The New Single-Employer Defined Benefit Plan Funding Rules: What's In Store For Defined Benefit Plan Sponsors and Participants?

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I. Introduction

The Pension Protection Act of 2006 (the "Act")[1] arguably marks the most sweeping changes to the pension laws since the enactment of the Employee Retirement Income Security Act of 1974 ("ERISA"). In general, the Act, which was signed into law on August 17, 2006, changes the funding rules for single-employer defined benefit pension plans,[2] expands the deduction limits for contributions to such plans,[3] modifies the rules determining lump sum distributions,[4] and provides clarification and adds new rules for cash balance pension plans.[5] The Act also provides special funding rules for plans maintained by airlines and airline catering companies,[6] provides new rules for multiemployer pension plans,[7] and requires increased disclosure of pension plan information.[8] In the defined contribution plan area, the Act adds rules relating to automatic enrollment plans, eliminating legal impediments to such arrangements and providing incentives for plan sponsors to adopt these arrangements.[9] There were modifications to prohibited transactions and other fiduciary rules under ERISA, particularly with regard to the provision of investment advice.[10] A welcome addition to the Act was the elimination of the expiration date of the tax provisions added as part of

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[1] Pub. Law No. 109-280, 120 Stat. 780.
[2] *See e.g.*, Sections 102 and 112 of the Pension Protection Act of 2006 (the "Act").
[3] Sections 801-803 of the Act.
[4] Sections 302-303 of the Act.
[5] Section 701 of the Act.
[6] Section 402 of the Act.
[7] *See e.g.*, Sections 201-204 and 211-221 of the Act.
[8] Sections 501-509.
[9] Section 902 of the Act.
[10] *See* Sections 601-625 of the Act.

the Economic Growth and Tax Relief Reconciliation Act of 2001 ("EGTRRA"), so that the increases in contribution limits to IRAs, 401(k), 403(b), and 457 plans, the catch-up contribution and the Roth 401(k), will continue to apply and not sunset in 2010.[11]

While the Act included many changes to the pension laws, the main driver behind these changes was the enactment of the new single-employer defined benefit plan funding rules. Some policymakers contend, however, that these new rules will invariably speed up the already impending demise of single-employer defined benefit plans.[12] It is well-established that defined benefit plans in the single-employer-provided pension system are slowly disappearing. For example, the Pension Benefit Guaranty Corporation ("PBGC")[13] has reported that from 1986 to 2004, 101,000 single-employer defined benefit plans with about 7.5 million participants have been terminated.[14] Other studies have shown that 44 percent of private sector employees were covered under a defined benefit plan in 1974, but that percentage has declined to only 17 percent today.[15] Despite this shift away from defined benefit plans, it does not appear that the Act will cause single-employer defined benefit plan sponsors to totally abandon the defined benefit plan system. However, it does appear that the Act will accelerate the trend of freezing participation or benefit accruals under existing plans.[16] The elimination of pension benefits payable under a single-employer defined benefit plan could reduce a worker's

[11] Section 811 of the Act.
[12] Statement of Congressman Earl Pomeroy (D-ND), 152 Cong. Rec. H6157 (July 28, 2006).
[13] The Pension Benefit Guaranty Corporation ("PBGC") is a federal program that insures certain benefits of the more than 34 million worker, retiree, and separated vested participants of over 29,000 private sector defined benefit pension plans.
[14] *An Analysis of Frozen Defined Benefit Plans*, PBGC, Dec. 21, 2005.
[15] *The Decline of Private-Sector Defined Benefit Promises and Annuity Payments: What Will It Mean?*, EBRI Notes, Vol. 25, No. 7, July 2004.
[16] *See, e.g.*, *Pension Reform: Impact on Defined Benefit Plans*, Committee on Investment of Employee Benefit Assets ("CIEBA"), September 2005.

retirement income, even if such benefits are replaced with defined contribution-type benefits, thereby calling into question the retirement security of single-employer defined benefit plan participants and the American public as a whole.

This article will explain the newly enacted single-employer defined benefit plan funding rules under the Act,[17] focusing exclusively on the minimum required contribution rules, the "at-risk" rules, the treatment and effect of credit balances, and the rules relating to restrictions on benefits,[18] and it will highlight some of the reasons why the current defined benefit plan funding rules were changed. In addition, the article will briefly discuss the impact the new rules may have on the defined benefit plan system and the retirement security of defined benefit plan participants.

II. The New Defined Benefit Plan Funding Rules

A. Reasons for the New Rules

Why did the Bush Administration (the "Administration") and Congress feel that changes to the current defined benefit plan funding rules were necessary? First, plan sponsors of underfunded plans that are subject to the current law deficit reduction contribution ("DRC") rules[19] demanded relief from determining pension plan liabilities

[17] Because this article is limited to the new single-employer defined benefit plan funding rules, references to the "defined benefit plan funding rules," the "defined benefit plan system," or a "defined benefit plan" throughout the remainder of this article shall be references to the "*single-employer* defined benefit plan funding rules," the "*single-employer* defined benefit plan system," or a "*single-employer* defined benefit plan."

[18] This article will not discuss the deductible limit for defined benefit plans, lump sum distributions, increased disclosure of pension plan information, and other PBGC-related changes made under the Act.

[19] Under the deficit reduction contribution ("DRC") rules, if a plan is less than 90 percent of its "current liability," or less than 80 percent of its current liability if the plan was at least 90 percent funded for 2 consecutive years out of the last 3 years, the plan sponsor is required to make additional contributions to the plan. A plan's current liability is all liabilities to employees and beneficiaries measured on a plan termination basis. In other words, current liability represents the amount of money the plan would need to pay benefits to employees and beneficiaries if the plan were terminated. Prior to 2004, for purposes of

based on the artificially low 30-year Treasury rate. As discussed more fully below, relief was sought because the artificially low interest rate resulted in artificially high liabilities, thereby requiring these plan sponsors to make greater contributions to the plan. The changes were also made in response to the concern that defined benefit plans are significantly underfunded,[20] which was due in large part to weaknesses in the current funding rules. Moreover, the political interests of other stakeholders in the defined benefit plan system, namely, employers in financially-troubled industries, converged with those of the Administration, the PBGC, and plan sponsors of underfunded plans, culminating in the enactment of the new defined benefit plan funding rules.

