May 30, 2024

Senator Bernie Sanders, Chair
Health, Education, Labor, and Pensions Committee
United States Senate

Submitted electronically to *pensions@help.senate.gov*

Re: Ways to Bolster the Defined Benefit Pension System—Request for Information

To Whom It May Concern:

The Retirement Practice Council (RPC) of the American Academy of Actuaries[1] (Academy) is pleased to respond to the request for information (RFI) in the report by majority staff of the U.S. Senate Health, Education, Labor, and Pensions (HELP) Committee, *A Secure Retirement for All,* dated February 28, 2024. The RFI asks what Congress could do to bolster and drive the creation of new defined benefit (DB) pensions. The Council appreciates the Committee's attention to this important matter, as well as the opportunity to provide commentary.

Summary

The concepts discussed in this letter are high-level in nature. We understand that implementing any of these suggestions would require more detail to craft effective legislation that balances the interests of workers, employers, and other stakeholders. We would welcome the opportunity for further discussion with HELP Committee Staff.

This letter primarily focuses on ways to promote and support single-employer DB pension plans under the Employee Retirement Income Security Act (ERISA), in a manner that could be beneficial to employers and participants alike. We would invite similar discussions on Social Security, multiemployer DB plans, DB plans covering public sector employees, and legislative changes related to defined contribution (DC) plans, as they relate to the RFI's focus on potential retirement solutions Congress might consider.

The following is a list of ways legislation could support DB plans for American workers. Each of these points is discussed further in this letter, with references to relevant Academy publications where applicable, along with commentary on issues related to these key suggestions.

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[1]The American Academy of Actuaries is a 20,000-member professional association whose mission is to serve the public and the U.S. actuarial profession. For more than 50 years, the Academy has assisted public policymakers on all levels by providing leadership, objective expertise, and actuarial advice on risk and financial security issues. The Academy also sets qualification, practice, and professionalism standards for actuaries in the United States.

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1. **Facilitate lifetime income.** DB plans are inherently structured to provide lifetime retirement income. However, over time, changes in federal law and accounting rules have made DB plans less appealing to employers and encouraged many DB plans to offer lump sum payouts in lieu of lifetime retirement income. Changing federal law has the potential to encourage employers, as well as employees, to favor plans providing lifetime retirement income over those providing or encouraging lump sums.

2. **Right-size PBGC premiums.** Based on the current funded status of the Pension Benefit Guaranty Corporation (PBGC) single-employer program, premiums are currently well above "the lowest level consistent with carrying out its obligations." Changes to the premium structure could better encourage the continuation of private pension plans.

3. **Expand and encourage permissible risk-sharing plan designs.** Over the past two decades, employers have moved away from traditional DB plans largely because of their risks, which are borne almost entirely by the employer. More recently, DB plan design has trended toward DB plans where the risk is shared by employers and plan participants. These designs vastly reduce employers' risk associated with plan investment returns, interest rates, and other factors, while still providing plan participants with secure lifetime retirement income.

4. **Allow pre-tax employee contributions to DB plans.** Most private-sector DB plans do not allow employees to contribute. When plans do allow it, employees are taxed up-front on those contributions. To put DB plans on equal footing with DC plans, federal law could be changed to allow these contributions to be made on a pre-tax basis. This change would allow employees to increase their lifetime income benefits in a tax-efficient manner through a DB plan, as they can today in a DC plan.

5. **Allow pooled DB plans.** The SECURE Act created a new kind of DC plan called a pooled employer plan (PEP). Changes in federal law could expand this concept to DB plans. If combined with risk-sharing plan designs, DB PEPs could significantly reduce the barriers of sponsoring a pension plan to employers and broadly expand coverage for American workers.

6. **Modify DB pension funding rules.** Current funding rules for single-employer defined benefit plans are not clearly consistent with the underlying economics of risk-sharing plan designs, such as variable annuity and market-return cash balance plans. Clarifications to the rules governing funding of these plans could encourage employers to offer this type of design. More broadly, DB plan funding rules could also be simplified and improved to strike a better balance between predictability of contributions and plan sustainability.

The Importance of Lifetime Income

The Academy believes that retirement security would be significantly improved by the promotion of lifetime income.[2] Lifetime retirement income should be pursued from both ends—plan sponsors can be encouraged to offer lifetime income options while individuals can be encouraged to take these options instead of lump sums.

[2] American Academy of Actuaries Position Statement, "Retirement Income Options in Employer-Sponsored Defined Contribution Plans," October 2017.

