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ON

EXAMINING THE IMPACT OF DELPHI'S BANKRUPTCY

ON EMPLOYEES AND RETIREES

COMMITTEE ON LABOR AND EDUCATION

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Thank you, Mr. Chairman and members of the committee, for inviting me here to speak with you this morning on the impact of Delphi's bankruptcy on Delphi's workers and retirees. I am a professor of law at both the University of Alabama and the Earl Mack School of Law at Drexel University. I also work with the Pension Rights Center on a variety of policy-related activities. I am, however, testifying on my own behalf this morning and my views should not be attributed to any of the organizations with which I am affiliated.

The story of Delphi's retirement and health commitments to its employees, and their extraordinary devaluation in bankruptcy, is a heart-wrenching human story in an inordinately complex factual and legal setting. It is a story that underscores both the success of the PBGC program and some of its shortcomings. As such, it provides a moment to rethink the various compromises made in ERISA between assuring worker pension expectations and constraining costs on plan termination, or put in interrogative form, how should we allocate the economic fallout when a pension plan terminates without adequate funding?

I have divided my testimony into three parts. The first part provides some historical background and context for thinking about the PBGC and the Delphi workers and retirees. The second part provides an overview of the limits of PBGC pension guarantees, with an emphasis on the losses suffered by Delphi salaried employees. The third part suggests some statutory changes to ERISA and bankruptcy law that Congress might consider in light of the Delphi bankruptcy.

Background and Context

What has happened, and is happening, to thousands of Delphi employees who have lost medical benefits and have suffered pension reductions, is tragic—and Congress should certainly consider providing relief to these hard-working but hard-hit Americans. But it is critical that we view their loss in its larger historical and social welfare context.

The enactment of ERISA was, in part, a response to the termination of the pension plan for American employees of Studebaker, when it shut down its United States operations in 1964. At that time, there was no PBGC or other program to ensure employee benefits from a terminated defined benefit plan. Plan participants received benefits from available plan assets, and if there were not sufficient plan assets, benefits were paid, reduced, or eliminated in accordance with the plan's provisions allocating assets to various benefit categories.

In Studebaker, the plan had been inadequately funded and did not have enough assets to pay full benefits only to those who had retired or were at retirement age. Other employees received nothing or next to nothing.

It was this tragedy that helped frame the need for a federal insurance system for defined benefit plans and more generally underscored the need for a federal pension reform statute, which ultimately lead to enactment of ERISA and the important protections on which millions of employees and retirees now rely.

The PBGC has been an extraordinarily effective agency over the last three decades. Without it, millions of employees would have suffered catastrophic losses, consigning many of them to poverty in old age. Even with the distressingly large losses that some Delphi employees have suffered, every Delphi employee is better off because Congress created the PBGC.

And we should not lose sight that the losses in Delphi are not typical—historically, 85% of participants in terminating plans have not suffered any pension loss.

From this broader perspective, the PBGC is an amazing success story and we need to ensure that the PBGC has the strength and resources to continue its important mission and that funding rules make underfunded plans a rare occurrence.

The PBGC Benefit Guarantees and Delphi Salaries Employees

The PBGC guaranty program has undergone extensive modification since ERISA's enactment in 1974, but the essentials of the actual benefit guarantees and limitations on them have been relatively stable. It is important to keep in mind that the limitations are statutory—they are in the statute that PBGC administers[1]—and PBGC does not have discretion to vary the guarantees even under the compelling circumstances presented today.

PBGC benefit guarantees are subject to two types of limitations. The first type of limitation is structural: PBGC does not guarantee all plan benefits, but only what we might think of as the basic vested retirement benefit. The second limitation is that this basic retirement benefit is subject to a dollar limit, which is stated in terms of a benefit in the form of a single life annuity commencing at age 65. The maximum guarantee amount for a life annuity commencing at age 65 is $54,000 for plans terminating in 2009, when the Delphi plan terminated. The guarantee is actuarially reduced if the benefit commences before age 65 or if it includes a survivor annuity.

So let us start with benefits that were not eligible for the PBGC guarantee. These include:

(i) normal retirement benefits that were not vested;

[1] In some cases, the limitations are in 30-year old regulations interpreting the statute.