1. Underfunding In the Defined Benefit Plan System

Weaknesses inherent in the current law funding rules have contributed to underfunding in the defined benefit plan system. For example, under the present law funding rules, defined benefit plans are subject to the "full funding limit." The full funding limit represents a measure of the funding status of a plan under which the plan is deemed to be fully funded.[21] In certain instances, the full funding limit places a ceiling on deductible contributions that may be made to the plan.[22] If a plan sponsor contributes amounts in excess of the maximum deductible limit, such excess amounts are not

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determining a plan's current liability under the DRC rules, the required interest rate was based on the 30-year Treasury rate.

[20] The GAO has reported that the level of underfunding has increased from $39 billion in 2000 to $450 billion in 2004. U.S. Government Accountability Office, *Recent Experience of Large Defined Benefit Plan Illustrate Weaknesses in Funding Rules*, GAO-05-294 (May 2005) (hereinafter "GAO Report, GAO-05-294").

[21] IRC § 412(c)(7). Currently, the full funding limit is equal to the excess, if any, of (i) the accrued liability under the plan (including normal cost), less (ii) the value of the plan's assets. Until 2004, the full funding limit equaled the higher of (i) 90 percent of the plan's current liability, or (ii) the lower of (a) the accrued plan liability or (b) 150 to 170 percent (depending on the year) of the current liability. As discussed above, current liability is all liabilities to plan participants and beneficiaries accrued to date. A plan's accrued liability is the plan's projected future benefits, including future salary increases.

[22] *See* IRC § 404(a)(1)(A), limiting deductible contributions to an amount equal to the full funding limitation determined under Code section 412.

deductible and the plan sponsor is subject to an excise tax.[23] Thus, based on the interaction between the full funding limit and the maximum deductible limit, plan sponsors are penalized if they are willing and able to contribute more than is otherwise required to fully fund the plan. Such interaction invariably limits the amount of cash contributions that can be contributed in a given year, which, compounded over time, often results in insufficient plan assets to cover plan liabilities.[24]

Another reason for underfunding was the interaction of market returns and interest rates. When interest rates fall, the present value of plan liabilities increase. Until 2004, underfunded defined benefit plans were required to determine the plan's liabilities based on the 30-year Treasury rate.[25] In October 2001, however, the Treasury Department stopped issuing 30-year Treasury bonds, which caused the interest rate yield to significantly decline to artificially low levels because the demand for the fixed 30-year Treasury rate was high, thereby placing downward pressure on the rate of interest. Such artificially low rates resulted in artificially high liabilities. These artificially high liabilities coincided with a reduction in the fair market value of plan assets due to market losses in the late 1990s and the early part of the 21st century. This "perfect storm" of high liabilities and significantly reduced plan asset values invariably resulted in increased underfunding.[26]

Other aspects of current law, and its interaction with falling interest rates and market returns, also contributed to underfunding in the defined benefit plan system.

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[23] *See* IRC § 4972.
[24] *See* GAO Report, GAO-05-294, p. 23-24.
[25] *See* former IRC § 412(c)(7).
[26] *See Report of the Working Group on Defined Benefit Plan Funding And Discount Rate Issues*, U.S. Department of Labor, November 7, 2003.

Specifically, plan sponsors of underfunded plans were permitted to determine the present value of plan liabilities by using the 4-year weighted average of the 30-year Treasury rate.[27] This weighting allowed the sponsor to "smooth" fluctuations in liabilities caused by volatility in the market. Thus, when interest rates fell, thereby causing an increase in liabilities, plan sponsors were able to use an above-market rate that gave the impression that plans were better funded.[28] Similarly, the actuarial value of plan assets that plan sponsors may take into account under current law may be averaged (i.e., smoothed) over 5 years and valued from 80 to 120 percent of the assets' market value.[29] The ability to average the value of these assets over 5 years and the ability to value assets above the fair market value had the effect of disguising the plan's funded status as plan assets continued to be reduced due to market losses. In this instance, plan sponsors were not required to make the contributions that would have made the plan better funded.[30]

2. Stakeholders In the Defined Benefit Plan System

Each of these factors posed serious implications for the major stakeholders in the defined benefit plan system. As discussed above, plan sponsors of underfunded plans were required to use the 30-year Treasury rate to determine plan liabilities, which generally required plan sponsors to make greater contribution to their plans. In 2004, these plan sponsors successfully pressured Congress to change the required interest rate for determining plan liabilities from the 30-year Treasury rate to a corporate bond yield

[27] *See* ERISA §§ 302(b)(5)(B), (d)(7)(C)(i) and IRC §§ 412(c)(5)(B), (l)(7)(C)(i).
[28] *See* GAO Report, GAO-05-294, p. 14.
[29] ERISA § 302(c)(2) and IRC § 412(c)(2).
[30] *See* GAO Report, GAO-05-294, p. 15.

curve that more accurately reflected market-based rates.[31] Specifically, Congress enacted the Pension Funding Equity Act of 2004 ("PFEA")[32] which replaced the 30-year Treasury rate with a temporary rate that used a blend of corporate bond rates. This rate, however, expired at the end of 2005. If the temporary rate was not extended, or a permanent rate was not enacted by the end of 2006, these plan sponsors would once again be subject to the artificially low 30-year Treasury rate to determine plan liabilities and would once again be required to make higher contributions to the plan. As a result, these plan sponsors mounted pressure for the enactment of some type of pension reform.

Pursuant to the systemic problem of underfunding in the defined benefit plan system, the Administration and the PBGC grew concerned that if a large number of underfunded defined benefit plans were to terminate, the unfunded liabilities would be pushed on to the PBGC. If the PBGC did not have sufficient assets to insure these unfunded liabilities, the American taxpayer may be required to foot the bill. To date, the PBGC is running a deficit (e.g., the PBGC reported a $23.3 billion deficit in 2004 and a $22.8 billion deficit in 2005).[33] In addition, recent high profile bankruptcies that resulted in the termination of underfunded defined benefit plans have already shifted an unprecedented amount of unfunded liabilities onto the financially strapped agency.[34] Moreover, the PBGC does not always guarantee 100 percent of a participant's benefit

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[31] For 2002 and 2003, a special rule allowed plan sponsors of underfunded plans to use an interest rate that was 120 percent of the weighted average of the 30-year Treasury rate. IRC § 412(l)(7)(C)(i)(III).

[32] Pub. L. No. 108-218, 118 Stat. 596.

[33] PBGC News Release, *PBGC Releases Fiscal Year 2004 Financial Results*, November 15, 2004; PBGC News Release, *PBGC Releases Fiscal Year 2005 Financial Results*, November 15, 2005.

