ORAL REMARKS
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THE ERISA INDUSTRY COMMITTEE

BEFORE THE COMMITTEE ON FINANCE
UNITED STATES SENATE
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ON FUNDING OF DEFINED BENEFITPENSION PLANS

Mr. Chairman, members of the Committee, thank you for the opportunity to present the views of The ERISA Industry Committee on the funding of defined benefit pension plans.

ERIC has a unique interest in funding rules for defined benefit plans because about 95% of the ERIC membership sponsor defined benefit pension plans. They also provide substantial 401(k), health, and other benefits.

ERIC is pleased to be testifying today because it is critical that the issue of the proper discount rate to use in determining current funding obligations of defined benefit plans be addressed quickly and in the appropriate way.

If we leave only one message with the Committee today, it should be that the continued absence of a permanent and appropriate discount rate in the law is tremendously damaging to the employer sponsors of DB plans and to their stockholders and employees. This damage will affect the ability of these firms to contribute to the economic recovery, maintain their DB plans, and enhance employment opportunities.

The stock price of DB plans sponsors is being adversely affected today because investment analysts are starting to notice the absence of a permanent appropriate discount interest rate and are advising investors to avoid the stock of companies with major DB plans. That puts companies that sponsor DB plans at a competitive disadvantage.

As we speak, corporate finance departments are developing cash flow needs for 2004 and beyond. The inability to plan with certainty at this late date for 2004, combined with the consequences of an artificially low discount rate for determining minimum pension funding, is pressuring businesses to re-evaluate their DB plans. Changes to benefit plans will be approved by July, or even earlier for major changes requiring significant administrative and system modifications.

Mr. Chairman and members of the Committee, this narrow provision on the discount rate for pension plan funding must be fixed immediately and in the right way or the damaging momentum already under way will be too great for any legislative fix to completely stop.

Having commented on the significance of the subject of this hearing, I would like to commend the Chair and the members of the committee for scheduling this hearing.

ERIC has a specific proposal that has earned widespread support and which I would like to explain.

The regulatory funding structure for Defined Benefit Plans is comprehensive:

- ERISA requires the sponsor of a Defined Benefit plan to meet minimum funding standards. In addition, there are maximum tax deductibility rules for contributions made by the employer, which were most recently improved by the Grassley Baccus amendments of 2001 to allow for larger contributions.

- ERISA also provides a special set of funding rules that accelerate funding if a plan's assets are significantly below the plan's current obligations. These "current liability "funding rules were added to the law in 1987, and are the focus of our discussion today.

In order to make the determination whether the accelerated funding rules apply, the actuary by statute must use a discount assumption that is within 90% to 105% of an average of 30-year Treasury bond rates, a very conservative measure. In addition, the mortality assumption is mandated for all plans.

Obligations of a typical pension plan stretch out as long as 50 years. The current liability test however is a snapshot of the current funded status of the plan. When the supply of the 30-year bond began to diminish in the late 1990s, the yield on the Bond fell precipitously. It fell further when the Treasury discontinued the bond. At the end of February 2003, interest rates on the 30-year bond had fallen to 4.8% compared to 6.35% at the end of December 1999. ERIC is proposing that we retain the same test in the law as today and update the interest rate and the mortality table. The interest rate would reflect typical long term investments on the fixed income side and the mortality table would be updated to reflect that people are living longer. ERIC proposes a composite average of high grade, long-term corporate bond indices as the appropriate interest rate. This rate would approximate a long-term commercial annuitization rate.

In short, ERIC's proposal would not change the comprehensive ERISA funding regimen. It would make a focused correction to the mandatory interest rate required to be used for minimum funding, PBGC premium, and lump sum calculation purposes.

ERIC also proposes a reasonable transition period to smooth the change for lump sums. ERIC's suggested interest rate change would, in reality, only replace the outdated 30-year Treasury rate with a conservative composite long-term corporate bond rate.

Our goal is that those who voluntarily make a pension promise to their employees be required to take prudent action to fund that promise. Excessive requirements in this area will have the opposite effect from what we and the Congress would want. Imposing artificial and arbitrary funding requirements based on unrealistically low interest rates will undermine benefit security.