By default, DB plans offer lifetime retirement income. DC plans, on the other hand, are individual retirement savings accounts. When the plan permits, participants can use their DC plan account balances to purchase a lifetime annuity from an insurance company at group insurance rates. However, in most cases, participants elect to manage their DC plan savings on their own, by spending the money down over their lifetime. For many retirees, there are significant risks with this approach, not the least of which is the possibility of outliving their retirement savings.

Over the years, an increasing number of DB plans have begun offering terminating and retiring participants the option to take their benefit as a single lump sum payment instead of a benefit payable monthly for their lifetime. In particular, cash balance and other hybrid plans often express benefits as lump sum amounts in their communications with participants. Although IRS regulations require all DB plans to offer a qualified annuity option,[3] participants often choose lump sums when offered, meaning that the participants must then manage the spending down of these benefits like DC plan accounts.

Currently, the legislative, regulatory, and accounting frameworks give DB plan sponsors incentives to offer participants lump sums. If a participant takes a lump sum, the plan sponsor bears no further risk for that participant's benefit. Any balance sheet liability related to that benefit is eliminated and the plan sponsor no longer has to pay PBGC premiums or administrative expenses for that participant.

Risk-sharing DB plan designs (which are discussed later in this letter) could encourage plan sponsors to provide lifetime retirement income options, rather than offering a lump sum when the participant terminates or retires. Changes to tax law could also encourage employees to elect lifetime income options at retirement. For example, lower tax rates could apply to a portion of a lifetime annuity an employee elects to receive from their retirement plan.

PBGC Premium Reform

PBGC's single-employer program plays a vital role in protecting pension benefits in private-sector DB plans. Currently, PBGC's single-employer program is in a strong financial position. At the same time, PBGC premium levels are so high that they may deter employers from sponsoring DB plans. Immediate and significant changes to the premium structure could encourage the continuation of voluntary private pension plans and maintain premiums at the lowest level necessary, consistent with PBGC's mission.

In March 2024, the Academy published an issue brief focusing on PBGC premium reform, "Aligning the PBGC's Single-Employer Premium Structure with Its Objectives." The issue brief outlines potential approaches to changing both the premium structure and premium-setting authority and parameters. It emphasizes that a combination of changes could result in a significant reduction in premiums if the goal of any proposal is to support PBGC's mission and remove premiums as a significant impediment to the ongoing maintenance of DB plans. The Retirement Practice Council sees value in focusing on the primary objective of quickly and significantly reducing premiums and removing any structural impediments to that objective—namely reforming the way premiums are handled for the purposes of congressional budget scoring. It would be entirely consistent with the principles discussed in this issue brief to focus on those objectives. Other modifications to the system that are more targeted at how premium costs are allocated among plan sponsors could be considered over a longer timeframe.

[3] IRS regulations, section 1.417(e)-1(b)(1), require DB plans to offer a Qualified Joint and Survivor Annuity (QJSA) option for non-de minimis lump sum amounts.

Improvements to Plan Designs

In September 2023, the Academy published an issue brief that discussed enhancements that could be made to both DB and DC retirement plan designs, "Enhancing Retirement Security Through Changes in Plan Design and Related Requirements."

We believe the following key points from this issue brief are most relevant to the scope of the RFI. We have also provided additional points and commentary we hope Committee staff will find helpful.

Risk-Sharing Plan Designs

Under a traditional DB plan design, the plan sponsor bears all risks related to investment returns and participant demographics. Alternative DB plan designs can fully or partially transfer these risks to participants while still providing them with lifetime income. These risk-sharing plan designs are often more attractive to plan sponsors than traditional DB designs.

One common risk-sharing design is the variable annuity plan (VAP). Under a VAP, the retiree receives a monthly benefit over their lifetime. The amount of that benefit, however, is automatically adjusted based on investment returns on plan assets. Many VAP designs include mechanisms that stabilize benefit volatility, so retirees have a more predictable monthly income. As discussed later in this letter (see the section on *Changes to Funding Rules*), changes to federal funding rules clarifying the valuation discount rate could encourage adoption of VAP designs.

Under current federal rules for DB plans, benefit adjustments under risk-sharing plan designs can be based on investment returns on plan assets or specified market indices, but they cannot consider non-investment experience such as participant longevity or demographics. It is important to note that certain public sector plans and church plans—which are not subject to ERISA requirements—already adjust benefits to reflect non-investment experience or plan funding levels.

