ERIC

The ERISA Industry Committee

Representing the Employee Benefits Interests of America's Largest Employers

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FOR JULY 26 FINANCE COMMITTEE MARKUP

July 25, 2005

Dear Senator:

The ERISA Industry Committee urges your attention to the following issues during the Finance Committee consideration of the "National Employee Savings and Trust Equity Guarantee Act of 2005" (NESTEG) on Tuesday, July 26. The bill would re-write long-standing funding rules for pension plans. This will be a complex process that will stretch out over many months and will require continued attention by the Committee.

Much of the current debate has focused on companies in two industries with special problems – airlines and steel. In fact, the vast majority of pension plans are not a threat to the PBGC, but harsh and volatile rules are a threat to the vast majority of plans and to the businesses that sponsor them. The challenge to Congress is to create a structure that ensures sound funding but that also encourages companies to establish and maintain defined benefit pension plans.

Key issues in the proposed NESTEG bill's modifications of the pension funding rules that are evident at this point include:

Averaging and Smoothing. For an employer to sponsor a defined benefit plan, required contributions must be predictable – that is, the employer must be able to anticipate contributions several years into the future in order to plan its business investment and operations. Required contributions also cannot be too volatile; otherwise they will be too difficult to accommodate in the cash flow operations of the business. The proposed NESTEG replaces the current-law averaged interest rate and smoothed asset values, which both provide predictability and moderate volatility, with a near-spot interest rate and near-market asset values. Spot assessments are very volatile and nearly impossible to predict. While the proposed NESTEG bill attempts to reduce volatility by imposing "collars" on how much contributions can go up or down from year to year, the method proposed is wholly new and must be vetted in the market before its effectiveness can be determined. Perhaps more importantly, the bill does not provide predictability of contributions, which will be a significant impediment to employers' ability to maintain and establish defined benefit plans.

Yield Curve. The bill replaces the current-law conservative composite corporate bond rate with a yield curve constructed by the Treasury Department. While yield curves are familiar tools in fields where future payouts are predetermined (e.g., mortgages and Treasury bonds), future payouts in pension plans are affected by future events such as when individuals will decide to leave the company or retire – even decades from now – that can only be guessed at. Thus, to say that a yield curve provides greater accuracy in pension plans is not correct. Moreover, the structure in the proposed NESTEG bill, unlike the current-law composite rate, is complicated, non-transparent, and highly subject to mistakes in construction or even to manipulation. We continue to believe that changing to a yield curve is a mistake.

Credit Ratings. ERIC strongly opposes the use of a company's credit rating to impose an "at risk" liability on companies. Many, many companies that are below investment grade never pose any threat to the PBGC whatsoever. The provision will result in too many "false positives," will discourage employers from providing pension plans, and, in some cases, will set off the "death spiral" that sound funding should seek to avoid. Moreover, the methods used by the credit companies to set their ratings are far from transparent and are under scrutiny in Congress and elsewhere in the government. Pension plans should not be accountable to a measuring mechanism that is itself under scrutiny. The important measure of the health of a pension plan is its funded status, not whether the sponsoring company is going through a time of trouble. If an "at risk" liability is to be imposed, it should be based solely on the funded status of the plan.

Pre-Payment of Contributions. The proposed NESTEG bill wisely appears to provide full credit for pre-payments of future contributions. The ability to pre-pay is critical for cyclical industries and serves as an important buffer against volatility for all industries. The proposed bill appropriately would adjust available credit balance values in accordance with the performance of the underlying assets. ERIC strongly supports encouraging the use of pre-payments through the credit balance structure.

Deductible Contributions. The proposed bill also revises the deductible contribution rules so that companies can make larger contributions on a deductible basis. The bill would allow contributions up to 180 percent of the plan's current liability and eliminates the overall limit on contributions where an employer sponsors both defined benefit and defined contribution plans. These changes are critically important as companies look down the road and fund for their future, and ERIC strongly supports these changes.

Lump Sum Calculations. While ERIC opposes use of a yield curve, it supports coordinating the interest rate used to calculate minimum lump sum distributions with that used for funding purposes. This is necessary to prevent a plan from being rapidly drained of assets if a large number of participants retire in a short period of time. Provision should also be made for plans that, under current law, use rates other than the 30-year Treasury bond rate to determine minimum lump sum amounts.

Delayed Effective Date. The bill delays the imposition of the new funding regime until 2007. Given the enormity of the changes proposed, and the complexity of implementing them, this is a rational change. Additional transitional relief may be needed as we continue to study the bill.

Thank you for your consideration of our views. Please contact us with any questions you may have.

Sincerely,

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