



DEPARTMENT OF THE TREASURY OFFICE OF PUBLIC AFFAIRS

The Administration Proposal to Improve the Accuracy and Transparency of Pension Information

The Proposal Will Strengthen and Secure American's Pension Security by:

- Improving the accuracy of the pension liability discount rate
- Increasing the transparency of pension plan information
- Strengthening safeguards against pension underfunding

1. Improving the Accuracy of the Pension Liability Discount Rate:

Accuracy is essential because too high a rate leads to underfunding, putting retirees and taxpayers at risk. Too low a rate causes businesses to contribute more than is needed to meet future obligations, overburdening businesses at this early stage of the recovery.

Use of Appropriate Yield Curve Discount Rate

The Administration recommends that pension liabilities ultimately be discounted with rates drawn from a corporate bond yield curve that takes into account the term structure of a pension plan's liabilities. For the first two years, pension liabilities would be discounted using the blend of corporate bond rates proposed in HR 1776 (Congressmen Portman and Cardin). A phase-in to the appropriate yield curve discount rate would begin in the third year and would be fully applicable by the fifth year. Using the yield curve is essential to match the timing of future benefit payments with the resources necessary to make the payments.

Phase In Use of Yield Curve for Lump Sums

Currently, lump sums are valued using a lower rate than that used for pension funding, draining pension plans' assets whenever lump sums are paid. In order to protect the retirement security of both those who have not yet retired, and those who have chosen to take benefits as an annuity, the Administration proposes that ultimately, lump sums be discounted by the same rate used for other pension liabilities. In order to avoid disrupting the plans of workers who will receive benefits in the immediate future, lump sums would be computed using the 30-year Treasury rate as under current law in years one and two. In the third year a phase-in to the appropriate yield curve discount rate would begin. By the fifth year lump sums will be discounted by the same rate used for other pension liabilities.

The Administration's proposal is:

- Easy and simple. It can be done using a simple spreadsheet.
- Provides the right level of contributions. Contributions will be based on an accurate determination of plan liability.
- Recognizes current conditions. The interest rate for the first two years will provide funding relief to plan sponsors.
- Pro-growth. Pension funds are a significant source of private investment that create growth and jobs.
- A well-established best practice in financial accounting.

2. Increasing the Transparency of Pension Plan Information:

Disclose Plan Assets and Liabilities on a Termination Basis

The Administration proposes that all companies disclose the value of pension plan assets and liabilities on a termination basis in their annual reporting. Too often workers are unaware of the extent of their plans' underfunding until their plans terminate, frustrating workers' expectations of receiving promised benefits.

Disclose Funding Status of Severely Underfunded Plans

The Administration proposes that certain financial data already collected by the PBGC from companies sponsoring pension plans with more than \$50 million of underfunding should be made public. Publicly available information would include the assets, liabilities and funding ratios of the underfunded plan, but not confidential employer financial information. This data is more timely and accurate than what is publicly available under current law.

Disclose Liabilities Based on the Duration-matched Yield Curve of Corporate Bonds

The Administration proposes that companies annually disclose their liabilities as measured by the proposed yield curve before duration-matching is fully phased in for funding purposes. By providing this information before the new discount rate is effective, workers and the financial markets will have more accurate expectations of a plan's funding obligations and status.

3. Strengthening Pension Funding to Protect Workers and Retirees:

Firms with Below Investment Grade Credit Rating

In an analysis of over half of PBGC claims, 90 percent of companies whose pension plans have been trusted by the PBGC had junk bond credit ratings for the entire ten year period before termination. Whenever such a plan increases promised benefits, these costs stand a good chance of being passed on to the pension insurance system, frustrating the benefit expectations of workers and retirees and penalizing employers who have adequately funded their plans. Under the Administration's proposal, if a plan's funding ratio falls below 50 percent of termination liability, benefit improvements would be prohibited, the plan would be frozen (no accruals resulting from additional service, age or salary growth), and lump sum payments would be prohibited unless the employer contributes cash or provides security to fully fund these added benefits.

Firms in Bankruptcy

Same restrictions as above plus PBGC's guaranty limit would be fixed as of the date the plan sponsors files for bankruptcy.

4. The Administration Supports Comprehensive Funding Reforms

Congress should immediately implement the discount rate, benefit protection and transparency reform proposals. The Administration also is exploring additional funding reforms to protect workers' retirement security by improving the funding status of all defined benefit plans. Issues under consideration include the proper establishment of funding targets; appropriate assumptions for mortality and retirement age and incentives for more consistent annual funding requirements.