[34] One of the more high profile bankruptcies was that of United Airlines. On April 22, 2005, United Airlines terminated its defined benefit plans. At termination, the plans held approximately $7 billion of assets to cover $16.8 billion of liabilities. The approximately $9.8 billion shortfall was assumed by the PBGC, of which only $6.6 billion was actually covered under the federal insurance program. The resulting loss of pension benefits amount to approximately $3.2 billion, the largest-ever loss of pension benefits under the defined benefit plan system.

(e.g., early retirement subsidies are generally not guaranteed by the PBGC).[35] Thus, there are instances in which participants may lose pension benefits that they were otherwise promised upon plan termination.[36] As a result, the Administration and the PBGC believed that action needed to be taken to require plans to be fully funded, thereby ensuring that promises to pay benefits are kept.

Finally, employers in financially troubled industries, such as the steel and airline industries, needed special relief under the current funding rules if they were to continue to maintain their plans. Specifically, a number of employers in these industries have already terminated their underfunded plans while in bankruptcy or agreed to have the PBGC take over their otherwise underfunded plans. In each case, the PBGC assumed the employer's unfunded liabilities.[37] Those financially troubled employers that continued to maintain their defined benefit plans under the current funding rules, nonetheless, faced the possibility of terminating their otherwise underfunded plans and shifting their unfunded liabilities on to the PBGC. This outcome appeared inevitable if the new defined benefit funding regime was enacted. These employers did not want to default on their obligations, and the PBGC did not want to see more defined benefit plans terminated. As a result, significant political pressure mounted for some type of pension reform that included special funding relief for these ailing industries.

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[35] *See* ERISA § 4022(b).

[36] For example, United plan participants lost approximately $3.2 billion in otherwise promised benefits.

[37] In the airline industry, the following airlines have defaulted on their obligations; Pan Am (1990), Eastern (1991), TWA (2001), U.S. Airways (2003), and United (2006). Those legacy airlines that have continued their plans are currently facing $22 billion in unfunded pension benefits. *See* Bradley D. Belt, *Growing Commercial Airline Pension Crisis*, Testimony before the House Subcommittee on Aviation, Committee on Transportation & Infrastructure, 107th Cong. (June 22, 2005). The most recent plan terminations in the steel industry are Bethlehem Steel (2002) and LTV Steel (2002). PBGC News Release, December 16, 2002.

B. Provisions of the Act

The new defined benefit plan funding rules eliminate the present law normal and DRC funding rules, and replace them with a new set of rules that generally require plan sponsors to fund their plans up to 100 percent. Under the present law funding rules, plans are required to be funded up to 90 percent. Because the new 100 percent funding requirement is a departure from current law, Congress opted to make the new rules effective beginning January 1, 2008, thereby giving plan sponsors two full years to make the transition to the new funding regime.

1. Minimum Required Contribution Rules

a. Minimum Required Contribution

The centerpiece of the new defined benefit plan funding rules is the minimum required contribution rules. The minimum required contribution is the amount a plan sponsor is required to contribute to the plan for the year to ensure that it is fully funded over time. In short, plans are required to make contributions to cover benefits earned during the year and to make up any underfunding over 7 years. Like all newly enacted statutes, the minimum required contribution rules set forth intricate definitions that fit together like pieces of a puzzle. To navigate through the minimum required contribution rules, one must become familiar with the formulaic way in which the minimum required contribution is calculated and the defined terms that go into the calculation. Below are some key definitions and illustrations that will help the reader understand how the minimum required contribution is calculated:

- If a plan's assets[38] are less than its "*funding target*," the minimum required contribution for the year is generally equal to the plan's "*target normal cost*" plus its "*funding shortfall*" amortized over 7 years.[39]

- A plan's *funding target* is the plan's accrued liability to date.[40] In other words, the funding target is the amount of money the plan would need to pay all participants and beneficiaries as of the plan's valuation date.

- A plan's *target normal cost* is benefit liabilities that accrue during the current year, including increases in past service benefits attributable to current year increases in compensation.[41]

- The *funding shortfall* is the excess of the plan's funding target over the plan's assets.[42] The funding shortfall represents the plan's underfunding (if any) which is amortized over 7 years.[43]

The following may be helpful in illustrating this new funding construct:

Plan Assets − Funding Target = Funding Shortfall[44]

Amortization of Funding Shortfall
+ Target Normal Cost = Minimum Required Contribution

- The "*shortfall amortization installment*" is the amortization payment that is calculated after amortizing the funding shortfall and that is due in the first year and each of the next 6 succeeding years.[45] This installment payment can be best compared to a mortgage; the total dollar amount owed is spread out over a number of years, yielding an amount that is paid over time (here, paid annually) until the obligation (here, the underfunding) is paid in full.

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[38] As discussed more fully below, for purposes of performing this calculation, a plan's assets must be reduced by its credit balance, unless the plan sponsor elects to reduce its credit balance prior to determining the value of the plan's assets for the year. *See* new ERISA § 303(f)(4)(B)(i), (f)(5) and IRC § 430(f)(4)(B)(i), (f)(5). This would generally have the effect of increasing the minimum required contribution due for the year.
[39] *See* new ERISA § 303(a) and IRC § 430(a). If plan's assets equal or exceed its funding target, the minimum required contribution is generally equal to the plan's target normal cost (because the plan does not have any underfunding for the year).
[40] New ERISA § 303(d)(1) and IRC § 430(d)(1).
[41] New ERISA § 303(b) and IRC § 430(b).
[42] New ERISA § 303(c)(4) and IRC § 430(c)(4).
[43] *See* new ERISA § 303(c)(1) and IRC § 430(c)(1).
[44] This illustration assumes that the plan is underfunded. If the plan were overfunded, the plan would not have a funding shortfall for the year, and thus, its minimum required contribution would generally equal its target normal cost for the year.
[45] New ERISA § 303(c)(2) and IRC § 430(c)(2).

- The *shortfall amortization installment* makes up the "*shortfall amortization base*" for the year. The *shortfall amortization base* represents the present value of the installment payment(s) that was due in past years.[46] In other words, the *shortfall amortization base* is made up of all of the past promises to pay the installments that were due each year in the 7 year period.

