

Tracking the Academy's Investment in a Healthy Private Pension System

LAST YEAR, *CONTINGENCIES* published an article that detailed the impact of the Enron scandal on the world of retirement security. A falling stock market and the inability to diversify left employees with little money in their 401(k)s, forcing Congress to quickly consider ways to stop this trend from continuing and better protect employees. So the question is, where are we now? It's been more than a year, and while many of the issues raised last year are still being debated (diversification out of company

stock and availability of investment advice), the focus has seemingly shifted from 401(k)s to defined benefit (DB) plans. While legislative and press attention to DB plans is a plus, it's unfortunate that the focus has thus far been on the flaws (i.e., funding problems) as opposed to the benefits.

The Academy's Pension Practice Council (PPC) has designated as one of its key priorities the leveling of the playing field between DB and defined contribution (DC) plans—in essence, the revitalization of DB plans. So the past year has provided an excellent opportunity to pursue this goal. The focus of the majority of the PPC's work in this area has been on replacing the 30-year Treasury bond.

For many years, the 30-year Treasury bond rate was tied to the funding of DB plans, as well as the calculations of lump sums and premiums for Pension Benefit Guaranty Corp. (PBGC) purposes. When the U.S. Treasury announced it would cease selling the 30-year bond, pension experts leapt into high gear to lobby for a replacement rate. The need for a quick fix led to a temporary weighted average, based on the 30-year Treasury rate being used. The provision, contained in the Job Creation and Worker Assistance Act of 2002, will sunset at the end of this year, leaving employers to wonder what rate should be used as they prepare to fund future pension liabilities.

By the time you read this article, it's likely that the status of legislation related to this issue could have changed, so I hesitate to mention specific proposals. A discussion without referring to the "next generation" in pension reform legislation, however, would be incomplete.

On April 11, Reps. Rob Portman (R-Ohio) and Benjamin Cardin (D-Md.) unveiled omnibus legislation that

would require the replacement of the 30-year Treasury rate with a conservative corporate bond rate, the exact index to be determined by the Department of the Treasury. Pressure to replace the current discount rate and the introduction of the Portman/Cardin legislation have provided a catalyst to consideration

of pension legislation.

In visits with congressional staff, however, the consistent message seemed to be that the temporary solution (i.e., 120 percent of the weighted average) would most likely be extended so that another period of debate on the best replacement could be pursued. The debate will likely contain much discussion on the yield curve concept reportedly being considered by the administration, specifically the PBGC.

The PPC has testified before congressional committees twice in the past year on DB-related issues such as the 30-year rate. A white paper, released in July 2002, detailed three potential alternatives, including a high-quality corporate bond index. As an objective party, in addition to opportunities to testify, we have received numerous requests for education on the funding issues DB plans are currently facing. In fact, we were encouraged by contacts on Capitol Hill to hold a briefing in June on the subject of funding to provide more education for those involved in the current debate.

Aside from the issue of the discount rate, funding limits are becoming a more significant issue for Congress—one that staffers want to understand. Over the past few months, we've seen more and more companies, even entire industries, announce that their pension plans are severely underfunded, affecting their overall financial security. Is this because the discount rate for liabilities is inordinately low? Or is this because contributions aren't deductible and are subject to an excise tax once a company has reached its full funding limit, thereby resulting in the inability to put more money aside for the pension plan when economic times are good? Would companies have even increased funding if allowed? These are just a couple of the questions policy-makers are facing as they examine the effect of underfunded plans on companies.

Earlier this year, the PBGC announced that given the occurrence of a "perfect storm"—low interest rates, fal-



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A Tale of Two People

The following is a short tale of two people, both nearing retirement and both facing a less secure future because of the recent economic downturn and the lack of a guaranteed retirement benefit.

The first, a woman, has worked for a mid-size insurance company for the past 32 years. Under her company's 401(k) plan, she'd managed to build a comfortable nest egg and was looking forward to early retirement, after which she would move up north to take care of her future grandchildren.

Unfortunately, despite her own efforts at diversification, she lost a substantial amount as the stock market fell and her company's stock (in which the matching funds were invested) faltered. Now, she no longer expects an early retirement and instead anxiously anticipates the company's gift for 50 years of service.

The second, a man, spent more than 30 years in the telecommunications industry, the past several working for a "little" company called WorldCom. Most of you know the story from here, as the company's difficulties were printed in every national newspaper.

He also had a 401(k), in which 100 percent of the company's match was

invested in its own stock. Not only did he lose a significant fortune; he was one of many laid off last year as the company hit rock bottom. Close to retirement, he was forced to join the many other unemployed to look for a job that would provide some security for his remaining years in the workforce.

After months of searching, he took a position with the federal government that paid less than his previous employer but provided a much more secure situation. (As we all know, the government has great retirement benefits, including a defined benefit plan.)

Despite the fact that these are my parents, until I took this position, I'd never really taken an interest in their plans for retirement. Now, it's a frequent topic of conversation. Despite the additional years both will have to spend in the workforce, they have each taken steps to better prepare for their future financial security.

One lesson that can be learned from their experience, and the experiences of many others in similar or worse circumstances, is that while a 401(k) provides an opportunity to accumulate additional funds for retirement, nothing beats the security provided by a defined benefit plan.

tering stock market, and a number of large bankruptcies—the organization that guarantees DB plans would be facing a substantial deficit. While the PBGC is not in a state of immediate crisis, lawmakers are being forced to examine the long-term status of the PBGC while at the same time keep the traditional pension system afloat.

The PPC has been active in examining minimum and maximum funding limitations. In addition to the testimony previously mentioned, the Pension Committee has drafted a white paper addressing maximum funding rules. The paper provides alternative means to loosen restric-

tions so employers have the ability to prepare for the down cycles when economic times are better.

In light of the funding problems faced by DB plans, another issue has managed to capture the attention of several vocal congressmen, as well as employers and employees across the nation: cash balance plans. While some run screaming at the very mention of this somewhat controversial issue, it's an area in which the Academy has much to offer.

Hybrid plans will very likely be the new generation of pension plans to provide security for an increasingly mobile

workforce. They offer employers more design and funding flexibility than DC plans, while providing more portability and less administrative complexity than traditional DB plans. And they generally promise employees an account balance that won't decrease.

There's great controversy, however, over the alleged age-discriminatory nature of this type of plan. While this is by no means a new issue, the release of proposed regulations by the Internal Revenue Service (IRS) in December of last year has increased public attention. By issuing the proposed regulations, which stated that the plans were not inherently age-discriminatory, the Treasury/IRS broke a lengthy moratorium on the issue and received a mix of criticism and praise.

Legislation was introduced earlier this year to mandate that when companies convert to cash balance plans, they provide employees with the option to remain in the traditional plan. Ironically, many congressional staffers that deal with this issue understand that choice doesn't always produce a positive result. When it comes to the pension system, choice for a company can mean the difference between providing a plan and providing no plan at all.

While this particular legislation is unlikely to pass, it's only the first in a promised string of legislation that could make retirement rules even less level, and discourage employers from providing DB plans at all. The PPC provided comments on the proposed regulations, but during those recent meetings with congressional staff, the Academy was encouraged to be even more vocal by conducting educational sessions for Hill staff explaining the benefits of cash balance plans.

As debates heat up and information is needed, the PPC will continue to provide objective analysis and education to congressional members and staff, regulatory agencies, the press, and the public on all aspects related to the creation and maintenance of retirement security. ●