Representing the Employee Benefits Interests of America's Largest Employers
1400 L Street N.W., Suite 350, Washington, D.C. 20005
phone 202-789-1400 / fax 202-789-1120 / e-mail eric@eric.org

November 9, 2005

RE: TODAY'S MARKUP OF PENSION LEGISLATION
(Pension Funding and Defined Contribution Plan Provisions)

Dear Representative:

The Ways and Means Committee today is expected to consider legislation (H.R.2830) that re-writes long-standing funding rules for pension plans. The bill also contains provisions addressing hybrid defined benefit plans as well as defined contribution plans. The legislation is complex and will have a dramatic impact on the ability of employers to sponsor pension plans in the future and on the retirement security of tens of millions of workers.

DEFINED CONTRIBUTION PLAN PROVISIONS

We are pleased to see several important improvements affecting retirement savings and defined contribution plans included in the Chairman's Mark. In particular, we highlight the provisions that would make the changes in EGTRRA permanent and that would provide permanence to the Savers' Credit. Also, ERIC's members are vitally interested in provisions that aid and encourage automatic enrollment arrangements. We applaud the Chairman for moving forward in this area, although, in order to make the provisions effective, employers are likely to need greater plan design flexibility than is provided under the proposed legislation.

PENSION FUNDING PROVISIONS

We believe that the final bill must meet the criteria and follow the recommendations outlined below if it is to encourage companies to establish and maintain pension plans in the future while also protecting participants in those plans through sound funding practices.

Funding rules must result in predictable, rational and stable funding over time.
Funding proposals put forward by the Administration were focused primarily on building a wall around the Pension Benefit Guaranty Corporation (PBGC). Dramatic and unpredictable upticks in funding would be required any time a plan's funded status dropped below 100% based on spot calculations. This is a very short-sighted approach. 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. An employer must be able to anticipate required pension 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 cash flow operations of the business. Many Members of Congress have focused not just on protecting the PBGC but also on ensuring the future ability of employers to sponsor pension plans, and we applaud them for their foresight.

** The Chairman's Mark appears to delay changes in required funding rules until 2007. It is already too late in 2005 to expect plan sponsors to know what is expected of them by 2006 under a complex new law, much less execute any changes required. We agree with the proposed delay, retaining the present law corporate bond rate and funding rules in the interim.

** The Chairman's Mark contains 3-year averaging and smoothing provisions. Only retention of meaningful (at least three full years) averaging and smoothing provisions can provide both predictability and effective volatility protection.

Increased funding requirements must be phased in gradually.
Under current law, plans that are funded at a 90% or higher level are not required to make deficit reduction contributions in recognition of the facts that (1) plans funded at this level are well able to meet their benefit obligations and (2) some fluctuation in the funded status of plans is entirely normal. The Chairman's Mark sets a new, 100% funding standard. If companies are asked to meet this new standard too quickly, they will be faced in the near term with sharp, unrealistic, and – since these plans are solid and well funded – entirely unnecessary cash calls, just as the nation's economy recovering from the recent downturn and new economic shocks. Pension plans will be frozen and jobs lost due to an unsound national policy.

** The Chairman's Mark includes a five-year phase-in of the new 100% target. This is helpful, although a longer phase-in would be even more helpful in keeping well funded plans in the system. The proposed bill also requires the inclusion of the incidence of lump sum payments in the target liability calculation, and a phase-in of this requirement should be included in the legislation.

A plan's liability must not be linked to the credit rating of the sponsoring employer.
The Administration's proposal to impose a higher liability calculation on plans sponsored by an employer with a below investment grade credit rating is off point and likely to set off the death-spirals and plan terminations it seeks to avoid. For a company who drops below investment grade, the proposals will impose sharp cash calls on a company at precisely the wrong time – endangering both the plan and the company. The company's credit rating does not determine whether the company's pension plan is adequately funded. Most companies that are below investment grade never pose any threat to the PBGC. In some instances, a company's credit rating reflects the rating companies' views of the industry and does not reflect the soundness of a particular company. 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 held hostage to a measuring mechanism that is both unrelated to the plan and under scrutiny. If an "at risk" liability is to be imposed, it should be based solely on the funded status of the plan, should be reasonably constructed, and should avoid excess charges of any sort.

** The Chairman's Mark appropriately imposes "at risk" liability only on plans that are less than 60% funded, but the assumptions used to calculate "at risk" liability are unnecessarily expansive. As opposed to what is in the Mark, "at risk" liability should base the increased liability calculation on participants eligible to receive benefits in the current or next 5-7 plan years (i.e., assume that these individuals will elect to receive their benefits and to receive them in the form that produces the highest liability) and should not include extra "load" factors.

Plans should be able to fund up in good times.
Present law imposes low ceilings and other restrictions on the amount of contributions that an employer can make to a pension plan on a tax-deductible basis. Credit balances (which allow previous contributions to be credited against current funding requirements) are a necessary mechanism that makes it economically possible for employers to pre-fund their plans. To protect participants in the future, legislation should allow substantially larger deductible contributions, eliminate a funding cut-off imposed only on employers that sponsor both DB and DC plans, and providing a workable pre-payment (credit balance) mechanism for plan sponsors.

** The Chairman's Mark should be amended to allow deductible contributions of up to 180% of current liability (instead of 150% as in the Mark).
** The Chairman's Mark should be amended to completely eliminate (rather than modify) the 25% of compensation limit on contributions where an employer sponsors both a DB and a DC plan.
** The Chairman's Mark should be modified so that pre-payments (credit balances) are not subtracted from assets in computing a plans funded status for purposes of benefit restrictions, "at risk" liability, or variable rate premiums.

The following actions also should be taken:

* Segmented Yield Curve: The Chairman's Mark should be modified to provide explicit directions to Treasury regarding how the segments in the bill's yield curve are to be calculated.

* PBGC Premiums Not Indexed: The Chairman's Mark should be modified so that under no circumstances will the amount of premiums an employer pays to the PBGC be indexed. ERISA (sec 4002) requires premiums to be kept at the lowest possible level. Only Congress should decide when a premium increase is needed.

* Benefit Restrictions Limited: The Chairman's Mark should be amended to provide a mechanism that will fund shut down benefits in an orderly manner while also protecting the PBGC against sudden increases in unfunded guaranteed benefits in a plan it is taking over. In addition, restrictions on benefit accruals and distributions will be highly disruptive to participants and impede sound workforce management. Any such restrictions should be strictly limited to egregious circumstances.

* Lump Sum Distributions: Under the Chairman's Mark, lump sum distributions would be calculated using the yield curve instead of the 30-year Treasury bond. It should be clear, as under present law and long-established practice, that rates producing a larger lump sum could also continue to be used. Failure to do so will result in employees eligible to retire leaving a company earlier than they otherwise would. It should also be clear that plans using a lower rate can move to the higher rate without violating the law.

* Reporting to the Government: The Chairman's Mark more accurately targets which plans must supply information to the PBGC under section 4010, a vast improvement over the current scatter-shot structure. It also requires additional information to be provided through the Form 5500, the primary source of government information on benefit plans.

* Reporting to Participants: While we agree that additional information can and should be provided on an expedited basis, we remain concerned that the Chairman's Mark adds layer upon layer that will increase administrative costs and confuse plan participants. We propose to work toward a more simplified structure before Congress completes work on the bill.

Thank you for your consideration of our views. If you have questions, please contact us.

Sincerely,

Janice M. Gregory
Senior Vice President

[HYBRID PLAN PROVISIONS ARE ADDRESSED IN A SEPARATE E-MAIL]