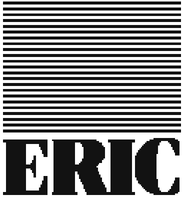

**The
ERISA
Industry
Committee**

December 8, 2005

The Honorable Dennis Hastert
Speaker
U.S. House of Representatives
H-232 U.S. Capitol
Washington, DC 20515

Dear Mr. Speaker:

The House is nearing consideration of "The Pension Protection Act of 2005" (H.R.2830). The Senate has already passed a companion bill (S.1783). House passage of H.R.2830 will leave to a conference committee the resolution of many outstanding issues that are vital to employers and employees and that will determine the future of retirement security for millions of American workers. Mishandled, final legislation will harm participants and stack the deck against employers who want to provide secure pensions for their employees. History has shown employers cannot retain their defined benefit plans under those circumstances.

After decades of statutory changes and increased regulation, the number of plans insured by the PBGC has dropped from 110,000 to fewer than 30,000 plans. Moreover, a number of large plans have recently been frozen, although not technically terminated. Thus, it is important to ensure that the House approves the best possible bill and is in a position to improve on the bill in conference.

The ERISA Industry Committee (ERIC) strongly supports legislation that will –

- improve pension funding,
- encourage employers to establish and maintain pension plans, and
- clarify that hybrid pension plans are lawful without imposing new "mandates" on benefits voluntarily provided by employers to their employees.

Early this year, ERIC developed *Consensus Proposals for Pension Funding, PBGC Reform, and Hybrid Pension Plans* (available at www.eric.org). Some of ERIC's proposals are reflected in H.R.2830, and we commend Chairmen John Boehner and Bill Thomas for their careful attention to the need to protect participants and meet business requirements for predictability and reasonableness.

We remain deeply concerned, however, that resolution of many key issues is uncertain and that some provisions in legislation that will be considered by conferees will accelerate the retreat from pension plans and undercut the retirement security of workers. The following discussion outlines major changes necessary to shift H.R.2830 and S.1783 from their present forms to sound pension reform.

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- **Funding rules must be predictable and stable.** In order to both operate their businesses and sponsor a pension plan, employers must be able to predict their future pension contributions. Required contributions also must not vary dramatically from year to year. Under current law, funding predictability and stability are provided by averaging over four years the interest rate used to compute liabilities and averaging over five years the value of assets available to meet those liabilities. This does not change the amount of money an employer will contribute to the pension plan over time; it merely makes the contributions more predictable and less volatile. H.R.2830 preserves these vital safeguards, but in a significantly reduced form. Moreover, averaging and smoothing rules in S.1783 provide no meaningful tools for employers, and the Administration is urging the elimination of such provisions entirely. Thus, it is critical that the averaging and smoothing provisions of H.R.2830 be clarified and strengthened in a final bill.

- **Pension liabilities must be set by plan status, not by an outside credit agency.** Proposals are being considered that would increase the measure of a plan's liability to an "at risk" liability based on a presumption that the plan may terminate in an underfunded status. The correct measure of whether a plan is financially unsound is its funded status – not whether outside credit agencies have tagged the sponsoring employer as above or below investment grade, as the Administration and S.1783 propose.

  H.R.2830 takes the more sensible approach of triggering "at risk" liability when the plan is less than 60% funded. However, H.R.2830's calculation of "at risk" liability is far too excessive, and a more reasonable liability calculation should be included in a final bill.

- **Funding challenges must be rationally phased in.** The bills require additional contributions to plans to:

  - Consistently reach a funding target of 100% instead of 90%,
  - Include the incidence of lump sum payments in liability calculations, and
  - Meet updated mortality assumptions.

  Employers can meet these challenges without disrupting their business operations only if they can transition to the new levels over time. H.R.2830 provides for a five year phase in of the funding target and mortality assumptions. Many companies will need more time to avoid employment cutbacks as well as to maintain business investment.

  By contrast, S.1783 provides even less time than H.R.2830, and neither bill provides for a phase in of the lump sum amounts. The Administration apparently opposes any phase in. Again, it is critical that the provisions of H.R.2830 be improved and retained in a final bill.

