Improving Pension Funding: What's in It for Me?

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1. Introduction

For the private pension system in the United States to be successful, it must satisfy the WIFMs of the three primary stakeholders involved: plan sponsors, taxpayers (represented by the government), and the American workers who are the ultimate beneficiaries of the system.

For those who are not familiar with the acronym WIFM, it stands for "What's in It for Me?" A good salesperson always knows his or her client's WIFM before attempting to close a sale. You can have the best product or service in the world, but if your client doesn't believe it will address his or her WIFM, you are not going to get the sale. A WIFM is what each of us expects to get in exchange for our time, our efforts, and our money.

This paper will explore the WIFMs of each of the three primary stakeholders with regard to pension funding and funding reform. It is not our intention to evaluate the WIFMs. They are what they are. The intent of this paper is to provide an important guidepost for the consideration of new pension funding reform ideas and concepts.

A private pension system that does not meet the fundamental WIFMs of

- The plan sponsors who finance the system
- The taxpayers who bear a portion of the financial burden through tax incentives or
- The workers who are seeking financial security

will surely fail. No matter how actuarially sound, no matter how logical or compelling an argument can be made for a pension funding reform idea, it will not work if it does not support the WIFMs of the parties involved.

2. Summary of Findings

For the American worker, the intended beneficiary of the private pension system, there is only one meaningful WIFM: the security of the benefit promise. The American worker wants to know that his or her pension benefit will be there when the day of retirement finally arrives.

For taxpayers, their fundamental WIFMs fall into two categories:

- Support for the WIFM of the American worker, that is, enhancement of the security of the benefit promise and
- Prevention of the transfer of funding risk from employers to taxpayers.

The first of these WIFMs is not new. It was around before enactment of the Employee Retirement Income Security Act of 1974 (ERISA) and was materially strengthened by ERISA. The second WIFM is an outgrowth of the funding crisis facing the Pension Benefit Guaranty Corporation (PBGC). The PBGC's recent acceptance of $5 billion of insured benefit liability from United Airlines and the concern that other airlines may follow have made this a headline issue.

Fundamental plan sponsor WIFMs are focused on the cost of a plan and the annual contributions needed to satisfy that cost. They include the following:

- *Predictability*—Knowing in advance with some degree of assurance what the financial and cash expense of a plan will be
- *Funding flexibility*—The ability to prefund pension obligations, and the ability to contribute more when financial conditions permit
- *Cost control*—As is true for any cost, business is not interested in paying any more for its obligation than is necessary.

This paper will present and discuss these and other WIFMs that came to light as a result of our research and analysis.

3. The Basis for Our Findings

All of the findings reported in this paper are based on information obtained from industry and association position papers, government sources, transcripts of testimony given before governmental bodies, and a survey we conducted. None of the findings rely solely on the opinion of the authors. We are reporting what we learned, neither justifying nor refuting any findings.

A complete bibliography of the information considered is attached. Facts, data, and significant statements of position are footnoted.

4. Pension Funding Reforms Created by ERISA

In the early 1970s it became apparent that the American private pension system was failing. Plans like Studebaker's were terminating without adequate funding to pay promised benefits. Career employees who had been counting on the company's promise of a steady monthly check when they retired were left, instead, with little or nothing (in some cases literally nothing) to retire on.

In the case of Studebaker, about 3,600 workers and retirees aged 60 and older or who were vested with at least 10 years of service received their promised benefits. Another 4,000 or so workers aged 40 or older received benefits of about 15 cents on the dollar. The remaining 2,900 workers under age 40 received nothing.[1]

The Employee Retirement Income Security Act of 1974 was enacted to fix the problems exemplified by Studebaker. ERISA mandated that covered defined benefit pension plans meet certain minimum funding standards.[2] It prescribed that covered plans secure a statement from an enrolled actuary that the plan has met its minimum funding obligation. Failure to meet minimum funding standards could result in an annual excise tax of as much as 100 percent of the deficiency.