Federal rules could be changed to permit risk-sharing DB plan designs to adjust benefit amounts based on non-investment experience, further protecting employers from risk. Laws could also give incentives to employers to adopt risk-sharing DB plan designs that provide lifetime income by permitting greater flexibility on funding requirements and by reducing PBGC premiums.[4]

For additional references, please refer to the October 2021 Academy issue brief on risk-sharing plan designs, "New Retirement Plan Designs: Degrees of Risk Sharing."

Effective Surplus Use

Over the years, many large employers that sponsor DB plans have frozen them, meaning their employees are no longer earning benefits under the plans. Currently, frozen plans are often overfunded, due to

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[4] As an example, the Giving Retirement Options to Workers (GROW) Act would have permitted multiemployer plan sponsors the option of adopting a risk-sharing design called the "composite plan," which would adjust benefits based on plan funding levels. As an incentive to adopt a composite plan design for benefits earned in the future, the proposal would have provided flexibility on funding rules for benefits earned in the past. The proposal would also have reduced PBGC premiums for plan sponsors that adopt a composite plan design. Similar provisions could be used to incentivize single-employer plan sponsors to adopt risk-sharing DB designs that provide lifetime income.

favorable investment returns and the rise in interest rates since late 2022. However, the Internal Revenue Code (IRC) imposes strict limitations on how plan sponsors can access these surpluses, leaving them "trapped" inside the plan.

The Enhancing Retirement Security issue brief, mentioned above, discusses increasing the flexibility with which plan sponsors can use the surplus of a well-funded frozen DB plan. Providing sponsors with more flexibility to use these surpluses may help employers feel more comfortable putting capital into these plans.

In November 2023, after the Academy issue brief was published, the IBM Corporation made headlines when it announced it would unfreeze its DB plan and implement a cash balance design going forward. The new benefits earned under the DB plan will replace contributions employees had been receiving under a 401(k) DC plan. The move gave IBM access to the "trapped" DB surplus and helped with IBM's cash flow management. This demonstrates that, compared with DC plans, DB plans can provide employers with more flexibility in the timing and amount of contributions.

This development raises the question of whether changes to federal law could encourage employers to utilize previously frozen DB plan funding surpluses while at the same time establishing future service formulas that provide lifetime retirement income. As noted earlier, providing flexibility on funding rules and reducing PBGC premiums could be used as incentives to encourage employers to adopt risk-sharing plan designs that provide lifetime income.

Employee Contributions

DC retirement plans usually permit employee contributions on a pre-tax basis. For example, employees participating in a 401(k) plan can grow their account balances by making contributions themselves—subject to IRS maximum limitations—in addition to whatever their employer contributes. As described in the Enhancing Retirement Security issue brief, mentioned above, single-employer DB plans subject to ERISA can only accept employee contributions on an after-tax basis, and only if the plan requires these contributions.

To put DB plans on a more even footing with DC plans, changes to federal law could allow DB plans to accept employee contributions on a pre-tax basis, providing comparable tax treatment to DC plans. Employees could make voluntary contributions to purchase additional DB benefits based on the value of those contributions. Cash balance plan designs can be more readily structured in this manner, although this concept could be extended to other designs as well.

Pooled Employer Plans

Small employers often do not have the resources to sponsor a single-employer DB plan. As discussed in the Academy's September 2023 issue brief, the "Setting Every Community Up for Retirement Enhancement (SECURE) Act" created pooled employer plans (PEPs), a new kind of plan meant to be accessible to a wider range of employer. Changing federal law to allow DB PEPs could provide a framework for employer-sponsored lifetime retirement income programs that are both widely available and truly portable. Employees who change jobs can accumulate pension benefits across multiple employers, regardless of their industry.

Permitting the establishment of DB PEPs could help ease the administrative burden of DB plans, but such permission would not ameliorate all of the issues that have driven employers away from DB plans over the years. If DB PEPs could be implemented with risk-sharing designs that minimize the possibility of unfunded liability, they would be more attractive to employers. For example, over the past decade, many multiemployer plans have implemented VAP designs with the goal of avoiding unfunded liability. Similar plan design concepts could be applied to DB PEPs.

Another important consideration is how DB PEPs track and administer employee benefits. Plan administration could be handled as a standalone entity or by a third-party provider, as is often the case with multiple-employer plans and multiemployer plans.

