URGENT: FOR TODAY'S VOTE ON MILLER MOTION TO INSTRUCT PENSION CONFEREES

July 24, 2006

Dear Member of Congress:

We are writing to respond to two letters you received from AARP dated June 29 and July 17, 2006, regarding the treatment of hybrid pension plans in pending pension reform legislation and to urge you to vote "no" on the motion to instruct conferees to adopt the provisions governing hybrid pension plans in the Senate bill.

The AARP letters make several claims that do not hold up under scrutiny. Furthermore, the letters fail to address serious flaws in the approach adopted in the Senate bill. To provide a regulatory framework that allows employers to establish and maintain defined benefit pension plans – including hybrid pension plans – for employees in the future, the conference agreement should instead follow the provisions in the House bill.

- **<u>Uniform vs. Piecemeal Approach.</u>** The AARP letters oppose the House bill's adoption of a uniform standard of age discrimination that applies to all defined benefit pension plans in favor of the Senate provisions that apply specific design criteria to cash balance plans alone.

    - The Senate bill does not establish a principle or standard of age discrimination. Instead, the bill sets forth a specific plan design that cash balance plans must meet. If they do, they are deemed to comply with federal age discrimination rules. The trouble with this approach is that many other defined benefit plans share common features with cash balance plans. Under the Senate approach, these other plans would appear to violate federal age discrimination rules because they do not satisfy the design criteria specified in the Senate bill. Enactment of the Senate approach would suddenly cast doubt on the validity of thousands of long-standing pension plans that cover tens of millions of employees in both the public and private sectors – including contributory defined benefit plans, variable annuity plans, indexed career average pay plans, living wage plans, other hybrid plans such as pension equity plans, and even cash balance plans that do not meet all the specific design criteria in the Senate bill.

    - In addition, because the Senate bill is design-based rather than principle-based, it would cast doubt on more complex pension formulas, which are common in the real world. For example, the Senate design criteria do not anticipate situations where only a portion of an employee's benefit is based on a cash balance formula or where the employee's benefit equals the greatest of the benefits determined under two or more formulas. In the context of a conversion from a traditional final average pay formula to a cash balance formula, the ability to provide a benefit equal to the greater of a traditional final average pay benefit or a cash balance benefit could be thrown into jeopardy.

    - The Senate bill's approach not only is inadequate—it would jeopardize defined benefit pension plans on which tens of millions of workers depend for their retirement security.

- **Comprehensive vs. Piecemeal Test.** The AARP letters oppose the House bill's adoption of a uniform age discrimination standard that is based on the participant's total accrued benefit. Under the House standard, a plan discriminates on the basis of age if an older worker has at any time earned a total pension benefit that is less than the total pension benefit earned by a similarly situated younger worker. The AARP letters propose instead to adopt a piecemeal, year-by-year test. The test proposed by AARP will not work and actually will harm older workers. In addition, the AARP test will invalidate many other pension plans in the country, for reasons that have nothing to do with age discrimination.

    - A piecemeal, year-by-year test would outlaw features that clearly benefit older workers. For example, some plans provide larger benefits to older workers and credit those benefits more quickly than the benefits earned by younger workers. Such plans would violate the AARP test, even though older workers will always have a larger total pension benefit than any younger worker. The failure under the AARP test occurs merely because in later years younger workers will belatedly be earning benefits that older workers have already earned. Because the AARP test fails pension plans for *favoring* older workers, the test makes no sense whatever.

- **Offsets.** AARP opposes the House bill's treatment of offsets. The House bill is consistent with existing case law, under which an offset based on social security or other retirement benefits is not considered age discrimination.

    - Offsets are an important tool for employers to provide a comprehensive retirement benefit to their employees. Such offsets are common in the public sector as a means of providing benefit portability to employees who move between jobs with different agencies in the same state or within a system of related public entities.

    - Offsets in the private sector serve similar functions. For example, if an employer acquires another company and wishes to provide acquired employees the same benefits as its current employees, the employer may provide pension credit to acquired employees for their service with the acquired company (and update the benefits attributable to their prior service to reflect future pay increases). However, to provide past service credit in this manner and avoid duplicating benefits, the employer needs to offset the benefits provided under its plan by the benefits provided under the acquired company's plan. The same approach is often used when employees move among different related companies or even in some cases among different employers in a single industry.

    - If the conference agreement fails to address offsets, these long-standing and legitimate practices will be called into question.

- **Wear-Away & Early Retirement Subsidies.** In stating that "the older you are the longer the wear away," the AARP letters misapprehend the effects of wear-away and early retirement subsidies. This assertion simply is not true.

- Wear-away occurs when a benefit already accrued by an individual is larger than a new benefit to which the individual becomes eligible. In effect, the individual's benefit remains static until the new benefit catches up with and exceeds the old, protected benefit. Wear-away can occur at any age and its length is determined by the size of the two benefits. Wear-away can occur as a result of a merger or acquisition, when acquired employees earn benefits under the purchaser's plans after the transaction but for some period of time the benefits earned previously are larger. Current law clearly provides for wear-away, and, indeed when Congress in the past reduced benefits that could be paid from a tax-qualified plan, wear-away was the method of transition prescribed by law.

- **Other Concerns with the Senate Bill.**

  - The Senate bill requires cash balance interest credits to fall within a specified corridor. The range provided is too restrictive, does not permit returns based on equity investments, and apparently would "outlaw" plans that do not currently meet these specific design requirements. The mandated corridor also makes no sense in the context of pension equity plans, which are another form of hybrid plan.

  - The Senate bill imposes a broad range of mandates on plan conversions that would turn potential future benefit levels into outright legal entitlements. This would be a fundamental departure from current benefit and employment law norms. It would deny employers the ability to remain in the defined benefit system and adapt their benefit programs to meet the evolving needs of their employees while remaining competitive in a rapidly changing global economy. The result will be that employers will avoid the mandates imposed by the Senate bill and simply exit the defined benefit system entirely.

  - There is widespread agreement that the "whipsaw" theory should be set aside. Under this theory, plans are required to pay out a much larger lump sum to a younger worker than to a similarly situated older worker. Unfortunately, the Senate bill would limit relief under the "whipsaw" theory to cash balance plans that meet the bill's many mandates. The Senate bill also takes the approach that this inappropriate practice is part of current law. Instead, Congress should enact the House bill's provisions, effective for all distributions made after the provision's effective date.

Because of these and other concerns with the Senate bill, we again strongly urge that Congress enact the House bill provisions on hybrid plans.

Sincerely,

Lynn Dudley
Vice President Retirement Policy
American Benefits Council
(202)289-6700
ldudley@abcstaff.org

Janice Gregory
Senior Vice President
The ERISA Industry Committee
(202)789-1400
jgregory@eric.org