(ii) subsidized early retirement benefits, unless as of the plan's termination an employee had met all the criteria for the subsidy (in Delphi, this was 30 years of service, or a combination of age and service totaling 85);

(iii) some supplemental benefits that are paid only until an employee attains the age of Social Security eligibility. (The idea is that once an employee attains Social Security eligibility, these benefits are replaced by Social Security benefits, so that retirement income remains stable despite the expiration of the supplemental benefits.)

Many employees, some of whom were only months away from qualifying for a subsidized early retirement benefit, lost tremendously valuable potential benefits.

I also note here that this is not simply a plan termination problem under Title IV of ERISA. When a plan sponsor sells a division or divests a subsidiary, employees with long years of loyal service can lose subsidized early retirement benefits because they no longer work for the same controlled group, even though they continue to work for the same company or division, doing exactly the same work they did before, often in exactly the same location.

And of course, the $54,000 dollar maximum guarantee for benefits that are ensured by PBGC was reduced for employees who begin receiving benefits before age 65 or who took benefits in the form of a joint-and-survivor annuity.[2] Again, this is mandated by the statute that the PBGC administers.

Salaried Delphi employees, then, lost benefits primarily in three ways: many lost the opportunity to qualify for the most valuable benefit under the plan—the subsidized early retirement benefit--because they did not have 30 years of service; many lost a portion of their supplemental benefit; and some lost benefits because they exceeded the maximum guarantee level.

Some Possible Statutory Changes

In light of the Delphi bankruptcy, Congressional might want to re-evaluate some provisions of Title IV, pension law generally, and bankruptcy. Here are some candidates for such re-evaluation:

1) It might be time to adjust some of the features of the PBGC guarantee, particularly for employees and retirees who take benefits prior to normal retirement age or as a joint-and-survivor annuity. An increase in the guarantee amount for married participants who take a joint-and-survivor annuity would have the beneficial effect of encouraging more participants to choose such annuities.

[2] When a company such as Delphi essentially disappears, it is often difficult for an employee to wait until age 65 to begin receiving benefits, so they take the benefits immediately despite the reduced guarantee level. And I can tell you from many conversations over the years, that employees often do not understand why a benefit under the nominal guarantee level gets a smaller guarantee amount, simply because they are married and take a joint-and-survivor benefit or because they begin receiving benefits before age 65.

2) A relatively costless measure would be to allow employees who have lost their jobs to begin receiving guaranteed benefits but to later suspend benefits, with a concomitant increase in the guarantee amount. An alternative might be to allow retirees to establish a tax-deferred savings vehicle to which they can contribute their early retirement benefits until they reach age 65.

3) Perhaps there should be some limited cost-of-living adjustments in the guarantee limits after plan termination, even if this is paid for by temporarily reducing the annual increases to the guarantee amount that applies at plan termination.

4) The PBGC and participants in health and retirement plans might be given expanded protections in bankruptcy proceedings by improving their priority above other unsecured creditors.

5) The problem of cliff-eligibility requirements for subsidized early retirement benefits, not only in underfunded plan terminations but also in cases of sales of subsidiaries or divisions or other corporate reorganizations, destroys important and reasonable employee expectations about when they are able to retire. It may be that when an event such as plan termination or a corporate structural change occurs, employees should receive a pro-rata portion of the subsidy, based on how close they came to fulfilling the eligibility requirements for such subsidies. In addition, or as an alternative, employees who continue working at the same desk after termination or a corporate restructuring should continue to be able to qualify for the subsidy.

6) It may be time to re-examine the Title IV asset allocations to different classes of benefits. The current allocations create a cliff—people who are either retired or could retire within 3 years of plan termination, can receive all of their benefits, while employees just a day younger can have their benefits substantially reduced.

7) The Pension Protection Act amended ERISA to provide that the date of plan termination is retroactive to the date a plan sponsor entered bankruptcy. Because Delphi filed for bankruptcy proceedings prior to the effective date of that PPA provision, the date of plan termination was in 2009 rather than 2006. If the Delphi plan termination date had been subject to this rule, the losses suffered by Delphi employees would have been far worse. This rule unfairly defeats employee expectations and Congress might consider repealing it.