ERISA also created the Pension Benefit Guaranty Corporation to insure pension benefits subject to certain limits.[3] The PBGC was created in direct response to the many underfunded plans that terminated without adequate funds to pay already accrued benefits, often at the same time the employer went under. No longer would American workers who spent their careers working toward a promised pension find themselves with little or nothing when they reached retirement.

ERISA worked. It met the needs of the American worker by providing greater assurance a plan would be adequately funded. Through the PBGC, it created an additional layer of funding security. There was now a government-sponsored insurance pool of funds available to protect the benefits of workers and retirees covered by plans that unexpectedly failed.

ERISA met the goals of the American taxpayers who support the private pension system with many tax incentives. In 1974 the private pension system was still

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[1] Carl F. Horowitz, "Pension Pain: The Other Social Insurance Crisis," posted June 17, 2004, on the Ludwig von Mises Institute Web site.

[2] Generally, government and church plans are exempt from the minimum funding requirement of ERISA.

[3] The PBGC was created by Title IV of ERISA. The maximum monthly insured benefit was $750 per month payable at age 65 as a life-only annuity.

considered the third leg of the three-legged stool of our national retirement income system, the other legs being Social Security and individual savings. Shoring up the private pension system meant less pressure on the Social Security system and other entitlement programs. It also meant more American workers would be able to maintain a reasonable standard of living when they retired.

From the viewpoint of the employers, it is less clear that ERISA met their expectations. Prior to ERISA there was minimal guidance as to how pension plans should be funded. The minimum funding requirements of ERISA placed a whole new burden on employers, but the minimum funding requirements were not beyond generally accepted norms. For example, for a plan with an unfunded actuarial liability, ERISA mandated that the unfunded liability be amortized over no more than 30 years. Although a few plans may have amortized their unfunded liabilities over more than 30 years, most plans were already amortizing liabilities over 10 to 30 years.

ERISA created the minimum funding standard account as a measure of funding adequacy. A plan that builds up a credit balance in its minimum funding standard account is able to apply that credit balance in later years to offset its funding obligation. In the years subsequent to the enactment of ERISA, employers encountered a regular series of changes to the pension funding rules that in some cases further limited the amounts that employers could contribute to their plans and in other cases required greater minimum funding contributions as Congress alternatively worried about excess tax deductions for small employers and inadequate funding for larger, PBGC-insured plans.

ERISA worked for a long time, but not forever Today, it is hard to argue that the mechanisms in place for funding of the private pension system are still working.

The PBGC is facing a crisis. Three years ago it was in a surplus position. Today it is facing a $23 billion deficit.[4] Rather than underwriting protection for plans across a broad spectrum of industries and geographies, the PBGC has become, in the eyes of some, a dumping ground used by failing industries to shed their pension liabilities. Most recently, the PBGC agreed to accept an estimated $6.6 billion in unfunded liabilities from United Airlines in exchange for $1.5 billion in UAL notes and convertible stock. The most recent estimate by the PBGC is that the unfunded liability for single-

[4] As of September 30, 2004. See Testimony of Ann L. Combs, Assistant Secretary of Labor, before the Committee on Education and Workforce, U.S. House of Representatives, March 2, 2005.

employer pension plans is more than $450 billion, with almost $100 billion associated with plan sponsors that are in financial difficulty.[5]

Clearly, defined benefit pension plans are not meeting the expectations of U.S. employers. Since 1980 the number of defined benefit plans insured by the PBGC has shrunk from 250,000 to about 80,000.[6] Since 2001, 23 percent of Fortune 1000 companies either have decided to freeze their pension plan or are actively considering a freeze.[7] Companies are turning instead to defined contribution plans, particularly 401(k) plans, as the primary vehicle for providing retirement benefits to their workers.[8]

For some American workers, ERISA has been and is still a success. There are over 500,000 Americans who are receiving monthly checks from the PBGC.[9] However, for employees of the many companies that have recently terminated their defined benefit plans in favor of 401(k) plans, ERISA has not provided them the kind of retirement security they had hoped for. Now their ability to retire at a reasonable standard of living is tied to the vagaries of the stock market, and in many cases the discretionary decision of their employer as to how much, if any, employer contribution will be added to their account each year. Moreover, their 401(k) benefits both before and after retirement are not insured by the PBGC.

