***ERIC BACKGROUND STATEMENT ON H.R. 4***

***Background**:*

The pension reform bill completely rewrites funding rules for single-employer defined benefit pension plans and addresses the legal uncertainty surrounding cash balance and other hybrid plans that also are defined benefit plans.  Under defined benefit plans, benefits are provided according to a formula, the employer bears the investment risk, and the employer typically makes all contributions to the plan.  Such plans anchor a worker's ability to accumulate retirement assets and must offer annuity benefits that a retiree cannot outlive.

How the details of the bill are structured can swing a company's funding obligations for its defined benefit plan by tens and even hundreds of millions of dollars a year and will determine whether hybrid plans go forward on a workable legal footing.  Whether the new structure will enable employers to maintain well-funded defined benefit plans, which are critically important and secure retirement vehicles, will depend on the following:

**Pension Funding:**

- An employer's required contributions will be less predictable and more volatile under the pension bill than under current law because the averaging of interest rates and asset values will be dramatically reduced.
- Employers must have adequate transition to new more stringent funding standards or many companies will be driven to freeze their plans both for financial and competitive reasons
- To reduce funding volatility and to protect themselves in economic downturns, employers must have the ability to fund future liabilities in advance.  In the past, Congress, ignoring pleas from employer groups, has opposed such advance funding for revenue reasons.  The effectiveness of new rules that do provide for deductible contributions for greater advance funding will depend on the practicality of other rules regarding credit the employer gains for advance funding – called credit balances.
- The bill's imposition of extra liability on plans deemed to be "at risk" will work only if the "at risk" penalties are reserved for very severely underfunded plans.  Rules regarding credit balances may sweep well funded plans into an "at risk" designation, unnecessarily imposing penalties, and driving more employers from the system. Employers also must have an adequate transition that will allow them time to fund up and avoid the new "at risk" penalties.

1400 L Street N.W., Suite 350 ▪ Washington, D.C. ▪ (202) 789-1400 ▪ Fax (202) 789-1120 ▪ http://www.eric.org

- Employers must be able to cease making required contributions when the plan is fully funded, otherwise the plan may become a needless burden siphoning cash from critical business and competitive needs.  How amortization schedules are structured and whether payments can cease when the plan is fully funded will determine how the bill impacts these business judgments.
- Because they will disrupt the employer's relations with its employees, restrictions on benefit payments and benefit increases that are too harsh will, again, direct employers away from defined benefit plans.

**Hybrid Plans:**

- Failure to provide certainty under age discrimination standards regarding the basic design of hybrid plans will turn employers away from a defined benefit design that many see as the primary hope for future sponsorship of defined benefit plans.
- Similarly, imposition of mandates on conversions or on plan design will steer employers who want to provide a retirement plan away from hybrids and toward plans that require greater employee responsibility and discipline.
- Failure to resolve adequately the "whipsaw" controversy will continue to result in lower annual contributions to hybrid plans reducing retirement benefits for many of the 9 million employees covered by these plans.

**Defined Contribution Plans & Other Reforms:**

The pension bill's provisions affecting all types of plans, including defined contribution plans, also change the landscape in many ways.

- Eliminating the current-law sunset on 2001 law that increased limits for all type of retirement plans and eliminated or streamlined many of the rules burdening plan administration (EGTRRA (P.L.107-16) will stabilize retirement plans in the future.  Failure to eliminate the sunset now will destabilize and undermine retirement security because retirement plans are long term obligations that require stable rules.
- Provisions providing a new framework for automatic enrollment provisions and default investment options must provide a practical framework to increase participation in defined contribution plans.  Otherwise additional employers will not use them and those currently in existence could be endangered.  (Employees typically are already enrolled automatically in defined benefit plans under current law.)

New disclosure requirements should be coherent and coordinated and not overwhelm participants with information overload.