Because the shortfall amortization base is made up of these past promises to pay, the amount of the payments are added together and subsequently subtracted from the plan's funding shortfall for the year. Thus, if a plan is underfunded for consecutive years, the plan's prior shortfall amortization installments are included in the calculation for determining the plan's underfunding for the year. Adding these new definitions to the above formula, the minimum required contribution is calculated as follows:

Plan Assets − Funding Target = Plan's Underfunding[47]

Plan's Underfunding − Shortfall Amortization Base = Funding Shortfall

Amortization of Funding Shortfall (if any)
+ Target Normal Cost = Minimum Required Contribution

This calculation would be repeated each year. One of the more interesting provisions under the new funding rules provide that if in a plan year, the plan's assets exceed its funding target (meaning there is no funding shortfall for the year), all of the shortfall amortization bases and installments for the preceding years are reduced to zero.[48] In this event, the plan sponsor would no longer be required to calculate its minimum required contribution for the year in the manner illustrated above. Instead, the plan's minimum required contribution would generally be its normal cost for the year.

[46] New ERISA § 303(c)(3) and IRC § 430(c)(3).
[47] Similar to the above illustration, we have assumed that the plan is underfunded.
[48] New ERISA § 303(c)(6) and IRC § 430(c)(6).

The new funding rules are phased in over 4 years starting in 2008. The transition period was included in the Act to accommodate the employer community, who successfully convinced Congress that plan sponsors needed more time to adapt to the new funding regime. While Congress acquiesced to employer demands, the transition rule was drafted in such a way that only a certain number of plan sponsors may be eligible for the transition relief. The limitations inherent in the transition rule call into question the utility of the relief as a whole. Specifically, under the transition rule, a plan will be considered to be fully funded in 2008 if the plan is 92 percent funded, 94 percent funded in 2009, 96 percent funded in 2010, and 100 percent funded thereafter.[49] Here, the funding target is not immediately 100 percent, rather the funding target ramps up to 100 percent over 4 years. However, for those plans that are not funded up to the applicable phase-in level for the year (e.g., 92 percent for 2008), these plans would not qualify for the transition rule, and therefore, would have a funding shortfall for the year based upon the difference between the plan's assets and the 100 percent funding target; not the applicable phase-in level. It is important to note that a plan may enjoy the transition relief in one year, but fail to be eligible for the phase-in in the following year. This inconsistency in the application of the transition rule will surely limit plans' eligibility for the phase-in.

b. Determination of Assets and Liabilities

i. Valuation of Assets

As illustrated above, the value of a plan's assets and liabilities are critical in determining the plan's minimum required contribution for the year. Under the new

[49] New ERISA § 303(c)(5)(B) and IRC § 430(c)(5)(B).

funding rules, the value of a plan's assets may equal the fair market value of such assets, or the assets may be "smoothed" over a 24-month period. However, the smoothing cannot result in values that are lower than 90 percent or greater than 110 percent of the fair market value of such assets at the time of valuation.[50] The manner in which plan assets are valued under the new rules is a slight departure from current law in that, the smoothing may occur over 2 years instead of 5 years. In addition, the corridor for determining the value of the assets is between 90 and 110 percent, not between 80 and 120 percent, which will arguably produce values that reflect the current market value of such assets.

ii. Determination of Liabilities

For purposes of determining the plan's liabilities, plan sponsors are required to use a mortality table prescribed by Treasury which will be based on the actual experience of pension plans and the projected trends in such experience.[51] Treasury will update this table at least every 10 years.[52] There is a special rule that allows certain plans to use plan-specific tables if certain requirements are met.[53]

Beginning in 2008, the interest rate used to determine the present value of plan liabilities will change to interest rates which reflect the duration of the underlying pension liability (i.e., the yield curve). These interest rates will be based on investment-grade corporate bonds that are in the top 3 quality levels (AAA, AA, and A ratings). Three different interest rates will be used to determine these present values based on the

[50] New ERISA § 303(g)(3) and IRC § 430(g)(3).
[51] New ERISA § 303(h)(3)(A) and IRC § 430(h)(3)(A).
[52] New ERISA § 303(h)(3)(B) and IRC § 430(h)(3)(B).
[53] *See* new ERISA § 303(h)(3)(C) and IRC § 430(h)(3)(C). Treasury is also directed to establish special mortality tables for determining disability benefits. New ERISA § 303(h)(3)(D) and IRC § 430(h)(3)(D).

duration of when the liabilities come due: those liabilities payable within 5 years, liabilities payable after 5 years and before 20 years, and liabilities payable thereafter. The rate for each of the three segments is determined by the Treasury Department each month based on bonds maturing during the applicable duration period (i.e., during first 5 years, after 5 and before 20 years, and after 20 years).[54] Each interest rate would then be averaged based on an unweighted 24-month average of these rates.[55] A plan sponsor, however, may make a one-time election to use the full corporate bond yield curve without any averaging, rather than using the 3 separate segment rates.[56] This would allow a plan sponsor to, for example, use rates based on corporate bonds coming due at the time the liability would come due. The use of the 3-segment corporate bond yield curve is phased-in over 3 years. A plan sponsor, however, may make a one-time election to opt out of the phase-in.[57]

The new 3-segment modified corporate bond yield curve is important because the interest rate is generally higher than the 30-year Treasury rate, which means underfunded plan sponsors won't have to make contributions based on artificially high liabilities due to the artificially low 30-year Treasury rate. In addition, the new interest rate gives these plan sponsors certainty that they no longer have to use the 30-year Treasury rate to determine plan liabilities. Recognizing that the new interest rate is not effective until 2008, Congress extended the temporary interest rate enacted under the PFEA (discussed

[54] New ERISA § 303(h)(2)(B), (C) and IRC § 430(h)(2)(B), (C).
[55] New ERISA § 303(h)(2)(D)(i) and IRC § 430(h)(2)(D)(i).
[56] New ERISA § 303(h)(2)(D)(ii) and IRC § 430(h)(2)(D)(ii).
[57] New ERISA § 303(h)(2)(G) and IRC § 430(h)(2)(G).

above) through 2006 and 2007.[58] Enactment of the new modified corporate bond yield curve was a key driver behind the push to enact the new funding rules.

c. Comparison of Current Law and the New Minimum Required Contribution

Under the current funding rules, the minimum required contribution is the amount required to balance all "charges" and "credits" to the funding standard account ("FSA"). In general, charges to the FSA (e.g., unfunded liabilities or losses to the plan) may be amortized over 5, 10, or 30 years.[59] If, however, a plan is subject to the DRC funding rules, unfunded liabilities may generally be amortized over 3 to 7 years.[60] Under this two-tiered funding regime, well-funded plans may determine liabilities based on a stated interest rate under the plan (e.g., 8 percent). Plans subject to the DRC funding rules, however, are required to determine its liabilities by using, for example, the 30-year Treasury rate (depending on the year).