It is important to note that ERISA already provides options for two or more employers to co-sponsor DB plans. These plans are limited, however, to employers in a common industry ("multiple-employer" plans), or to collectively bargained employees covered by the same union or unions ("multiemployer" plans).

Changes in federal law could expand access to these co-sponsored DB plan arrangements, such as relaxing the common-industry rule. However, employers may be reluctant to adopt these plans without further changes, such as a guarantee that the PBGC will not hold employers responsible for another participating employer's benefit obligations.[5]

The RPC's Pension Committee discussed these concepts in greater detail in a 2016 letter to Senator Susan Collins, which covered both DB and DC pooled employer plans.

Allow Additional Flexibility in How DB Benefits Accrue

Current federal laws and regulations require that DB plans provide "definitely determinable" benefits that accrue according to a stipulated formula that is not subject to the employer's discretion. Changes in these rules could allow a plan sponsor to vary the level of benefits provided in a given year, including the right to eliminate benefit accruals altogether for that year, based on the sponsor's ability and desire to fund the benefit at the time it is earned. DC plan sponsors are permitted to provide a "profit sharing" contribution in years when the sponsor is able and willing. This proposal would extend the same treatment to DB plan sponsors with the requirement that the benefit be payable in the form of an annuity at normal retirement, as is the case with any other DB plan accrual.

Changes to Funding and Accounting Rules

Changes to Funding Rules

Current funding rules for single-employer DB plans, which tie the discount rate to bond yields, were established with traditional DB formulas in mind. This approach is not consistent with the underlying economics of risk-sharing plan designs, such as variable annuity and market-return cash balance plans, as discussed in the Enhancing Retirement Security issue brief, mentioned above. Clarifications to the rules governing funding of these plans, allowing for consistency between the rate of return used to project future benefits and the interest rate used to discount those benefits, would encourage employers to offer

[5] One way to address this particular concern would be for PBGC to treat each employer's portion of the plan as if it were a single-employer plan.

this type of design. Legislative changes to the rules governing discount rates may be necessary to give regulators the comfort they need to reflect this approach.

In April 2022, the Academy published an issue brief detailing various considerations for changes to funding rules for all single-employer DB plans, not just VAPs. The "Public Policy Considerations for Changing Single Employer Pension Plan Funding Rules" issue brief discusses approaches for balancing the interests of various stakeholders and making minimum contribution requirements sustainable and appropriate.

In June 2021, the RPC's Pension Committee wrote a letter to the U.S. Department of Treasury suggesting changes to funding rules for single-employer DB plans that would simplify and increase flexibility on the maintenance and application of funding credit balances. We believe these changes would help maintain the original intent of the funding balances under the Pension Protection Act of 2006.

Changes to Accounting Rules

Note: The RFI requests commentary on possible updates to "accounting and funding rules for pensions." We recognize that Congress does not control financial accounting standards, but we have included the commentary below for completeness. Many plan sponsors find pension accounting rules to be a significant deterrent to maintaining DB plans, due to fluctuations in balance sheet liabilities.

The Financial Accounting Standards Board (FASB) overhauled pension accounting rules in December 1985 with the release of Statements Number 87 and 88. Over the 35 years since these rules were established, DB pension plan design has changed significantly but the accounting rules have not kept up. In response to FASB's 2021 Invitation to Comment, the RPC's Pension Committee offered a written response that includes a number of significant suggestions and comments related to the existing rules.

Employee Education

Educating individuals in personal finance, including retirement planning, is a worthy and valuable societal goal. Many schools offer instruction in personal finance, though it is unclear to what extent that includes retirement planning topics. The Department of Education could consider collecting information on this issue, in an effort to establish federal programs and create additional recommendations to develop educational tools and materials for all ages.

In the workplace, individuals with plan coverage are provided information about their plans and plan benefits, but not all that information is as helpful as it could be. In the RPC's Lifetime Income Risk Joint Committee's November 2020 letter to the DOL on Lifetime Income illustrations, we provided input that would improve the value of the information being provided to plan participants.

Enhancing DC Plan Designs

With the rising popularity of DC plans, it is critical to consider how best to encourage those plans to provide participants lifetime income options. The Academy paper on alternative DC plan designs outlines innovative designs that could help with this effort.

Closing

The Academy's RPC and the Pension Committee appreciate the opportunity to respond to the RFI in the report by HELP Committee majority staff. We would welcome the opportunity to discuss any of the ideas included in this letter with HELP Committee staff in more detail.

Respectfully submitted,

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