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Commentary

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Rethinking Laws and Regulations for Defined Benefit Pension Plans

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There is no more efficient way to deliver appropriate levels of retirement income to employees than through a defined benefit (DB) plan. Defined contribution (DC) plans, producing unpredictable amounts of retirement income, simply do not measure up in this regard. The U.S. pension system should encourage DB and DC plans to work together. Current rules and regulations are, however, ruining DB plans. ERISA failed to protect the role of DB plans because it fixed too many things that were not broken. We still have situations like Studebaker (ERISA's raison d'être). We have more plan terminations and lost benefits. There are virtually no new plans and we are experiencing a dramatic shrinkage of the private pension system. There is an urgent need for strategic rethinking about the future viability of DB plans.

A number of things went wrong following ERISA. The rules became absurdly complex. The funding requirements have turned long-term pension commitments into very short-term financial obligations with horrendous consequences, e.g., forced corporate bankruptcies, lost jobs, shattered retirement promises. Our system of plan termination insurance is bizarre. PBGC variable premiums are unreasonable in amount and unfair in application. Only 1% of covered plans represent 80% of the PBGC exposure. A shrinking number of healthy plans support a relatively small number of plans that are "catastrophic cases." Plan termination insurance has become a self-fulfilling prophecy. Last but not least, financial accounting rules generate illogical results, such as writing off large pension assets because of short-term market fluctuations and producing tremendous volatility in corporate earnings on a year-to-year basis.

What can be done? We must take a holistic view–no more band-aid solutions. All parties (employers, employees, government agencies, unions, regulators, and practitioners) must be willing to compromise. Some things assumed "sacred" must be rethought and changed. It will take an Act of Congress, such as my proposals for correcting the current problems through The Defined Benefit Retirement Income Security Act of 2004 (DBRISA). This proposed Act would directly implement reforms to plan governance, funding, accounting, and the role of the PBGC.

A board of Plan Trustees would be responsible for plan governance–like the U.K. and the public sector. The Trustees would replace the plan administrative committee. Membership would be a balance of employer, employee, and outside representatives. The Plan Trustees would employ the actuary, and adequate funding would be the actuary's primary role. The employer would use its own actuary for corporate purposes. The plan actuary would not be allowed to recognize any equity risk premium in the investment return assumption. In return, the employer would be able to take an asset reversion at any time without a plan termination, provided that the plan assets exceed plan liabilities by a specified margin. Unless the plan document specifically stated otherwise, excess plan assets belong to the employer. Asset reversion taxes would be eliminated. With regard to minimum funding, there would be no deficit reduction contribution and no funding standard account. The IRS could grant funding waivers. Details of the new funding rules are also part of my solution.

We'd fix our plan termination insurance system and in the process cure the employer funding problems. The PBGC trust funds would be turned over to the U.S. Treasury. Since the unfunded pension obligations in the private sector are trivial compared to the federal budget (and small compared to military and federal civilian unfunded pension liabilities), benefits could be guaranteed by the full faith and credit of the U.S. Government. There would be no PBGC premiums. New funding requirements will permit increased benefits granted by the employer only when there is a high probability that the plan sponsor can afford them in the long run. Short-term economic and market fluctuations will not result in "Chicken Little" reactions in the form of the harsh new funding requirements we've seen in recent legislation. The current PBGC would continue to administer the plan termination insurance program. Administration would be the PBGC's only role and the agency's name would be changed accordingly.

Specific transition provisions for existing plans are part of my proposals. There are several key self-regulating features including conservative (but not harsh) funding rules, an independent Board of Trustees, an actuary independent of the corporation, no income tax gaming with regard to asset reversions and no confiscatory excise taxes. The SEC would also be required to rethink accounting rules. The annual accounting charge would be tied to the minimum and maximum IRS contribution and there would no longer be any "additional minimum liability" and the unnecessary problems it creates.

It's time to stop killing DB plans and to begin nurturing them. A revitalized defined benefit pension system is in the best interests of all parties, particularly future generations of retirees.