5. Calls for New Reforms

It is not surprising, then, that there is a growing call for reforms to the current system for funding pension plans. The calls have come from all three of the primary stakeholders in the system: taxpayers represented by the government (notably but not exclusively the PBGC), the employers who sponsor pension plans, and the American workers.

Mark J. Warshawsky, Assistant Secretary of Treasury, in his March 2, 2005, remarks before the United State House Committee on Education and the Workforce, stated that "If we want to retain defined benefit plans as a viable option for employers

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[5] Testimony of Bradley D. Belt, executive director, PBGC, before the Subcommittee on Select Revenue Measures, Committee on Ways and Means, U.S. House of Representatives, March 8, 2005.

[6] *Plan Sponsor,* February 23, 2005.

[7] Testimony of Henry Eickelberg before the Subcommittee on Select Revenue Measures, Committee on Ways and Means, U.S. House of Representatives, Washington, DC, March 28, 2005.

[8] Recent examples include IBM, the State of West Virginia, Motorola, and a proposal by the Northwest Airlines pilots union.

[9] See the PBGC Web site, www.pbgc.gov/about.

and employees, fundamental changes must be made to the [single employer, private pension] system to make it financially sound."[10]

If reforms are coming to the private pension system, what attributes must the reforms have to be acceptable to the three primary stakeholders: plan sponsors, taxpayers, and American workers? Put another way, what are the WIFMs of the three stakeholders that any changes to the private pension system must satisfy?

6. WIFMs of the American Worker

Of the three stakeholder groups, the WIFMs of the American worker are the most straightforward. In fact, there is only one WIFM: *Security of the Benefit Promise*. The American worker wants to know that his or her pension benefit will be there when the day of retirement finally arrives. To some workers, the benefit promise includes the benefit they have already earned and all expected future accruals through their date of retirement. To these workers, events like a plan termination and the reduction or freezing of future benefit accruals constitute a broken promise.

IBM's conversion from a traditional pension plan to a cash balance pension plan is a good example of how some view the benefit promise. IBM decided to change from a traditional unit benefit pension plan to a cash balance plan. It is worth noting that IBM could have decided to terminate its plan altogether or to switch to a defined contribution plan, but chose instead to continue to provide its workers with the security of a defined benefit plan.

Nonetheless, IBM was roundly criticized by its employees and others for "pulling the rug out from under" employees near retirement who will earn smaller future benefits under the cash balance plan in the years leading up to their retirement, leaving them with a smaller pension when they retire. The outcry was so great as to reach the halls of Congress, and the conversion was successfully challenged in federal court. It is currently going through the appeals process.[11]

The WIFM of the American worker—the security of the benefit promise—has not changed since before ERISA. It was the driving force behind the enactment of ERISA. The PBGC was created for the purpose of satisfying this WIFM, and it still exists today

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[10] Testimony of Mark J. Warshawsky, Assistant Secretary of the Treasury, before the Education and the Workforce Committee, U.S. House of Representatives, March 2, 2005.

[11] For a more detailed explanation of the IBM cash balance conversion see "IBM's Cash Balance and Pension Equity Formulas Violate ERISA, District Court Rules," Deloitte LLP, *Washington Bulletin,* August 4, 2003.

to provide benefit security for American workers. The PBGC is in peril today with a $23 billion deficit, including the estimated $5 billion or so in net liabilities it will accept from United Airlines.