- **<u>Legislation must protect hybrid (cash balance & pension equity) plans.</u>** According to the most recent data filed with the government, approximately nine million individuals rely on hybrid pension plans for their retirement security. Until thrown into uncertainty by recent litigation, hybrid plans had been the favored option for employers who wanted to establish or maintain a responsive and secure defined benefit pension that meets the needs of employees in a dynamic economy.

  It is important to understand that two very separate issues are involved in the current debate. One is whether the basic design of hybrid plans is lawful under age discrimination statutes. The other reflects concerns that have been raised regarding conversions from traditional to hybrid plan designs. If workers are to have secure pensions in the future, then plan sponsors *MUST* know that the basic design of hybrid plans is lawful.

  H.R.2830, with technical corrections, will provide that certainty – but only for the future. S.1783 establishes an entirely new legal framework for hybrid plans that will call into question the legality not only of existing hybrid plans but of other types of defined benefit plans. In addition, S.1783 imposes several new mandates both on the design of hybrid plans and on conversions to hybrid plans. Those mandates will steer companies away from hybrid plans and will significantly undermine employer confidence in offering other types of benefits as well, which ultimately will harm participants. A final bill must both provide certainty for all hybrid plans and reject the counterproductive path of imposing new benefit mandates.

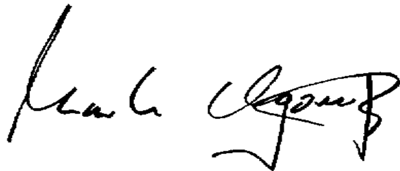
- **<u>Employees' benefits should not be summarily terminated.</u>** It is critically important that companies, especially those in cyclical industries, be able to make extra contributions in good times and use those contributions to offset payments during economic downturns. Thus, a workable scheme for credit balances is essential to sound funding reform. However, because of the rules applying to credit balances in H.R.2830, it is possible for a plan to have assets sufficient to cover all promised benefits, yet the plan will be frozen, employees denied their lump sum payments, and the plan subjected to arbitrary increases in its liability. In addition, H.R.2830 would prohibit the payment of shut down benefits, which are particularly valuable benefits for older employees when the facility where they work is closed. These provisions are unreasonable and unnecessary.

  H.R.2830 contains an excessively restrictive framework for crediting and using contributions made to a plan in advance (credit balances). H.R.2830 then does not count these assets in determining whether "at risk" liability or benefit restrictions are triggered. S.1783 does not subtract pre-funded assets in determining whether the plan has an at risk liability or benefit restrictions are required, but still would impose increased liabilities on many companies that have pre-funded their obligations. S.1783 contains a mechanism that would allow payment of shut down benefits in most instances without exposing the PBGC to a sudden increase in liability. Final legislation must encourage and protect pre-funding of contributions and must preserve employees' benefits.

- **Reasonable changes can address known problems.** H.R.2830 and S.1783 shorten the amortization period for plan amendments, include lump sum utilization in liability calculations, require credit balances to track market gains or losses in the underlying assets, increase information provided to participants, and make other targeted changes that will help plans remain well funded in the future. S.1783 (more so than H.R.2830) also increases the amount of contributions to a plan that can be made on a deductible basis. At the same time, H.R.2830 and S.1783 impose an entirely new construction for the funding of pension plans. The impact of some changes – such as the abolition of the long term ERISA funding rule and the shift from a market discount rate to a yield curve constructed by the Treasury Department – are not yet fully understood.

Too much of the recent debate has focused on the fortunes of the PBGC. Since its creation in 1975, the PBGC has trusteed a total of approximately 3,500 pension plans. During that same period, over 165,000 plans were terminated fully funded – i.e., *without* imposing any obligations on the PBGC. The proof of any pension reform bill is whether it will signal to employers to sponsor pension plans and whether it provides workable mechanisms to keep their plans well-funded. We commend Chairmen Boehner and Thomas for keeping these goals in sight when crafting legislation even though we believe more work needs to be done.

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



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cc: Members of the House of Representatives