

Pension Funding Should Not Be Based On Credit Ratings

The credit rating test, originally proposed by the Administration in 2003, was drafted to address the growing deficit at the Pension Benefit Guaranty Corporation (PBGC) without regard to the impact of the proposal on actual pension plan sponsors.

- The test is based on the faulty premise that any plan sponsor with a below investment credit rating will have a distress termination, turning the plan over to the PBGC.
- Distress terminations, however, can only occur when a plan sponsor declares bankruptcy. While bankrupt companies always have below investment grade credit, not all companies with a below investment credit rating declare bankruptcy.

A credit rating test is included in the Senate-passed pension reform bill (S. 1783) but not in the House-passed bill (H.R. 2830).

The Senate bill deems a plan “at risk” and requires a plan sponsor to fund at termination liability if the plan sponsor’s credit rating is below investment grade, i.e., “junk status,” for three consecutive years or if two of the previous three years were deterioration years, unless the plan is at least 93 percent funded. (Under current law, the funding target for “fully funded” is 90 percent.)

- Termination liability assumes the plan is terminating in the current year, requiring an enormous cash call.
- Under this test, an employer’s liability increases even though the plan’s benefit payments remain the same.

In contrast, the House bill deems a plan “at risk” if it is funded below 60 percent of liabilities.

A credit rating test would have a severe, negative impact on plan sponsors,

- Many factors determine whether a plan sponsor has a rating below investment grade including a downturn in the economy, a low in the business cycle or competitive demands or their industry.
- A large cash call during periods of below investment credit rating on a company that otherwise has a well-funded plan would impose an even greater hardship on a company and make it more difficult for the company to attain an investment grade credit rating.
- Credit rating agencies themselves are not transparent in their ratings. Moreover, under the proposals, the government would be forced to decide the creditworthiness of private companies and companies that are not rated.
- At-risk provisions should be based on a plan’s actual risk and liability to the PBGC. Severely underfunded plans pose a risk to the PBGC, not plans funded by companies that have below investment credit ratings

Over the long-term, a credit rating test would have a chilling effect on the voluntary nature of defined benefit pension plans, ultimately curtailing this type of employee benefit that offers a lifetime income stream during an employee’s retirement.