Some policymakers contend that the new minimum required contribution is not a significant departure from current law. Instead, they argue that the new minimum required contribution is a simplification of current ERISA rules because the new funding rules subject all plans to one standard. Specifically, all plans are subject to the same funding target (e.g., 100 percent of liabilities), and all plans must amortize their underfunding over 7 years. Moreover, all plans are required to use the 3-segment modified corporate bond yield curve to determine plan liabilities, unless they elect the single corporate bond rate.

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[58] *See* Section 301 of the Act.
[59] *See* ERISA § 302(b) and IRC § 412(b).
[60] *See, e.g.*, IRC § 412(l)(4).

An interesting inconsistency that results from subjecting all plans to a single funding regime, however, is that plans that are not subject to the current law DRC funding rules will be required to be funded over a shorter period time, while those plans subject to the DRC rules may be funded over a longer period of time. For example, non-DRC plans are permitted to amortize its liabilities over 5, 10, or 30 years, while DRC plans may generally amortize these amounts over 3 to 7 years. Therefore, notwithstanding the fact that the underlying intent of the new funding rules was to ameliorate the problem of underfunding in the defined benefit plan system, it appears that subjecting all plans to a single funding regime punishes well-funded plans and rewards underfunded plans.

2. "At-Risk" Rules

Because the Act eliminates the DRC funding rules, there needed to be a mechanism for requiring increased funding when there was a higher likelihood that an underfunded plan may be terminated. This mechanism was incorporated into the new funding regime under the newly enacted "at-risk" rules. In general, if a plan is "at-risk," the plan sponsor must make greater contributions to the plan (i.e., "at-risk" liability increases the plan's funding target and target normal cost (defined above)). Specifically, "at-risk" liability is determined as if all participants who are eligible for benefits during the current plan year and the next 10 years retire at the earliest possible date and elect benefits that result in the highest present value of liabilities (e.g., subsidized, early retirement payments).[61] If a plan is "at-risk" for 2 out of the 4 preceding years, a load factor of $700 per participant and 4 percent of the funding target and target normal cost

[61] New ERISA § 303(i)(1) and IRC § 430(i)(1).

would apply.[62] This load factor is used to make the funding reflect the reality of a plan that needed to terminate – purchasing annuities on the open market had an additional cost that providing them through the plan did not. For plans that have been "at-risk" for less than 5 consecutive years (starting in 2008), the "at-risk" liability is phased in over 5 years.[63]

A plan will be considered "at-risk" under the new funding rules if, in the previous plan year, the plan is both (i) less than 80 percent funded using the actuarial assumptions set forth under the general funding rules and (ii) less than 70 percent funded using the "at-risk" actuarial assumptions. The 80 percent test is phased in over 4 years: 2008—65 percent, 2009—70 percent, 2010—75 percent, and 2011—80 percent.[64] Plans with 500 or fewer participants are never considered "at-risk."[65] Importantly, as discussed more fully below, for purposes of determining whether a plan is "at-risk," a plan's assets must be reduced by its credit balance, unless the plan sponsor elects to reduce its credit balance prior to determining the value of the plan's assets for the year.[66] Under certain circumstances, well-funded plans that maintain a significant credit balance may fall below the applicable "at-risk" funding threshold if the plan's assets are reduced by its credit balance.

[62] New ERISA § 303(i)(2) and IRC § 430(i)(2).
[63] New ERISA § 303(i)(5) and IRC § 430(i)(5).
[64] New ERISA § 303(i)(4) and IRC § 430(i)(4).
[65] New ERISA § 303(i)(6) and IRC § 430(i)(6).
[66] *See* new ERISA § 303(f)(4)(B)(i), (f)(5) and IRC § 430(f)(4)(B)(i), (f)(5) (discussed more fully below).

3. Treatment and Effect of Credit Balances Under the New Funding Rules

a. Credit Balances Under Current Law

Under current law, if a plan sponsor makes a contribution in excess of its minimum required contribution for the year, these amounts would be treated as a "credit" on the plan's FSA (referred to as a "credit balance"). Credit balances may be used to satisfy the plan's required contribution in future years. If the credit balance is not used during a year, the balance is credited with investment earnings at the interest rate the plan uses to determine its plan liabilities (e.g., an 8 percent interest rate); not the market rate or the actual rate the plan's assets earned. In effect, plan sponsors could pre-fund their plans in good years so that in bad years they can use a portion or all of their credit balance to satisfy the required contribution for the year. If a plan did not use its credit balance during a year, the balance would generate interest at a healthy rate.

In general, it appeared that the ability to maintain credit balances would have a positive impact on funding a defined benefit plan due to the ability to pre-fund the plan. However, the maintenance of a credit balance enabled several plan sponsors to take a funding "holiday" by using its credit balance to satisfy the plan's minimum required contribution for the year instead of contributing hard dollars to the plan. This phenomenon was exacerbated when the fair market value of plan assets declined significantly. Specifically, while plan sponsors were able to apply its credit balance to the plan's required contribution, the plan's actual funding status continued to deteriorate due to the lack of actual dollars being contributed to the plan by the plan sponsor. In addition, the credit balance grew at an assumed rate of return, which, in a down market,

was at a rate higher than the rate the assets in the plan were actually earning. Thus, the credit balance was sheltered from any market losses. For example, a plan with a $10 million credit balance in 2006, growing at 8 percent, would have a credit balance of $10.8 by 2007. Assume, however, that during 2006 the market dropped by 25 percent. Had the $10 million been subject to the 25 percent drop, the credit balance would have been $7.5 million. Here, the plan may use $3.3 million ($10.8 - $7.5) that essentially no longer exists.[67] This phantom amount effectively masked the need for additional funding, thereby contributing to the underfunding of the plan.

b. Credit Balances Under the New Funding Rules

Many plan sponsors continued to believe that, notwithstanding those situations in which plan sponsors effectively masked their plans' underfunding through the use of credit balances, permitting plan sponsors to maintain a credit balance provides a strong incentive to pre-fund plans. However, the Administration and critics of credit balances feared that credit balances would continue to contribute to underfunded plans. In the end, the Congressional conference committee responsible for negotiating the final terms of the Act fashioned a compromise with regard to the maintenance and use of credit balances, thereby allowing a plan sponsor to continue to use credit balances to reduce its minimum required contribution for the year. This so-called compromise, however, has been viewed by many as a disincentive to maintaining a credit balance. Specifically, under the new rules, plan sponsors are permitted to maintain credit balances, but such credit balances must be used to reduce the plan's assets for certain funding purposes (as discussed more fully below).

