expense is truly the Administration's only concern, a much fairer change would be to round up or down to the nearest increment. It is unclear why the Administration would want to lower private pensions across the board even in fully funded plans except to raise revenue to pay for other portions of the bill.

The $90,000 limitation under Code section 415(b)(1)(A) on benefits paid and the $30,000 limit on annual additions under section 415(c)(1)(A) would rise only in $5,000 increments. The $7,000 limit on elective deferrals under section 402(g)(5) would be indexed in $500 increments. The $300 compensation minimum eligibility requirement under section 408(k)(8) would move in $50 increments. Finally, the $150,000 compensation limit under section 401(a)(17) would move in $10,000 increments. This change would be effective for plan years beginning after December 31, 1994.

Thus, if the normal COLA calculations for the indexed amount under 402(g)(5) was $9,148, the final limit would be rounded down to $9,000. Only when the cumulative COLA calculations caused the amount to rise above $9,500 would the final limit reach the next $500 increment. Indexing would be based on the quarter ending September 30, so that the following year's values could be determined before the plan year began.

Limitation on cross-testing in defined contribution plans.—Preferable tax treatment is available only to pension plans that do not discriminate in favor of "highly compensated employees."[73] The Code generally allows a plan to qualify by cross-testing, i.e., testing a defined contribution plan on the basis of its impact on actual benefits. Many employers used age-weighted profit-sharing plans in which the level of contribution varies with the age and seniority of the worker. These plans allow employers to reward employees who have been with the company for long periods of time. Because older employees have fewer years left in which to save for retirement, it is generally easier for age-weighted plans to qualify for tax-favored treatment by cross-testing. The Administration has concluded that the ability to cross-test has been abused to qualify plans which favor only top management. The RPA would eliminate this option and require defined contribution plans to test solely on the basis of actual contributions.[74] Employers would be allowed to test based on benefits only if a substantial portion of the employer-provided benefits came from one or more defined benefit plans.

This proposal has been one of the most controversial of the bill's provisions. Many companies have argued that it would handicap their ability to reward the loyalty and long service of employees who have been with the company for many years. Although the Administration at first resisted making any changes to this provision, it is now attempting to reach a compromise with employers over the issue. This provision is effective for plan years beginning after September 30, 1993, except that for defined contribution plans in existence before September 30, 1993, the effective date is for plan years beginning after January 1, 1995.

Funding of restored plans.—In certain cases, a plan that has been terminated may be restored, provided the employer agrees to funding provisions. The bill makes it clear that the new amendments

[71]RPA § 406.
[72]RPA § 407.
[73]Code § 401(a)(4).
[74]RPA § 408.

would not affect the payment schedules of existing restoration plans between employers and the PBGC.[75]

Conclusion

Some form of pension reform is likely to pass this year, and the main emphasis of the legislation will be on increasing the contributions that employers with underfunded defined benefits must make to their plans. However, the political pressure exerted by unions and employers with underfunded plans together with the need to pay for any lost tax revenue caused by higher pension contributions may mean that this reform, like the ones that preceded it, fails to stem—let alone reverse—the growth in underfunding.

According to the most likely schedule for congressional action, the House Ways and Means Committee is expected to approve a bill in mid-July. The House Education and Labor Committee would approve its own bill later that month, with a bill moving to the floor in late July or early August. Senate action is likely to take place in August and a conference on the proposed legislation would begin soon after. Final passage of a conference bill would probably not occur until after the Congress returns from its August recess.

Such reform as is passed this year may not address deeper problems associated with the changing nature of pensions in the U.S. economy. There are several signs that, like health reform in the early 1990s, broader issues of pension reform are about to resurface for serious policy discussion. These can be expected to include mandatory employer sponsorship, investment risk, fund management, fiduciary status and relationships, beneficiary eligibility and sharing, defined benefit plan portability, antidiscrimination, investment suitability and limitations, terminations, and integration with Social Security. Reform of the PBGC is likely to be just the first in a series of legislative proposals concerned with such matters over the next few years.

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[75]RPA § 409.