

## **BUSH ADMINISTRATION PROPOSAL EXPECTED TO RADICALLY CHANGE PENSION FUNDING**

*Recently, the Bush Administration has circulated the highlights of a proposal to overhaul the funding rules for single employer defined benefit plans. On February 7, as part of its 2005/2006 budget submission to Congress, the Bush Administration is expected to formally present the proposal with many of the details not previously disclosed. The stated goals of the proposal are to protect workers and avoid the need for a taxpayer bailout of the PBGC.*

*If this proposal – or anything that resembles it – becomes law, the funding requirements for many employers would change radically.*

### **OVERVIEW**

In response to concerns about the financial condition of many defined benefit plans and the PBGC, early in 2004, Congress indicated that comprehensive funding reform was needed –

- to enhance employees' retirement security
- to make contributions less volatile and more predictable
- to improve disclosure to employees covered by underfunded plans.

The Bush Administration's funding proposal intends to be a response to that "sense of Congress."

### **HIGHLIGHTS**

The proposal is intended to –

- enhance employee security by –
  - better targeting the companies that are more likely to have problems satisfying their benefit obligations ("at risk" companies) and raising their funding requirements
  - prohibiting certain poorly funded plans from making plan improvements, paying lump sums, or granting additional benefit accruals until conditions improve
  - improving the financial viability of the PBGC by increasing the PBGC flat-rate premium to \$30 and applying a higher variable premium rate (to be set by the PBGC) to a new unfunded liability measure that will be higher for at risk companies

- make contributions less volatile and more predictable by –
  - simplifying the rules for minimum funding and maximum tax-deductible contributions
  - increasing the spread between minimum and maximum contributions, thereby allowing companies to contribute more when they can afford to
- expand employee disclosure and government reporting requirements.

## MAJOR THEMES

The Administration's proposal is expected to simplify the current funding rules in many respects. We anticipate it will –

- create a new solvency standard through a focus on a plan's current financial status
- impose various restrictions on benefits in plans that are significantly underfunded
- eliminate "credit balances"
- liberalize the maximum tax-deduction rules
- eliminate asset smoothing (by requiring the use of current market values)
- change the discount rate used for current liabilities by –
  - using current interest rates rather than a historical 4-year average
  - using a "yield curve" to discount future benefits rather than a single rate as is currently required
- divide plan sponsors into two risk categories, with each risk category having differing funding requirements.

An upcoming issue of *For Your Information* will provide further analysis and a more detailed history of funding requirements and the forces underlying the proposed changes as soon as the proposal is officially released.

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