[67] *See What's a Credit Balance*, American Academy of Actuaries, March 2005.

i. Electing to Maintain a Credit Balance

Under the Act, a plan sponsor with a pre-2008 credit balance may elect to maintain the balance as a "funding standing carryover balance"[68] (hereinafter referred to as "old credit balance"). Beginning in 2008, a plan sponsor that contributes amounts in excess of the plan's minimum required contribution for the year may elect to maintain all or a portion of that amount as a "pre-funding balance"[69] (hereinafter referred to as "new credit balance"). Similar to current law, plan sponsors may elect to use the plan's old and new credit balance to reduce its minimum required contribution for the year.[70] Plans that are less than 80 percent funded under the new funding rules, however, may *not* use these balances to reduce the minimum required contribution.[71] For purposes of reducing the minimum required contribution for the year, the old credit balance must be used before the new credit balance may be used.[72]

ii. Reduction of Plan Assets By Credit Balances

In general, plans that maintain an old or new credit balance (or both) are required to reduce the plan's assets by these balances (or both, if applicable) for purposes of determining:[73]

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[68] New ERISA § 303(f)(1)(B) and IRC § 430(f)(1)(B).
[69] New ERISA § 303(f)(1)(A) and IRC § 430(f)(1)(A).
[70] New ERISA § 303(f)(2)(A), (f)(3) and IRC § 430(f)(2)(A), (f)(3).
[71] New ERISA § 303(f)(3)(C) and IRC § 430(f)(3)(C).
[72] New ERISA § 303(f)(3)(B) and IRC § 430(f)(3)(B).
[73] New ERISA § 303(f)(4)(B)(i) and IRC § 430(f)(4)(B)(i). In the case of a plan that is subject to a binding written agreement with the PBGC that provides that the plan's credit balance is not available to reduce its minimum required contribution for the year, plan assets are not reduced by the old and new credit balance for purposes of determining the amount of the funding shortfall used to determine the minimum required contribution for the year. Note, plans subject to such a PBGC agreement must continue to reduce plan assets by its credit balance for purposes of determining whether the at-risk rules and benefit restrictions apply. See new ERISA § 303(f)(4)(B)(ii) and IRC § 430(f)(4)(B)(ii).

- The amount of the funding shortfall used to determine the minimum required contribution for the year. This would generally result in a higher minimum required contribution due for the year.

- Whether the plan is "at-risk." As discussed above, this would result in a plan having to make greater contributions to the plan during the year in which the plan was "at-risk."

- Generally, whether the benefit restrictions apply. As discussed more fully below, this would require the plan to limit benefit increases, restrict certain benefit payments, and freeze benefit accruals if the plan did not meet an applicable funding threshold.

Unlike reducing plan assets by the old *and* new credit balance (as required for those funding purposes listed above), the Act adds intricate requirements for reducing plan assets for certain other purposes, namely, determining the 80 percent limitation on the use of credit balances (discussed above) and whether a plan is eligible for the phase-in of the 100 percent funding target (also discussed above). For purposes of determining eligibility for the funding target phase-in, plan assets are required to be reduced by the new credit balance, but *not* the old credit balance (if any), *but only if* the plan sponsor affirmatively elects to apply a portion of the new credit balance to reduce its minimum required contribution for the year.[74] Moreover, for purposes of applying the 80 percent limitation, a plan sponsor is required to reduce its plan assets by its new credit balance, but *not* its old credit balance (if any).[75]

iii. Waiving Credit Balances

In light of the limitations policymakers successfully wove into the rules relating to the maintenance and use of credit balances, these same policymakers gave plan sponsors the ability to get rid of its credit balances altogether. Specifically, plan sponsors may

[74] New ERISA § 303(f)(4)(A) and IRC § 430(f)(4)(A).
[75] New ERISA § 303(f)(4)(C) and IRC § 430(f)(4)(C).

elect to reduce all or a portion of its old or new credit balance prior to determining the value of the plan's assets for the year. If such an election is made, however, such balances are eliminated forever. The old credit balance must be reduced to zero before the plan sponsor can elect to reduce all or any portion of its new credit balance.[76]

iv. Investment Earnings

Finally, in response to the anomalies resulting from crediting a plan's credit balance with an assumed rate of return, the Act provides that the old and new credit balances must be adjusted annually to reflect investment performance in the underlying plan assets. Treasury is directed to issue regulations instructing how the adjustment is made.[77]

5. Benefit Restrictions

Under the current funding rules, plan sponsors are prohibited from increasing benefits[78] or making certain benefit payments[79] under certain circumstances. The underlying policies of these limited provisions are to prevent plan assets from leaking out of the plan and preventing a "run on the bank" when a plan sponsor finds itself in financial difficulty. The Act expands these restrictions to apply more broadly and adds new benefit restrictions to further these policy goals. Specifically, policymakers believed that additional safeguards should be incorporated into the new funding rules to ensure that plan assets stay in the plan in situations where a plan is significantly underfunded.

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[76] New ERISA § 303(f)(5) and IRC § 430(f)(5).
[77] New ERISA § 303(f)(8) and IRC § 430(f)(8).
[78] Generally, a plan may not be amended to increase benefits if the plan's funded current liability percentage is less than 60 percent or the plan sponsor is bankrupt. IRC §§ 401(a)(29) and 401(a)(33).
[79] Plans with a "liquidity shortfall" under the quarterly contribution requirements cannot pay benefits in a form other than a life annuity. ERISA § 206(e). In general, a plan has a liquidity shortfall if the plan's liquid assets are not sufficient enough to meet its required quarterly installment payment. *See* IRC § 412(m)(5)(E)(i).

a. In General

Under the new funding rules, limitations are placed on (i) benefit increases, (ii) benefit payments, (iii) benefit accruals, and (iv) the payment of shutdown benefits if a plan is below a certain funded threshold. These limitations are based on a plan's "adjusted funding target attainment percentage." A plan's adjusted funding target attainment percentage is the ratio of the plan's assets (reduced by its credit balances, unless the plan sponsor waives these balances (discussed more fully below)) compared to its funding target, but the funding target is increased by an amount that assumes that the plan purchased annuities for all participants who were non-highly compensated employees for the preceding two years.[80]

b. Benefit Increases

Under the new funding construct, a plan cannot be amended to increase benefits if the plan has an adjusted funding target attainment percentage that (i) is less than 80 percent, or (ii) would be less than 80 percent taking into account the amendment.[81] The restriction on benefit increases does not apply if the plan sponsor makes contributions (or provides security) to the plan (i) to pay for the increase, or (ii) to satisfy the 80 percent funded threshold.[82] In addition, this restriction does not apply if an amendment to the plan provides for an increase in benefits under a formula which is not based on a participant's compensation, so long as the rate of such increase is not in excess of the contemporaneous rate of increase in average wages of plan participants (e.g., cost-of-

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[80] New ERISA § 206(g)(9)(B) and IRC § 436(j)(2).