The agreement with United calls for the PBGC to accept about $6.6 billion in insured liabilities and receive $1.5 billion in notes and convertible stock in the reorganized UAL Corporation. United's unfunded liability is estimated to be close to $9.8 billion, meaning not all pensions will be fully insured. One flight attendant estimated her pension would be reduced from $1,700 per month to $800 per month.[12] Even though the PBGC is stepping in to protect a portion of her benefit, she and others like her probably do not feel their WIFM has been met.

The American worker WIFM: We want any changes to the system for funding private pension plans to enhance the security of the benefit promise, not take away from it.

7. Taxpayer WIFMs

Private pension plans are supported by tax incentives and advantages that reduce general tax revenues that could be used to support other worthwhile government programs that benefit our society. Taxpayer WIFMs are based on the premise that, in exchange for these tax incentives and advantages, taxpayers have a right to expect that the private pension system will benefit society in general. One benefit sought by society is greater financial security in retirement for American workers. Thus the first taxpayer WIFM is really a corollary of the American worker WIFM.

Taxpayer WIFM #1: Any changes to the system for funding private pensions should help ensure that pension promises are kept.

This WIFM has been stated by governmental officials on several occasions. It has also been acknowledged by industry and plan sponsor sources. Assistant Secretary of the Treasury Warshawsky stated before a congressional committee that President Bush's solution to fundamentally reform the pension funding rules is based on the principle that the funding rules should ensure pension promises are kept. "Such changes will increase the likelihood that workers and retirees will actually receive the benefits that they have earned."[13]

[12] Dave Carpenter, Associated Press, "Judge Approves End of United Pension Plans," May 10, 2005.
[13] See note 10 above.

Bradley D. Belt, executive director of the Pension Benefit Guaranty Corporation, expressed the administration's position similarly: "Private-sector defined benefit plans are intended to be a source of stable retirement income for more than 44 million American workers and retirees. That system, however, has on occasion been beset by problems that have undermined the economic security that workers and retirees have counted on."[14]

Larry Zimpleman, representing a number of employer and industry groups including the U.S. Chamber of Commerce, in comments before the U.S. Senate Finance Committee began his substantive comments by noting that "The best way to protect pensions for future retirees and working Americans is for Congress to enact permanent rules that lead to a fair and stable system."[15]

There are other general societal benefits that come from a private pension system that keeps its promises. For example, it reduces dependence on government-funded entitlement programs such as Social Security. For years, the three-legged-stool analogy was used to describe the structure that supported a worker's financial security in retirement. The legs of the stool are Social Security, the employer's retirement plan, and personal savings. Without the employer-sponsored plan, more support—more benefits—will be needed from the Social Security leg. Higher Social Security benefits, of course, mean higher Social Security costs.

Assistant Secretary of Labor Combs emphasized the importance of the American worker WIFM by noting that the loss of promised benefits "has a very real human cost," reminding us that we are not dealing only with statistics.[16]

Taxpayer WIFM #2: We want reforms to the system for funding private pensions that eliminate the transfer of risk for funding pension plans from plan sponsors to taxpayers.

This WIFM relates to the unfunded pension plan liabilities that are underwritten by the PBGC. No one, with the possible exception of UAL itself, seems happy that a federal bankruptcy judge upheld PBGC's acceptance of $6.6 billion of unfunded pension liabilities from UAL in exchange for $1.5 billion in UAL bonds and convertible stock. For many United employees, their WIFM was violated. Benefits valued at around $4.8 billion will not be paid by the PBGC. Those benefits are forever lost.

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[14] See note 5 above.

[15] Testimony of Larry Zimpleman, F.S.A., M.A.A.A., on behalf of the Business Roundtable (and others) before the Finance Committee, U.S. Senate, March 1, 2005.

[16] See note 4 above.

