



THE ERISA INDUSTRY COMMITTEE

Advocating the Employee Benefit & Compensation Interests of America's Largest Employers

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Congress does not at this time have sufficient information to mandate the use of a yield curve. The Administration's proposal raises serious policy, legislative, and practical issues:

Policy issues include:

1. It is not at all clear that use of a yield curve will cause plans to be “better funded” over time or that it will address specific vulnerabilities faced by the PBGC. The discount rate is only one piece of a large and complex funding structure. It is not the rate, but the interaction between the rate and the structure that determines funding levels.
2. Mandating use of a plan-specific yield curve while still requiring a uniform mortality assumption would produce inaccurate results.
3. Preliminary studies indicate that when plan-specific interest rates and mortality assumptions both apply, there is typically very little practical impact on liability calculations compared to the use of a composite corporate rate. Thus, the result of mandating a yield curve may be to impose considerable complexity on an already over-regulated pension system, with little practical result.
4. Preliminary studies indicate that only when a yield curve is very steep, as in recent months, would it have a measurable impact on a plan's liability calculations. However, Congress in the past has always tried to defer additional pension contributions beyond an economic downturn in order to avoid damaging companies and deepening a recession.
5. A yield curve may affect benefit calculations in some plans in a way that increases benefits for younger workers while lowering them for older workers.
6. A yield curve would increase pressure to shift investments from equities to bonds – impacting the capital markets, possibly undercutting ERISA's diversification requirements, and making plans more expensive to maintain.
7. A yield curve may cause employers with younger workforces to delay funding their plans and may prevent employers who have cash available from advance-funding their obligations, exacerbating future funding problems.
8. The implications of applying a yield curve to lump sum distributions are poorly understood and may undermine ERISA's vesting requirements.
9. Congress must decide whether to apply a yield curve for purposes of variable rate premium payments to the Pension Benefit Guaranty Corporation.
10. A corporate bond yield curve would not be transparent, is not widely understood, and is not widely used or available in the market.

Legislative issues include:

11. **The yield curve is NOT transparent.** It matters by whom and how will the curve be constructed. While financial markets are familiar with yield curves based on government securities, these are based on similarly constructed bonds issued by a single issuer. The corporate bond market is based on many different issuers. Construction of a corporate bond yield curve involves a substantial degree of judgmental decision making by whomever produces the curve, especially since the market is very thin for corporate bonds of some durations, so that in some instances the shape of the curve could be affected by events at a single company.
12. Congress would have to rewrite the entirety of the current liability funding rules. Current law constructs a funding scheme dependent on averaging of interest rates and smoothing of pension assets prior to calculation of funding obligations. This construction makes little sense with a spot yield curve.
13. Loss of averaging and smoothing would expose employers to very volatile contribution rates that would tend to exacerbate the business cycle. Contributions could go up during recessions and be prohibited during good times.
14. Congress would need to construct an entirely new set of smoothing rules in order to prevent wide year-to-year swings in an employer's contribution requirements and allow businesses to plan for their future operations.
15. Congress has crafted meticulous funding rules in the past, but the Administration's July 7 proposal appears to ask Congress to give regulators full authority over extraordinarily significant pension funding and benefit issues.
16. Failure fully to understand the impact of a new funding scheme on individual companies and to enact an adequate transition is likely to result in some companies facing extraordinary contributions and others not being able to fund their plans at all.

Practical issues that may be insurmountable if rushed include:

17. The curve will have to be constructed. It is not readily available on the market.
18. A massive educational campaign would be required to educate pension technicians on the construction and proper use of the curve.
19. Data regarding the use of optional forms of benefits such as lump sum payments and early retirement benefits must be collected and incorporated into actuarial calculations.
20. Actuarial platforms will have to be retooled. This is likely to be a very significant task.

Rather than imposing an entirely unknown system on 44 million Americans who depend on defined benefit pension plans, Congress should, instead, study proposals for fundamental change in the pension funding rules – including use of a yield curve – and make a later determination regarding changes that may improve the likelihood that employers will sponsor defined benefit plans while also ensuring that such plans are adequately funded.