THE ERISA INDUSTRY COMMITTEE

1400 L Street NW, Suite 350, Washington DC 20005 (202) 789-1400 fax: (202) 789-1120 www.eric.org
Advocating the Benefit and Compensation Interests of America's Major Employers

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CONFERENCE CONSIDERATION OF PENSION REFORM BILLS
H.R.2830/S.1783

Dear Conferee:

Employers are at a critical juncture in the provision of retirement benefits. In the face of changing global and workforce conditions and years of regulatory uncertainty, more employers than ever before are re-examining the role of retirement plans in their overall compensation strategy. What Congress does within the next several weeks regarding proposed pension reforms will have direct and immediate repercussions for the decisions employers will make – including whether sponsorship of a defined benefit pension plan remains a viable option.

The ERISA Industry Committee (ERIC) is a nonprofit association committed to the advancement of the employee retirement, health, incentive, and compensation plans of America's major employers. ERIC's members have sponsored innovative and responsive benefits programs for decades. They have consistently supported sound funding of pension plans, most recently in ERIC's comprehensive funding and hybrid plan reforms proposed May 23, 2005. ERIC's recommendations can be found under the "Policy Statements" section on its website (www.eric.org).

Although frequently in a different form, ERIC has proposed reforms in several areas also addressed in the pending bills, including:

– higher funding targets,
– shorter amortization periods,
– higher limits on deductible contributions,
– updated mortality assumptions,
– inclusion of the incidence of lump sums in the liability calculation,
– valuation of credit balances based on the gains and losses of the underlying assets,
– validation of the design of hybrid defined benefit plans,
– permanency of the 2001 EGTRRA pension reforms,
– facilitation of automatic enrollment and growth-oriented default investments in DC plans, and
– proposals to ease administrative burdens on plan sponsors.

The form and details of any reform proposal are vital. It is critical to remember that our employment-based system is voluntary. To encourage employers to establish and maintain plans, the rules governing a voluntary system must be rational, not cumbersome, and must accommodate an employer's need to meet the competition, execute its business plans, and avoid cash flow "surprises."

A careful examination of the fundamental retirement security issues raised by the bills before the conference is essential. The issues are admittedly complex, and ERIC is gratified by the time and concern that those Members of Congress on the conference committee have devoted to this task. The bills in conference are very broad in scope. There are many issues to settle, and conferees must avoid resolving them in a way that drives employers away from providing pensions and endangers the retirement plans and security of millions of Americans.

As your deliberations continue, ERIC urges that you take the following actions:

DEFINED BENEFIT PLAN FUNDING ISSUES

- **Averaging and Smoothing.** In order to maintain a defined benefit plan, the sponsoring employer must be able to anticipate future pension contributions in its business plan. The averaging of interest rates and smoothing of asset values is absolutely essential to enable companies to predict future contribution requirements. Averaging and smoothing also reduce year-to-year volatility of mandatory contributions while not reducing the employer's financial obligations to the plan over time nor undermining sound funding of the plan. Conferees should follow the three-year averaging and smoothing provision in the House bill, which already is a significant reduction from current law. Funding is a long-term process that should not be dramatically impacted by temporary changes in interest rates or asset values.

  While the current debate has focused on averaging of interest rates, both interest rates and asset values affect a plan's funded status. When both are examined, it is clear that anything less than the House provisions would deny employers the predictability they need and increase volatility to unmanageable levels.

- **"At Risk" Liability & Credit Rating.** In determining whether a plan is "at risk," conferees should follow the House bill, which triggers "at risk" status if a plan's funded ratio drops below 60 percent. The Senate bill looks primarily to the credit rating of the plan sponsor. The Senate credit rating proposal assumes a cause and effect that is not now true, but, if enacted, could endanger workers' jobs as well as their retirement by imposing an out-sized liability that unnecessarily diverts cash in a company that is restructuring to remain competitive. The Senate proposal also would impede the purchase of weaker companies by stronger companies; would "validate" the current credit rating system that is under considerable unfavorable scrutiny by Congress, and would result in the federal government bureaucracy determining the financial "health" of companies, universities, hospitals, and other entities that do not have a credit rating. This is an extraordinary intrusion of government into the marketplace and a major incentive for an employer not to sponsor a pension plan at all. The Senate proposal to use a company's credit rating to determine the liability of its pension plans should be rejected.