United's competitors are not happy. They remain saddled—at least for the time being—with a cost that United has now shed. Delta Airlines has warned it may be headed to bankruptcy court, and it too has unfunded pension liabilities in the billions of dollars. AMR, parent company of American Airlines, has reportedly said it will keep its pension plans but is concerned that United has gained a financial advantage with the elimination of its pension obligations.[17]

On behalf of taxpayers, PBGC executive director Belt has expressed the concern that the liabilities transferred to the PBGC could grow too large to be borne by premium payers. "If this were to occur, there undoubtedly would be pressure on Congress to call upon U.S. taxpayers to pay the guaranteed benefits of retirees and workers whose plans have failed."[18]

Mr. Belt explains that there is a structural flaw in the current environment in which the PBGC finds itself. He refers to it with the term "moral hazard." Unlike a properly designed insurance system that encourages responsible behavior that lessens the likelihood of an insured risk, PBGC coverage can be gamed. A financially weak company will have an incentive to make generous but unfunded pension promises rather than increase wages. The PBGC is mandated by ERISA to cover such plans. Moreover, PBGC premiums are set by Congress, not the marketplace.[19] Mr. Zimpleman's testimony on behalf of an industry coalition included minimizing the moral hazard in the pension system as one guiding principle for reform.[20]

One other taxpayer WIFM was noted by more than one of the sources we investigated.

Taxpayer WIFM #3: A vibrant, well-funded private pension system is good for the U.S. economy.

Mr. Eickelberg, in his testimony before the House Ways and Means Subcommittee on Select Revenue Measures, remarked that single-employer defined benefit plans paid benefits in excess of $120 billion in 1999 (the last year for which data were available).[21] In his testimony, Mr. Zimpleman noted that as of the end of 2003 the $15 trillion of U.S. equity capitalization in private-sector defined benefit plans represented more than 6 percent of all U.S. equity capitalization. He added that "First

[17] See note 12 above.
[18] See note 5 above.
[19] See note 5 above.
[20] See note 15 above.
[21] See note 7 above.

and foremost, any reform proposal should be measured by the benefits or consequences for the U.S. economy. It is in no one's interest for pension reform to disrupt our economy or the capital markets since a strong economy benefits workers, retirees, plans, employers and the PBGC."[22]

8. Plan Sponsor WIFMs

The U.S. private pension system is a voluntary system. Unlike the case in some other countries, there is no requirement or law that an employer must sponsor a pension plan, let alone a defined benefit pension plan with its attendant liabilities, responsibilities, and risks. An employer sponsors a defined benefit pension plan because the employer has determined that such a plan is in its best interest; the plan satisfies one or more general business WIFMs of the employer.

When a plan no longer satisfies the employer's WIFMs, change is inevitable. For many years now, employers have been moving away from defined benefit plans in favor of 401(k) plans. 401(k) plans are meeting plan sponsor WIFMs while defined plans are not. In 1979 two-thirds of workers who were covered by a retirement plan were covered by a defined benefit plan. By 1998 only one-third of covered workers had defined benefit plan coverage.[23]

This paper is focused on the funding of defined benefit plans. It is outside its scope to discuss the all of the WIFMs that may have contributed to this trend. For example, a recent paper released by the Divisions of Research and Statistics and Monetary Affairs of the Federal Reserve Board in Washington, DC, attributes the shift from defined benefit plans to defined contribution plans in part to changing workforce demographics (demand) and in part to a reduced value of defined benefit plans (supply).[24]

Plan Sponsor WIFM #1: More Predictable Funding. Pension funding reform should reduce the volatility and unpredictability of employer funding obligations.

[22] See note 15 above.

[23] American Benefits Council, "Funding our Future: A Safe and Sound Approach to Defined Benefit Pension Plan Funding Reform," February 2005.

[24] Stephanie Aaronson and Julia Coronado, "Are Firms or Workers behind the Shift Away from DB Pension Plans?" Finance and Education Discussion Series, Divisions of Research and Statistics and Monetary Affairs, Federal Reserve Board, Washington, DC, February 2005.

Volatility was acknowledged as a plan sponsor issue by every source paper, every record of congressional testimony, and every survey we encountered in developing this paper.

