Spring 2004

Pension Funding Equity Act of 2004

Congress finally has responded—well, sort of, anyway—to the appeals of financially strained pension sponsors, in the recent enactment of the Pension Funding Equity Act of 2004. The new law offers relief to some plans, and, empty symbolism to others. But all single- and multi-employer pension sponsors need to review basic provisions of the new statute to determine whether it contains any "Funding Equity" for them.

Key provisions of the law include the following:

Single Employer Measures:

- Temporary interest relief for another 2 years
- Alternate deficit reduction contribution for ailing industries
- Ability to transfer assets to retiree health accounts extended to 2013
- Greyhound Bus is exempt from deficit reduction contribution for 2 years

Multiemployer Measures:

- New, mandatory annual notice to plan participants
- Option to defer part of 2002 experience loss amortization for 2 years
- Withdrawal liability assessments for old avoidance actions

General:

- Congress signals its intent to provide permanent reforms

CHEIRON's Comments:

This bill provides significant, but very temporary minimum funding relief for single employers, and provides additional special relief for specific industries and certain specific entities.

For multiemployer plans the bill provides relief only for those that qualify under requirements that professionals believe will limit their application to a small fraction of plans. Even for those plans, it is hardly a relief measure. In fact, it will require more burdensome payments later, and require all plans to annually provide potentially very alarming funding notices to all plan participants.

Relief for Single Employers

1. Applicable to all single employers.

Currently, whenever the funded status of a single employer pension plan is below 90% of the Current Liability, special additional funding requirements are triggered. The measurement of this "Current Liability" was historically based on 30-year Treasury bond yields which have steadily decreased over recent history, leading to an increase in the value of Current Liability for all plans. In addition, the 30-year Treasury bond is no longer issued. At the same time, the 2000-2002 bear market has led to steep declines in equity values. The combination of increasing Current Liability and declining assets means that many plan sponsors are facing sharp increases in contributions.

The relief now enacted substitutes the yields on high quality corporate bond indices for the 30-year Treasury yield. This is expected to produce higher interest rates and correspondingly lower liabilities and lower minimum funding requirements.

This law also increases the interest rate used to compute the PBGC variable premium in the same way, and so it is expected to reduce those premiums. The new interest rate is only in effect for 2 years, meaning that it is one area Congress is sure to revisit.

2. Applicable to specific industries or entities:

The airline and steel industries and one tax exempt organization have successfully lobbied hard for additional relief which is exclusive to these organizations.

The additional minimum funding requirements that are payable when the plan is less than 90% funded on a Current Liability basis are further reduced for these plans. Instead of the full additional minimum contribution, they only need pay the greater of 20% of the normal amount and the anticipated increase in the Current Liability due to accrual of benefits.

Plans electing this deferral cannot increase benefits during the deferral period unless there is also an amendment providing increased contributions sufficient to cover the increase in funding charges due to the benefit increase, or unless the amendment is required by a collective bargaining agreement which was already in effect by the enactment date of the relief.

In addition, a written notice must be sent to all participants and beneficiaries showing the due date of the alternative contribution, the amount by which it is reduced, and with a full description of the benefits eligible for PBGC guarantees, including any limitations.

Finally a written notice must be sent to the PBGC indicating the number of years it will take the plan to restore full funding, with the reduced contributions, and how the under funding of the plan compares with the capitalization of the company.

3. Applicable to one plan
There is a special exemption for any additional contributions for one company that the law states which is "engaged primarily in interurban or interstate passenger bus service" (i.e., appears targeted at Greyhound).

"Relief" for Multiemployers:
1. Applicable to all Multiemployer plans
Starting in 2005, the act requires that multiemployer plans provide an annual notice to their participants, labor organizations, employers, and the PBGC. The key information that the notice is required to cover includes:

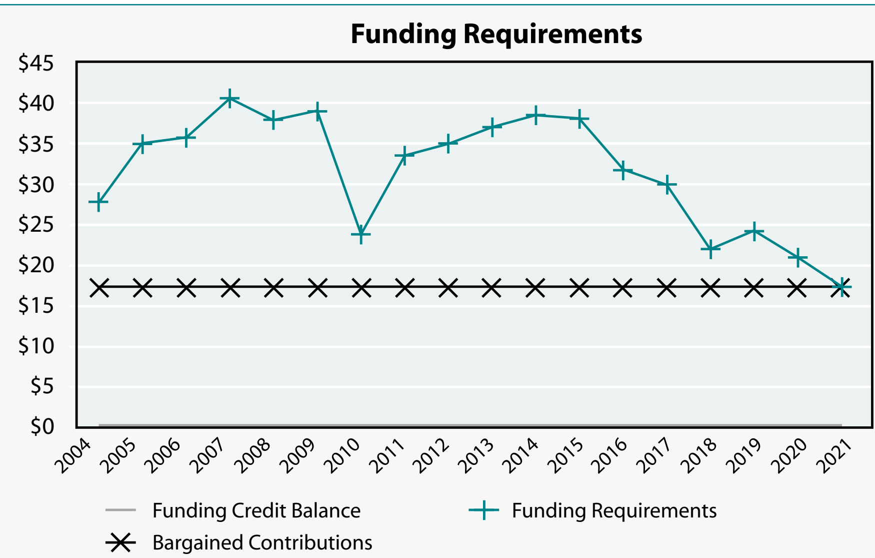
- The plan's funded current liability percentage if it's not at least 100%
- The value of the plan assets, annual benefit payments, and the ratio of assets to benefit payments
- A summary of the government rules for insolvent multiemployer plans
- A description of the benefits PBGC guarantees