[81] New ERISA § 206(g)(2)(A) and IRC § 436(c)(1). As discussed more fully below, a plan's assets must be reduced by its credit balance (unless the plan sponsor elects to waive the balance) for purposes of determining whether the plan is 80 percent funded. *See* new ERISA § 303(f)(4)(B)(i), (f)(5) and IRC § 430(f)(4)(B)(i), (f)(5).

[82] New ERISA § 206(g)(2)(B) and IRC § 436(c)(2).

living increases in flat-dollar plans are generally excepted from this restriction).[83] Further, this restriction does not apply to new plans for the first 5 plan years.[84]

c. Benefit Payments

The new rules also provide that (i) a plan that has an adjusted funding target attainment percentage that is less than 60 percent, or (ii) a plan whose sponsor is in bankruptcy and is less than 100 percent funded cannot pay benefits in a form other than a life annuity.[85] However, if a plan's adjusted funding target attainment percentage is between 60 percent and 80 percent, the plan is permitted to make a one-time lump sum payment that is limited to the lesser of (i) the present value of the participant's maximum PBGC guaranteed benefit or (ii) 50 percent of the amount of the payment that could otherwise be paid.[86] This restriction does not apply to a plan that is frozen as of September 1, 2005, and continues to be frozen thereafter.[87] If a plan is no longer subject to this restriction, benefit payments, including lump sum payments, may resume unless otherwise provided for in the plan.[88]

d. Benefit Accruals

Another restriction under the Act provides that if a plan has an adjusted funding target attainment percentage that is less than 60 percent, the plan must freeze all future

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[83] New ERISA § 206(g)(2)(C) and IRC § 436(c)(3).
[84] New ERISA § 206(g)(6) and IRC § 436(g).
[85] New ERISA § 206(g)(3)(A), (B) and IRC § 436(d)(1), (2). As discussed more fully below, a plan's assets must be reduced by its credit balance (unless the plan sponsor elects to waive the balance) for purposes of determining the plan's funded threshold. *See* new ERISA § 303(f)(4)(B)(i), (f)(5) and IRC § 430(f)(4)(B)(i), (f)(5).
[86] New ERISA § 206(g)(3)(C) and IRC § 436(d)(3).
[87] New ERISA § 206(g)(3)(D) and IRC § 436(d)(4).
[88] New ERISA § 206(g)(8) and IRC § 436(i).

benefit accruals.[89] Similar to the restriction on benefit increases, this restriction does not apply if the plan sponsor makes contributions to the plan (or provides security) to satisfy the 60 percent funded threshold,[90] and it does not apply to new plans for the first 5 plan years.[91] Similar to the restriction on benefit payments, if a plan meets the applicable funding threshold, benefit accruals may resume unless otherwise provided for in the plan.[92]

e. Shutdown Benefits

Finally, shutdown benefits (or benefits payable upon any other unpredictable contingent event) may not be made if a plan has an adjusted funding target attainment percentage that (i) is less than 60 percent or (ii) would be less than 60 percent by reason of paying such benefits.[93] Similar to the restriction on benefit increases, this restriction does not apply if the plan sponsor makes contributions to the plan (or provides security) to (i) pay for the provision of the benefits, or (ii) satisfy the 60 percent funded threshold.[94] Also, this restriction does not apply to new plans for the first 5 plan years.[95]

f. Notice of Restrictions

With respect to the restrictions on (i) benefit payments, (ii) benefit accruals, and (iii) the payment of shutdown benefits, the plan administrator must furnish written or

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[89] New ERISA § 206(g)(4)(A) and IRC § 436(e)(1). As discussed more fully below, a plan's assets must be reduced by its credit balance (unless the plan sponsor elects to waive the balance) for purposes of determining whether the plan is 60 percent funded. See new ERISA § 303(f)(4)(B)(i), (f)(5) and IRC § 430(f)(4)(B)(i), (f)(5).
[90] New ERISA § 206(g)(4)(B) and IRC § 436(e)(2).
[91] New ERISA § 206(g)(6) and IRC § 436(g).
[92] New ERISA § 206(g)(8) and IRC § 436(i).
[93] New ERISA § 206(g)(1)(A) and IRC § 436(b)(1). As discussed more fully below, a plan's assets must be reduced by its credit balance (unless the plan sponsor elects to waive the balance) for purposes of determining whether the plan is 60 percent funded. *See* new ERISA § 303(f)(4)(B)(i), (f)(5) and IRC § 430(f)(4)(B)(i), (f)(5).
[94] New ERISA § 206(g)(1)(B) and IRC § 436(b)(2).
[95] New ERISA § 206(g)(6) and IRC § 436(g).

electronic notice of the respective restriction to participants within 30 days of its application.[96]

g. Effect of Credit Balances on the Benefit Restrictions

As discussed above, opponents of credit balances successfully added limitations to the use and maintenance of credit balances by requiring plan assets to be reduced by such balances for certain funding purposes. One such purpose is the application of the newly enacted benefit restrictions. Specifically, for purposes of calculating a plan's adjusted funding target attainment percentage (discussed above), the plan's assets must be reduced by its credit balance, unless the plan sponsor elects to waive its credit balance prior to determining the value of the plan's assets for the year. However, the Act includes an important exception to this rule. Under this special rule, if a plan is at least 100 percent funded *without reducing* plan assets by its old or new credit balance, the benefit restrictions shall *not* apply. Like the phase-in of the 100 percent funding target (discussed above), this 100 percent threshold is phased in over 4 years, thereby enabling plans to avoid the benefit restrictions altogether if the plan is funded up to the following phase-in levels: 2008—92 percent; 2009—94 percent; 2010—96 percent; and 2011 and thereafter—100 percent. This transition rule is not available if a plan fails to meet the applicable funding threshold for the preceding plan year.[97]

Notwithstanding this favorable rule, the new funding rules include two special rules that require plan sponsors to automatically waive (i.e., reduce) its credit balance at the beginning of the plan year if the plan is below any of the applicable funding

[96] New ERISA § 101(j).
[97] New ERISA § 206(g)(9)(C) and IRC § 436(j)(3).

