

Issuing Debt to Fund Corporate Pension Plans

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March 2010

Sponsors of underfunded corporate defined benefit plans will be required to fund their plans over the next few years. However, in the current economic environment, many companies might prefer to hold on to their cash for maximum flexibility. Could issuing debt be an answer?

Reasons to Consider Issuing Debt to Fund a Corporate Pension Plan

Reduce PBGC Premiums

Underfunded plans must pay the Pension Benefit Guaranty Corporation (PBGC) \$9 million per \$1 billion of unfunded liabilities each year. The PBGC is a government agency responsible for guaranteeing pension promises of bankrupt entities. Fully funded plans do not have to pay these "penalty premiums."

Avoid Lump Sum or Benefit Restrictions

Under the Pension Protection Act (PPA), if your plan is less than 80% funded, the participants may not be allowed to receive their full lump sum benefit. If your plan is less than 60% funded, participants "may not receive" any lump sum benefits. Sponsors of significantly underfunded plans may even be required to freeze the plan.

Lower Pension Expense

Simply put, if your plan is better funded, you will have a lower pension expense (or higher pension income). Actual results depend on your unique circumstances.

Take Advantage of Tax Incentives

There are tax incentives associated with issuing debt to fund a pension plan. First, when you issue debt, you can reduce your taxable corporate income. Second, your contributions to the plan are tax-deductible. Finally, qualified plan assets grow tax free.

Low Interest Rates = Low Borrowing Costs

As many economists expect interest rates to rise, this may be an opportune time to issue debt while rates are at historic lows.

Simplify the Budgeting Process

If you issue debt to fund your plan and simultaneously invest plan assets in a liability-hedged bond portfolio, you can turn the volatile PPA contribution requirements into a steady stream of interest payments, principal payments, and annual accruals.

Extend Funding Time Horizon

The PPA rules are designed to right-size your plan in seven years. You can issue a longer-dated bond at a fixed rate, giving you the flexibility to pay off the debt in a time period more favorable to your business.

Side-Step Administrative Headaches

Under the PPA, if your plan is significantly underfunded, you must provide extra details in your annual funding notice. This notice will likely prompt calls to HR from concerned participants and maybe a few anxious executives (non-qualified benefits cannot be funded for severely underfunded plans). Issuing debt to raise cash for reducing your funding gap can forestall these administrative headaches.

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