The funded current liability percentage to be disclosed is likely to be, for all plans, lower (worse) than the funded percentage the actuary normally includes in the valuation, which is usually based on the assumed rate of return, not the current liability interest rate. Before this legislation, current liability has not been of much concern to the multiemployer pension plan. Going forward, this funding notice requirement is going to focus attention on current liability. Many multiemployer plans already have a funded ratio of less than 100% when measured on the assumed rate of return. Lowering that interest rate for this measurement will make these funds appear that much worse funded, and the average plan participant is likely to be highly concerned.

2. Applicable for "qualifying" Multiemployer Plans
The act provides multiemployer plans very limited relief for certain experience losses. The strict eligibility requirements are:

1. Plan must have experienced a 10% investment loss in the first plan year starting after 2001.
2. Plan projections must show that there will be a minimum funding deficiency in at least one plan year after 6/30/2003 but before 7/1/2006.
3. No employer can have failed to pay its contribution to the plan in a timely fashion nor had an excise tax imposed.
4. The average contribution rate actually paid each year since 6/30/1993 must be greater than 10 cents. (This means many plans with contribution holidays in the past may not be eligible.)
5. No funding waivers or 412(e) extensions can have been made since 6/30/1993.
6. Plans electing this deferral must send a written notice to all participants, labor unions, employers, and the PBGC that includes:
   - The amount of any minimum funding charge deferred, and the period of deferral, and
   - The maximum guaranteed monthly benefit payable by the PBGC if the plan terminated while under funded.
7. Plans electing cannot increase benefits during the deferral unless there is a contribution increase than covers the cost.

This chart shows a plan with no existing minimum funding credit balance by the end of 2004. In order to avoid a deficiency, the contributions to this plan would have to increase by 65% in 2004.



Amount of Relief

If eligible and elected, the relief defers for up to two years, the plan's recognition of up to 80% of the experience losses arising from the 2002 plan year. The charges can be deferred for only the two plan years beginning after June 30, 2003.

So, for example, the amortization payment of a calendar year 2002 loss, (first measured in the valuation at January 1, 2003) must still be paid in 2003, but then 80% of that charge may be deferred for 2004 and 2005 plan years. Then, the deferral for the 2004 has to be paid by 2006, and the 2005 deferral in 2007. However, during 2004 and 2005, the plan must pay interest on the amounts deferred.

Our analysis shows that not many plans will be able to avail themselves of the relief either because they are not expected to have a deficiency in the funding standard account within the time frame or because the asset loss in the 2002 plan year is not greater than 10%.

To the extent that plans do meet the qualification thresholds, our analysis further shows that the "relief" being granted is not substantial. (Please see the example shown in the charts.)

Other Miscellaneous Provisions:

Retiree Health:

The law has provisions postponing to 2013, a 2005 "sunset" provision to allow well funded single employer pension plans to transfer assets from the pension plans to fund retiree health program costs.

Withdrawal Liability:

Under the existing law the plan's assessment of withdrawal liability is presumed to be correct. An employer who wishes to contest a withdrawal liability assessment has the burden of proof to show that the assessment is incorrect.

The new law changes the existing law's burden of proof for a withdrawal liability assessment for what appears to be a targeted situation.

Lump sum calculations:

In testing lump sum cash outs against the IRS maximum limits, plans may use 5.5% in lieu of 5% interest during calendar years 2004 and 2005.

Congress to review pension funding laws:

With the exception of the transfers to retiree health plans all the funding relief measures in the Pension Funding Equity Act are temporary. Congress realizes that a permanent replacement for the discount rate is required and that comprehensive reforms are needed to achieve "accurate and sound pension plan funding to enhance retirement security for workers who rely on defined benefit pension plans".

The Pension Funding Equity Act of 2004 also covered some items that are not related to pension funds. These items have not been addressed in this bulletin.

To learn more about how the Pension Funding Equity Act of 2004 may impact your pension fund and what steps you should consider taking, please contact your Cheiron consultant today. See www.cheiron.us for more details.

Cheiron is a full-service actuarial consulting firm assisting corporations, public employers and Taft-Hartley plans manage their benefit plans proactively to achieve strategic objectives and safeguard the interests of plan participants and beneficiaries.

With the pension reform option to defer 80% of the 2003 loss base for two years the plan just makes it through 2004, showing a small credit balance by year end. The trade-off for eking out one more year of funding comes in the years 2006 and 2007 where the funding requirement is substantially higher than it would have been without the delay.