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Highway Bill's Pension Language Makes Taxpayer Bailout of PBGC More Likely

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Serious pension funding issues have no place being hidden in a transportation funding bill. This is especially true if the pension language could cause an even greater taxpayer bailout of the Pension Benefit Guaranty Corporation (PBGC).

Shifting Private Pension Costs to Taxpayers

Taxpayers are already likely to have to send $23 billion to the PBGC, and the Senate's Highway Investment, Job Creation, and Economic Growth Act of 2012 (S. 1813), which reauthorizes transportation programs for the next two years, would almost certainly increase that amount significantly.

The PBGC insures corporate defined-benefit ("traditional") pensions and must make payments to retirees (up to a limit) if those plans are underfunded and the sponsoring company files for bankruptcy. A small provision hidden in S. 1813 would enable companies to contribute less money to their defined-benefit pension plans. This would increase the chance that the PBGC would have to take over many of these plans and would endanger the retirement security of their present and future retirees.

One reason that the provision was added to the Senate transportation bill is that the reduced pension contributions, which are tax deductible, would increase corporate profits so much that it would increase federal corporate tax collections by about $7 billion. That money would help offset the cost of the bill, but such a significant reduction in pension contributions should send a strong warning. If contributions to defined-benefit pension plans fall that much while pension benefit promises continue to be stable or to grow, someone else may end up paying the difference. And that someone else is almost certain to be the taxpayers.

It is irresponsible for corporations to make promises to their employees, fail to fund those promises adequately, and then expect taxpayers to make up the difference when the PBGC runs out of money. Although the PBGC has not required tax dollars so far, those days are ending, and the Senate language will only increase the amount that taxpayers will have to pay. Corporations are free to make whatever promises they wish to their employees—but only if they pay the full cost of those promises. The Senate provision is bad pension policy because it encourages companies to manage their plans poorly. It is even worse to do so just to raise federal tax revenues that would go to pay for more spending for completely unrelated purposes.

Senate Pension Language Reduces Corporate Pension Costs

The language that the Senate tucked into its version of the transportation bill would allow corporations that still sponsor traditional pension plans to contribute less money to those plans. It does this by changing the interest rate that corporations must use to calculate how much they must contribute each year.

The required interest rate is designed to estimate the investment earnings that the pension fund could expect to earn and thus to inform sponsoring corporations of the cash contribution needed to keep the pension plan adequately funded.

This paper, in its entirety, can be found at **http://report.heritage.org/ib3560**

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The higher the interest rate corporations can use, the lower the cash contribution they need to make. The Senate language does not affect private retirement savings plans such as 401(k)s or any retirement plans offered by state or local governments.

The transportation bill language changes the interest rate from the current two-year average of the interest rate paid on AA-rated corporate bonds to a rate that is within 10 percent of the 25-year average interest rate for those corporate bonds. This year, the difference between the two measures would be about 1 percentage point, which would reduce the amount of cash that sponsoring corporations must contribute to their plan by between 10 percent and 15 percent. For all companies that sponsor a defined-benefit pension plan, this could be a significant saving. Over time, the difference between the two measures would shrink, but the damage would already have been done.

Since interest rates are very low at the moment and the Federal Reserve says it plans to keep them low until 2014, companies believe that using the current interest rate measure causes them to have to pay more to their pension plans than they should. There is some justice to this claim, but the lower contributions would also make it more likely that the pension plans of troubled companies would end up with much higher underfunding levels.

Citing previous efforts to ease pension funding rules, Fitch, the credit rating agency, notes that, "For example, Goodyear took advantage of the liberalized funding rules between 2008 and 2011. Pension funding fell from $700 million in 2007 to $250 million in 2011, while the deficit doubled from $1.5 billion in 2007 to $3.0 billion in 2011."[1] Fitch's conclusion about the Senate pension language:

> While we agree that a smoothing of funding rules for better-funded plan sponsors could lead to greater cash flow stability, we believe the proposed change could raise the risk that companies with large pension deficits could dig larger holes by using loosened assumptions to delay necessary funding.

Unfortunately, the additional changes proposed in the Senate transportation bill would apply to all companies, regardless of how well they have funded their pension plans. Thus, if the looser pension funding rules go into effect, all defined-benefit pensions are likely to be less funded than they would be under the current rules. And as Fitch points out, just like Goodyear's experience between 2008 and 2011, poorly funded pension plans would end up even more underfunded. This, in turn, would require even greater contributions to the pension plan in the future—or, more likely, the company would end up in bankruptcy and try to pass that underfunding to the PBGC.

The Effects of Corporate Bankruptcy on the PBGC

In the event of a corporate bankruptcy, distressed companies often seek to pass the responsibility for pension promises to the PBGC. If they are successful, the PBGC receives all of the assets in the corporate pension plan and is required to make payments to individual retirees—up to a cap that limits the amount that can go to an individual. The PBGC pays qualifying retirees monthly benefits up to a set maximum amount, which can vary depending on the age of the retiree at the time of the bankruptcy and the amount promised. Any benefits that the individual retiree was promised above the PBGC cap are lost.

Most recently, AMR Corporation, which owns American Airlines, attempted to send its four defined-benefit pension plans to the PBGC as part of its Chapter 11 bankruptcy. The PBGC managed to persuade the bankruptcy court to reject the attempt. AMR's plans owed about $18.5 billion in future and current retirement benefits but had only $8.3 billion in assets to pay for them.[2] If AMR had succeeded, about $9 billion of its $10.2 billion underfunding would have been added to PBGC's deficit, while AMR's employees

1. News release, "Pension Funding Relief May Again Prove Counterproductive," Fitch Wire, March 8, 2012, at http://www.fitchratings.com/web/en/dynamic/articles/Pension-Funding-Relief-May-Again-Prove-Counterproductive.jsp (accessed April 4, 2012). Funding levels for defined-benefit pension plans measure current pension plan assets plus both future contributions from the employer and investment earnings on the total amount in the fund against the estimated amount of benefit payments. If the employer makes a smaller contribution to the pension fund, that also reduces the expected investment earnings, because a smaller amount is invested. Neither employer contributions nor investment earnings affect the estimated amount of benefits that would go to retirees; they merely reduce the amount of money that will be available to pay them.
2. Hazel Bradford, "PBGC Worthy Opponent in AMR Bankruptcy Fight," *Pensions and Investments*, February 6, 2012, at http://www.pionline.com/article/20120206/PRINTSUB/302069984 (accessed April 4, 2012).

would have seen their pensions reduced by a total of about $1 billion.

Senate Transportation Pension Language Increases Taxpayer Risks

Pension funding issues are extremely complex and technical. Even seemingly small changes can have a great effect on the health of a pension plan and the potential cost to taxpayers. Prior to 2006, pension funding requirements were so loose that many corporate pension plans were extremely underfunded. This led to the 2006 Pension Protection Act, which was designed to protect taxpayers and retirees from the consequences of underfunded plans. The pension language in the Senate transportation bill is part of a continued effort by employers to roll back the stricter 2006 funding requirements.

For decades, legislators have been hiding significant legislative changes in unrelated legislation. However, major pension funding reforms should be considered on their own merits as independent legislation and not as a rider attached to unrelated legislation. Legislators may be attracted by the $7 billion in revenue the pension language could raise, but the ultimate cost to corporations with defined-benefit pension plans, to their current and future retirees, and to taxpayers may end up being significantly higher.

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