thresholds. Specifically, if a collectively bargained plan maintains an old or new credit balance, such balances must be reduced to the extent such reduction will result in the plan not being subject to (i) the prohibition against increasing benefits, (i) the requirement to freeze benefit accruals, and (iii) the restriction on paying shutdown benefits. If *any* plan is prohibited from paying benefits in a form other than a single life annuity (e.g., the plan is less than 60 percent funded) and the plan maintains an old or new credit balance, such balances must be reduced to the extent the reduction will result in the plan not having to limit benefit payments.[98]

III. Effect of the Act on Defined Benefit Plan Participants

A. Plan Sponsors May Freeze Their Defined Benefit Plans

Participation rates among defined benefit plans have stagnated over the past three decades due in large part to the decision to freeze participation in a defined benefit plan and instead, offer participation in a 401(k) plan.[99] Most recently, a number of profitable companies have chosen to freeze participation in, or future benefit accruals under, their defined benefit plans.[100] It appears that this trend will continue, if not speed up, due to the enactment of the new defined benefit plan funding rules. Specifically, a recent study shows that 60 percent of the chief investment officers of many of the nations' largest corporate pension plans stated that the enactment of the new defined benefit plan funding

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[98] New ERISA § 206(g)(5)(C) and IRC § 436(f)(3).
[99] U.S. General Accounting Office, *Private Pensions: Improving Worker Coverage and Benefits*, GAO-02-225, April 2002, p. 6-8.
[100] *See* Ellen E. Schultz, Charles Forelle and Theo Francis, *Forecast: More Pension Freezes*, The Wall Street Journal, Jan. 12, 2006; Pamela Yip, *Companies Warm to Freezing Pensions*, Dallas Morning News, Jan. 11, 2006, Albert B. Crenshaw and Amy Joyce, *IBM Adds its Name to List of Firms Freezing Plans*, Washington Post, Jan. 6, 2006, at A01; Nanette Byrnes, *The Rush to Shut Down Pensions*, BusinessWeek, Jan. 9, 2006.

rules would prompt them to freeze their plans in some capacity (i.e., freeze participation or future benefit accruals).[101]

Why will the new defined benefit rules prompt plan sponsors to freeze their plans? First, the new defined benefit plan funding rules require plan sponsors to fund their plan up to a higher level and over a shorter period of time. This may force a plan sponsor who maintains a well-funded plan to, for example, freeze benefit accruals because the plan sponsor is unable to make the required level of contributions to the plan under the new funding schedule. In addition, an employer may determine that its future economic performance will be negatively impacted due to its long-term funding obligations under the new rules.

Another reason why the new funding regime could force a plan sponsor to freeze its plan is the addition of the new restrictions on benefits. For example, a plan may choose to permanently freeze its plan if the plan is required to freeze benefit accruals because the plan is less than 60 percent funded. In addition, some plan sponsors may decide that they could mitigate any employer-employee relations' issue by freezing its defined benefit plan and offering a defined contribution plan instead of telling plan participants that they cannot receive a lump sum benefit. Moreover, collective bargaining negotiations may be hampered if a plan sponsor is unable to increase benefits.

While arguably not a direct reason why plan sponsors would freeze their plans, the effect credit balances will have on plan assets under the new funding regime may be viewed a condition that punishes those plan sponsors that have, and intend to, pre-fund

[101] *Pension Reform: Impact on Defined Benefit Plans*, Committee on Investment of Employee Benefit Assets ("CIEBA"), September 2005.

their plan. Consideration of this arbitrary rule may cause company executives to conclude that maintaining a defined benefit plan is no longer worth the time and effort. This may be especially true if a well-funded plan would otherwise be considered "at-risk" or subject to benefit restrictions as a result of reducing their plan assets by an otherwise large credit balance.

B. Possible Effect of the Act on the Retirement Security of Defined Benefit Plan Participants

The employer-provided pension system was established to augment a worker's retirement security. Social Security benefits were created to serve as a foundation from which a worker can build their retirement income. Rounding out the oft quoted "three-legged stool" of retirement income is individual savings and earnings. Although Social Security benefits contribute to most of an individual's retirement income (approximately 42 percent), pension benefits make up about 18 percent of a person's retirement income.[102] If the amount of pension benefits payable to an individual is diminished, the individual's retirement security would be called into question, requiring the individual to generate retirement income from other sources. In addition, studies have shown that defined benefit plans generally provide more benefits per dollar than other savings vehicles, such as defined contribution plans.[103] Thus, by freezing participation or benefit accruals under a defined benefit plan and, for example, offering a defined contribution plan, would not be an adequate replacement of a worker's retirement income, thereby adversely affecting a worker's overall retirement security.

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[102] U.S. General Accounting Office, *Retirement Income: Implications of Demographic Trends for Social Security and Pension Reform*, GAO/HEHS-97-81 (July 1997), p. 23-24.
[103] *See Pension Reform: Impact on Defined Benefit Plans*, Committee on Investment of Employee Benefit Assets ("CIEBA"), September 2005.

Moreover, freezing participation or benefit accruals under a defined benefit plan would eliminate guaranteed retirement benefits generally payable for life. Specifically, defined benefit plans provide guaranteed benefits based on a fixed formula that takes into account a worker's years of service, earnings or both, and are generally paid out over the life of the worker. Because the employer guarantees these benefits, the employer is essentially shouldering all of the risk associated with funding the benefit. In contrast, benefits under a defined contribution plan are not guaranteed and instead are made up of contributions of the employer, the employee, or both, which are invested in some type of interest bearing vehicle (e.g., bonds or equities) on the open market. Here, the individual bears the risk associated with investment performance and is generally responsible for augmenting his or her own retirement income by socking away their own money. If the guaranteed benefits provided under a defined benefit plan are eliminated or replaced with defined contribution-type benefits, an individual's retirement income could be reduced significantly.

IV. Conclusion

While the rules set forth under the Pension Protection Act of 2006 were not intended to push plan sponsors into freezing their defined benefit plans, the Act was intended to ensure that the promise to pay expected benefits to workers was kept. This underlying intent is illustrated by requiring plans to be 100 percent funded and requiring plan sponsors of significantly underfunded plans to make greater contributions to the plan under the “at-risk” rules. The Act was also intended to address the problem of underfunding caused by the use of credit balances and the ability to mask underfunding

by averaging plan assets and liabilities, which often did not reflect current market values. To be sure, it appears that the Act will accomplish its goal of ameliorating the problem of underfunding in the defined benefit plan system, but this goal may be reached at the expense of current defined benefit plan participants who may see their pension benefits frozen, thereby calling into question the retirement security of defined benefit plan participants and the American public as a whole.