On behalf of the coalition of business and industry groups for which he spoke, Mr. Zimpleman noted that "Surveys suggest that employers view this [the lack of predictability] as the top impediment to maintaining a defined benefit plan.[25] Mr. Zimpleman was referencing a survey done by Hewitt Associates LLC. Its 2003 survey of over 200 employers found "volatility of cost" to be the greatest threat to employers continuing to sponsor defined benefit pension plans. The level of overall plan costs was the second greatest threat, although what Hewitt termed "unfriendly regulatory environment" factors were in the aggregate a greater threat than overall plan cost.[26]

The consistent thread from plan sponsors is the negative impact that volatility has on the ability of employers to develop reliable long-term strategic plans for their businesses. Janemarie Mulvey, Ph.D., and chief economist for the Employment Policy Foundation, stated the issue thus: "This volatility also would make it more challenging for firms to develop reliable long-term financial and/or strategic plans for their company."[27]

Volatility and unpredictability are not necessarily synonymous. Volatile funding obligations can be predictable and still cause problems. From the information we reviewed, it appears the more significant problem for plan sponsors is unpredictability rather than volatility. Mr. Zimpleman added that "Predictable funding rules are important because they allow employers to make long-term financial plans. Future pension costs can represent significant investments—more than $1 billion per year for some employers. Financial decisions of this magnitude require planning and substantial lead time. This can only occur with predictable funding rules."[28]

It should not be surprising that unpredictability is a problem for plan sponsors. For years actuaries have helped employers minimize the impact of volatility and unpredictability with such techniques as amortizing gains and losses and asset-smoothing techniques. Employers go to great lengths to project future events to plan for capital investments, staffing needs, and almost every other aspect of managing a business. An unforeseen pension expense can have a material impact on net profits.

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[25] See note 15 above.

[26] Hewitt Associates LLC, Survey Findings, Current Retirement Plan Challenge: Employer Perspectives 2003,Lincolnshire, IL.

[27] Testimony of Janemarie Mulvey, Ph.D., chief economist, Employment Policy Foundation, before the Committee on Education and the Workforce, U.S. House of Representatives, March 2, 2005.

[28] See note 15 above.

Investors regularly punish companies that fail to achieve their projected revenue or profit targets.

The top priority of this WIFM among plan sponsors is supported by our own, albeit limited, research. When asked to rank the importance of six pension funding reform WIFMs from 1 to 10, the plan sponsors who responded to our survey ranked predictability the highest by a significant margin. Affordability was the second highest rated WIFM, although there were a number of WIFMs closely grouped with affordability.

Additionally, we solicited comments from pension actuaries around the nation on the priority of employer-related pension funding reforms. Again, the issues surrounding the unpredictability and volatility of pension funding were at the top of the list. A related plan sponsor concern is the rigidity of the pension funding rules that discourages and in some ways prohibits employers from advance funding their plans in good economic times.

Mr. Zimpleman in his comments before the U.S. Senate Finance Committee referred to the need to eliminate barriers to prefunding: "Employers need to be able to fund up their plans when they have the capacity to do so." On behalf of the employer groups he represents he asked for greater flexibility as to the timing of tax deductions and rules that encourage, not discourage, advance funding.[29]

Plan Sponsor WIFM #2. More Funding Flexibility. We would like to be able to make greater contributions to our plans when we are flush. We would like the opportunity to prefund our pension obligations when we can afford to do so.

Taxpayers, represented by the government, acknowledge plan sponsor WIFM #2.

In his testimony before the House Education and Workforce Committee, Assistant Secretary of the Treasury Warshawsky stated that "Many believe that the inability of plan sponsors to build sufficiently large funding surpluses during good financial times under the current rules has contributed to the current underfunding in the pension system."[30] The current rules referred to in his comments include the general limitations on deductibility of contributions under IRC Section 404, the most recently imposed full funding limitations, and the imposition of excise taxes on nondeductible contributions.

[29] Ibid.

