

Dr. Phil's Guide to Pension Funding Reform

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The current defined benefit funding rules resemble a bad-parenting episode that you might see on Dr. Phil. The government, (the parents in this metaphor) greatly want to encourage plan sponsors (we'll call them the children, but please don't read too much into that) to have well funded defined benefit pension plans for the good of the citizenry (the rest of the family).

However, the house rules have been established in such a way as to discourage the very behavior that the parents desire. The parents want well-funded private pensions, but have established a framework that makes it too easy to avoid making contributions. So the children choose not to make contributions when possible.

This works fine while the economy is humming along, but unfortunately the good times don't last. Responding to cries from the rest of the family, the parents recognize that the defined benefit plans they crave are in jeopardy, and decide to punish the behavior of the children via draconian additional funding charges for their naughty behavior. They do this even though the children have done everything required of them in the undisciplined environment the parents have created.

(In the midst of this, the parents also yammer and nag incessantly about numerous peripheral issues like cash balance plans, treasury rates, and relative value disclosures encouraging the kids to tune out. But that's another story.)

The children, rightly feeling that their punishment is cruel, unusual and unfair insofar as they have done everything asked of them to date, are justifiably confused. They respond in the only way they can, and refuse to accept the punishment. Instead of going to their rooms quietly, they mope and complain and refuse to make the contributions to the defined benefit plans required of them, especially with the economic downturn and all.

So, what is a parent to do? Anyone who has ever seen Dr. Phil (and here I am not admitting that I have) knows that children need **consistency**. That is the only way the lesson will be learned, and behavior changed. So what does the government do? Like a doting father, it does not follow through on the punishment. Instead it relents and lets the whining children out of their rooms, writes checks to cover their liabilities from his PBGC checkbook, and takes them out for ice cream.

The end result? The parents don't have what they want. The children have learned nothing about proper behavior, and the family is rapidly losing their retirement security.

To paraphrase the good doctor, “There are 14 characteristics of a serial failure, and the current defined benefit funding system possess at least nine of them!” It’s time to stop the madness!

The objective of my paper is to outline how the proliferation of rules surrounding the private defined benefit system have led to today’s underfunding and plan termination crisis. I will also propose a solution to the funding crisis that will address contribution volatility and benefit security in a way that attempts to get plan sponsors to behave the way the government has wanted them to all along.