  In addition, the calculation of "at risk" liability in both bills presumes that every participant will receive the most valuable form of payment at the most valuable date. This presumption is "worse than worst case" because, in fact, if more employees than anticipated retire, some will retire before they otherwise would have qualified for a subsidized early retirement benefit. The Senate bill addresses this somewhat – but not completely – by limiting the mandated assumptions to those eligible to retire within seven years and by not including the excessive "load factors" found in the House bill. Conferees should, at a bare minimum, follow the Senate bill in this regard.

- **Advance Contributions/Credit Balances.** Sound pension rules will allow a company to make contributions in advance of when they would otherwise be needed. The Senate bill significantly increases the amount of contributions the plan sponsor can make on a tax-deductible basis. If this proposal had been in place during the 1990s, many companies would have been able to better withstand the downturn that occurred in the early 2000's. Those provisions should be enacted and should not be reduced.

  In addition, credit balances are a critical incentive for companies to pre-fund their obligations during good times so that calls on the company's cash can be reduced during economic downturns. In that regard, each bill provides important incentives to encourage pre-funding. Under the Senate bill, credit balances are treated the same as other assets in the plan for most purposes, and under the House bill no new amortization schedule is required for any year in which a plan meets its funding target (including the credit balance), and employers have the option to waive their credit balances at any time. The conferees should adopt these incentives to pre-fund contributions from both bills while also reforming current law by ensuring that the value of the balances reflect the actual gains and losses of the underlying assets in the plan and by following the House provision that allows a company to waive its credit balance at any time.

- **Transition.** The bills are the most comprehensive re-write in thirty years of the funding rules applicable to the $2 trillion private sector defined benefit plan system. In order to effect a smooth transfer to the new regime, it is imperative that adequate advance time be provided for companies to understand the new rules and for the detailed regulations required to be drafted and promulgated. We are already well into 2006, and a 2007 effective date will not meet these necessary goals. The application of the funding changes should be delayed at least until 2008, and the bills should ensure that a good faith compliance standard will apply prior to final regulations.

  Plans need a minimum of five years to transition to the bill's new current liability funding target of 100 percent. For a plan with assets of $10 billion, changing from a 90-percent target to a 100-percent target means the company must increase the fund's assets by $1 billion. Failure to provide an adequate transition will adversely affect a company's ability to compete, expand its business and hire new workers, and will instead force companies to find ways to offset precipitous cost increases. These results benefit no one.

  In addition, the bill that passed the full House provides no funding target transition at all to many companies that are not now making deficit reduction contributions (DRC). This could increase the funding target for some companies by as much as 20 percent in a single year. The funding target transition should be provided to all plans not paying DRC.

  Finally, the bills' transition rules need to be expanded to include the bills' requirements regarding payment of normal cost and regarding the inclusion of the incidence of lump sum payments in a plan's liability.

- **Amortization.** The descriptions of the various pension funding proposals consistently have stated that companies will have seven years to amortize new pension funding obligations. In fact, plans typically will have between one and five years to amortize new losses because the bills amortize losses but require gains to be ignored. This is unreasonable on its face, will increase the volatility of funding requirements, and will have disparate impacts on similarly situated employers. The bills should amortize both gains and losses. Moreover, we urge, in order to

reduce volatility, that consideration be given to increasing the amortization period to ten years, in accordance with the Administration's stated position that ten years is a reasonable amortization period.

- **Assumptions.** The bills impose a new, untested, and controversial segmented yield curve as the prescribed interest rate for funding purposes. If it is retained, three modifications are necessary: (1) The bills' statutory language implementing the yield curve segments references bond maturities, which will not replicate the yield curve. The language should instead require the segments to replicate the yield curve. (2) The methodology for constructing the yield curve should be promulgated through regulations subject to advance notice and comment. (3) The curve should primarily reflect A and AA bonds that do not have puts or calls without make whole provisions; it should not overweight AAA bonds relative to their volume in the market.

  Some large active or frozen plans have quantifiable mortality experience that is significantly different from standardized tables, and the provisions of both bills that provide for plan-specific tables in such instances ensure accuracy of liability calculations. Under the Senate bill, however, Treasury can approve a plan-specific mortality table only if it applies to all employees of the employer. This is illogical because an employer may have very different mortality experience for different work groups. It should be modified so that if an employer requests the use of plan-specific mortality assumptions, separate plan-specific mortality assumptions would apply to each plan of the employer that is large enough to qualify for Treasury approval. In addition, under the House bill, it should be made clear that projections under the new prescribed mortality table are made up to the valuation date and not beyond it.