[30] See note 10 above.

Assistant Secretary of Labor Combs provides a good summary:

> The current funding rules can place a pension plan sponsor in the position of being unable to make deductible contributions in one year and then being subject to accelerated deficit reduction contributions in a subsequent year. This problem is caused by the interaction of the minimum funding requirements and the rules governing maximum deductible contributions. The rules restrict employers' ability to build up a cushion that could minimize the risk that contributions will have to be severely increased in poor economic times. This volatility in required contributions makes it difficult for plan sponsors to predict their funding obligations, and makes it difficult to prevent large required contributions during economic downturns when the company is least able to pay.[31]

As she points out, not only do the current funding rules restrict the ability of employers to build up a funding cushion—a goal of plan sponsor WIFM #2, but they also contribute to the problems that create plan sponsor WIFM #1: volatility and unpredictability.

Plan sponsor WIFM #3 was articulated in several ways, but with a consistent message.

Plan Sponsor WIFM #3. Any pension funding reforms that increase the cost of sponsoring a defined benefit plan will discourage us from sponsoring such plans.

The private pension system is a voluntary system financed by for-profit U. S. companies. These companies compete in an ever-expanding global market place. It is an Economics 101 concept that controlling costs at the lowest possible level is necessary for survival. Plan sponsors have a concern that some pension reform ideas will drive up the cost of maintaining a defined benefit plan. To do so will violate plan sponsor WIFM #3.

Mr. Eickelberg identifies "expensive and excessive regulation" as one of the primary reasons for the 23 percent of Fortune 1000 companies that, since 2001, have initiated a freeze or are actively considering freezing their defined benefit plan.[32] Mr. Zimpleman talks of the consequences of excessive contribution obligations in the same terms: "Employers that confront inflated contribution obligations will have little choice but to stop the financial bleeding by freezing or terminating their plans." He also notes

[31] See note 4 above.

[32] See note 7 above.

that inflated pension contributions divert resources from investment opportunities that create jobs and contribute to general economic growth.[33]

Thus, the concern expressed by Mr. Eickelberg and Mr. Zimpleman has a potentially long tail: excessive or unnecessary costs associated with sponsoring a plan, a violation of plan sponsor WIFM #3, leads to the freezing or termination of plans, a violation of the American worker WIFM and taxpayer WIFM #1.

In its paper on development of a sound approach to pension plan funding reform, the American Benefits Council states "in the strongest possible terms" its opposition to any legal structure that penalizes plans for investments in equities. In addition to its concern about the impact on the economy, the Council argues that over time pension plans earn more from their investment in equities than from bonds. If plans are required to invest only in bonds, the loss of investment income to pay for plan benefits will result in directly equivalent increases in employer cost. Their conclusion: "As plans become more expensive, it goes without saying that there will be fewer plans and lower benefits in the plans that remain."[34]

9. Observations

It is not the intent of the authors to interject their opinion on the many proposed pension reform ideas that have been recently put forth. However, we offer the following observations with regard to reform proposals we have seen and their interaction with the WIFMs introduced in this paper.

1. Any reforms that lead to the elimination of the protections for American workers provided by the PBGC without replacement with an alternative solution violate two fundamental WIFMs.
2. Any reforms that would make the funding of defined benefit plans more expensive, such as mandating that plans could not be funded with equities, would violate WIFMs of all three stakeholder groups.
3. Any reforms that would eliminate employer utilization of credit balances created by contributions in excess of the minimum funding requirements would discourage a key plan sponsor WIFM. Discouraging plan sponsors from making contributions that create credit balances, is also inconsistent with the American worker WIFM of enhancing the security of the benefit promise.

[33] See note 15 above.

[34] See note 23 above.

4. As long as the U.S. private pension system is a voluntary system, any reforms that fail to meet fundamental employer WIFMs will also fail the American worker WIFM because employers will turn away from defined benefit plans in favor of alternatives that meet their WIFMs.

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