Legislation Weakens Pension Protections

Bill Designed to Bolster Underfunded Plans Creates New Ways for Employers to Cut Benefits

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Pending federal legislation aimed at pushing companies to shore up underfunded pension plans also eliminates some longstanding retirement protections and gives employers new powers to reduce some workers' pensions.

Both the House and Senate have passed versions of the legislation, and within the next month lawmakers are expected to begin the work of reconciling the two. No one knows for sure how the final bill will look, but congressional leaders have said they hope to send it to President Bush by early March.

For the most part, lawmakers and lobbyists have focused publicly on how the legislation, under debate for more than two years, is intended to toughen employer obligations to contribute money to pension plans. Among other things, it requires employers with underfunded plans to pay higher premiums to the Pension Benefit Guaranty Corp., a government-run insurer of private pension plans.

But several little-noticed provisions appear to let employers bolster their pension plans at the expense of employees. For example, measures in both the House and Senate versions would force employers whose plans become under funded to freeze pensions and, in the House version, even revoke benefits in some situations. Other measures would allow employers to significantly reduce the size of pensions they pay to many departing and retiring workers. Companies also would gain greater ability to transfer more money from pension funds to pay for other retiree benefits.

One of the most far-reaching changes in both the House and Senate versions would reduce the payment workers receive from their pension plans when they take single, lump-sum payments in lieu of monthly distributions. The payment reduction would result from changing the interest rate used to calculate the size of lump-sum distributions.

Here's why: Pensions are usually calculated as a monthly payment for life after retirement, but plans often allow retirees to take a one-time lump-sum payment instead. Currently, the promised stream of payments is converted to a lump sum using an interest rate set by law, matching the interest rate for the 30-year Treasury bond. The legislation would change that and tie the payments to an unspecified mix of corporate bonds -- which usually carry higher yields -- tailored to the age of a company's work force. Consequently, it would generally reduce what many retirees take with them. The change would be phased in over several years.

Employers say that current low interest rates give workers taking a lump sum -- as many do -- a "windfall," which also saps funds that are needed to pay other workers' pensions. Retiree advocates note that employers don't complain when high interest rates lower lump-sum values.

This has happened before. In 1994, employers got Congress to let them replace a low discount rate they were required to use with the 30-year Treasury rate, which was then higher.

The move slashed billions of dollars from the pensions paid out to people who took lump-sum payouts following the change.

A spokesman for the American Benefits Council, which represents employers, declined to comment on the pending legislation.

The legislation was sparked by rising concerns about the eroding health of so-called defined-benefit pension plans, which promise workers retirement benefits based on their pay and years on the job. Though robust through the 1990s, many pension plans became underfunded in recent years after declining interest rates boosted their liabilities and several years of poor stock market returns reduced their assets. Nationally, pension plans are underfunded, meaning they don't have enough money to pay all the projected benefits of the participants, by an estimated $450 billion.

Though much of this underfunding could disappear as rates rise and the stock market continues its recovery, lawmakers and the PBGC are concerned by the number of large companies that have abandoned their plans in recent years. Among them have been big airlines, including US Airways Group Inc. and UAL Corp., and steel companies, such as Bethlehem Steel.

The proposed legislation would pertain to the roughly 22 million workers participating in private-sector defined-benefit pension plans, representing one out of every five private-sector workers. (An additional 22 million retirees, and former employees who are entitled to a pension later, would be largely unaffected by the proposed legislation.)

Among the most significant legal changes in the proposed legislation are rules in the House version that would allow poorly funded plans to take away certain pension benefits that older employees have already earned. This would reduce the plan's payment obligations, and thus render it better funded.

Specifically, such plans could eliminate early-retirement incentives, a core feature of many pensions that provides a subsidy to people who retire between 55 and 65, and can boost the total pension payout by 20% or more. The change would apply to so-called multiemployer plans, which are generally plans for workers at different companies represented by the same union and cover about 25% of the private work force with pension plans.

The change, if adopted, would reverse a key protection under federal pension law, which forbids employers from rescinding a benefit that has already been earned. But pension advocates worry that modifying a core protection in the law would establish a dangerous precedent that would soon be extended to the majority of pensions, so-called single-employer plans.

Advocates of the changes say smaller employers could be forced into bankruptcy without the provisions, because they couldn't afford to contribute enough to the plans to make up for funding deficiencies, says Randy DeFrehn, executive director of the National Coordinating Committee for Multiemployer Plans, a trade group for the pension plans. He adds that any benefit cuts would have to be approved by parties to the union contracts.

The bills from both houses would also automatically freeze pensions that drop below 60% funded, meaning all employees would immediately stop building up new benefits under such

plans. In itself, the freeze would improve pension funding levels because, while it wouldn't increase assets, it would reduce the pension's future obligations, or at the very least keep them from rising further. But critics of the measures say the provisions reward employers that allow their plan to become underfunded, because the law would require the pensions to be frozen even if the benefits were subject to a union contract.

The legislation would also make it easier for companies to transfer funds from well-funded pension plans to use for other retiree benefits. Currently, when pension plans are sufficiently overfunded, employers are allowed to withdraw surplus assets to pay retiree medical benefits, a move that enables companies to preserve cash flow. Employers that make such transfers are obligated to preserve those medical benefits at a certain level for at least five years.

Under the Senate version of the pending legislation, companies would be allowed to make such transfers when the threshold of overfunding in their pension plans reaches 115%. Currently, this funding threshold minimum is 125%.

After some companies did this in the late 1990s, it left their plans with smaller cushions to protect against investment losses just a few years later, and retiree advocates worry that easing the restrictions could weaken now-flush plans if investment returns worsen again.

But Prudential Financial Inc., which lobbied for the change, said it toughens the law because it would also require employers to ensure their pensions remained funded at 115% for five years after the transfer. Currently, funding in the pension can fall below that level once the transfer is made.