- **Other Funding Issues**: Senate provisions that require cash contributions to avoid benefit restrictions in union plans will encourage unions to push for benefits without adequate consideration of their cost and should be rejected. The Senate bill also would force fiduciaries to bring suits over any possible question regarding nonqualified deferred compensation in order to protect themselves against being sued by the Department of Labor, rather than settling questions through normal regulatory processes. Both of these provisions should be rejected. In addition, neither bill adequately protects company financial information provided to the PBGC from disclosure by the PBGC or other parties. If companies' proprietary information is subject to exposure, they will have little choice but to get out of the pension business. The final bill should retain the safeguards of current law.

HYBRID PLAN ISSUES

- **Validation of Plan Design**: It is important to understand that two separate issues are involved in the hybrid (cash balance) plan debate. One is whether the basic design of hybrid plans is lawful under age discrimination statutes, an issue that arises whether or not a conversion from a traditional plan occurred. The other regards conversions from traditional plans to hybrid plan designs. In line with prior determination letters and Treasury Department statements as well as the preponderance of court decisions, plan sponsors are seeking validation of the basic design of hybrid plans simply and without litigation or other reservations. The provisions of the House bill, which clarify age discrimination standards for defined benefit plans generally, should be followed – and should apply to existing plans.

- **Conversions**: Every conversion from a pre-existing plan into a hybrid plan entails unique and different practical and compliance issues. These issues should be left to current law and the

courts. Moreover, in keeping with a voluntary system, Congress must not enact conversion requirements that create rights to benefits that employees have not yet accrued. Studies repeatedly have shown that in conversions employees have not lost benefits they had already accrued. If Congress enacts rules that mandate the continuation of current benefits or otherwise create new restrictive and prescriptive rules regarding plan conversions, employers not only will avoid sponsoring or maintaining defined benefit plans, their confidence in offering any form of employee benefit will be severely undermined. The Senate bill's conversion mandates should be rejected.

- **Whipsaw**: The so-called "whipsaw" issue has forced many employers to lower the interest rate they credit on employee cash balance accounts. In fixing this problem, the conferees should follow the House bill, applied to "distributions" after the effective date. In addition, the conference agreement should include an explicit statement that providing a minimum guaranteed interest rate will be permitted under the House bill's requirement not to credit interest in excess of a market rate of return.

- **Interest Crediting Rates**: The Senate bill's mandated interest crediting rates are inappropriate and should be rejected on their face. Such a mandate would interject Congress into the design and level of pension benefits in an unprecedented manner. Moreover, the provision has no relevance in the context of pension equity plans.

GENERAL PENSION REFORMS

- **EGTRRA Permanence:** Widely-supported bi-partisan pension reforms enacted in 2001 as part of EGTRRA should be made permanent now as in the House bill. Retirement savings is a long-term commitment on the part of participants, companies, and providers. Few issues are more urgent for our nation than acting now to stabilize the law in order to encourage and increase retirement savings to accommodate our aging population. Waiting until the 2001 provisions expire will cause chaos in plan administration, prevent plan formation, and unnecessarily curtail retirement savings. This must not be allowed to happen and the present opportunity to settle the law is too important to let pass.

- **Automatic Enrollment & Default Investments:** Both bills provide rules for plans that automatically enroll employees in retirement savings plans. Auto-enrollment is a proven method of increasing participation in retirement plans otherwise dependent on proactive action by employees. ERIC strongly believes employers should have the option to install automatic enrollment provisions in their plans, and strongly supports the bills' preemption of state garnishment laws. However, many of the design mandates in the bills will be counterproductive and steer employers away from this effective tool. ERIC also supports provisions of the bills regarding default investments so long as it is clear that long-term growth options are acceptable.

HEALTH CARE

- **FSA Rollover:** Health care costs are a critical challenge facing employers, employees, and the nation. ERIC urges enactment of the provision of the House bill that provides for an annual rollover of $500 in employee flexible spending accounts for health care. More than 80 percent of employees eligible for FSAs do not take advantage of them because of the current law "use-it-or-lose-it" rule, impeding health care reforms that capitalize on consumer interest to hold down

costs. To the contrary, current law encourages excessive health care utilization as employees are forced to use up their cash at the end of the year. This is counterproductive.

- **Retiree Health:** ERIC urges conferees to enact the Senate provision that will permit excess pension assets to be used to provide plan participants with additional access to retiree health benefits so long as the pension plan remains overfunded. This provision provides double protection for employees.

Sincerely yours,

Mark J. Ugoretz	Janice M. Gregory	Edwina Rogers
President	Senior Vice President	Vice President, Health Policy