

**TESTIMONY OF HENRY EICKELBERG**

**ON BEHALF OF THE**

**AMERICAN BENEFITS COUNCIL**

**BUSINESS ROUNDTABLE**

**ERISA INDUSTRY COMMITTEE**

**NATIONAL ASSOCIATION OF MANUFACTURERS**

**US CHAMBER OF COMMERCE**

**BEFORE A HEARING OF THE**

**HOUSE WAYS AND MEANS**

**SUBCOMMITTEE ON**

**SELECT REVENUE MEASURES**

**ON**

**THE ADMINISTRATION'S PROPOSAL FOR**

**SINGLE-EMPLOYER PENSION FUNDING REFORM**

**MARCH 8, 2004**

**Testimony of Henry Eickelberg  
Staff Vice President for Human Capital Processes  
for the General Dynamic Corporation**

**on behalf of the  
American Benefits Council  
Business Roundtable  
ERISA Industry Committee  
National Association of Manufacturers  
US Chamber of Commerce**

**Before a Hearing of The House Ways and Means  
Subcommittee on Select Revenue Measures**

**Washington, DC  
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Chairman Camp, Ranking Member McNulty, I thank you for the opportunity to appear before you today on this critically important topic. I am Henry Eickelberg, Staff Vice President for Human Capital Processes for the General Dynamics Corporation, which is a major defense and aerospace company employing over 65,000 people within the United States. In addition to managing General Dynamics' U.S. payroll function and health and safety initiatives, I oversee the design and administration of all of General Dynamics' benefit programs, including its defined benefit pension plans.

Today, I am serving as a spokesman for the American Benefits Council, Business Roundtable, the ERISA Industry Committee, the National Association of Manufacturers, and the U.S. Chamber of Commerce. These organizations represent a broad cross-section of American business. We come before you today with a single voice to emphasize the need to advance our nation's voluntary, employer-sponsored defined benefit pension system.

In recent years, the myth has developed that defined benefit pension plans are dinosaurs -- lumbering giants headed to extinction. Nothing could be further from the truth. Defined benefit plans are a core element of how most large and many smaller U.S. employers provide retirement security to their workers. Across the country, some 34 million Americans rely on single-employer, private-sector defined benefit pension plans as a critical element of their retirement security. More than 18 million of these Americans are active workers from a diverse range of industries.

Employees value defined benefit plans because of their unique features. Pension benefits do not typically depend upon employees making their own contributions to the plan, but are instead funded by the employer. In addition, employers, rather than employees, bear the investment risk of funding benefits, and investment professionals manage the assets of the plans. Further, benefits are guaranteed within certain limits through the Pension Benefit Guaranty Corporation (the "PBGC"). Benefits are also offered in the form of a life annuity assuring that participants and their spouses will not outlive their retirement income.

Employers also value defined benefit plans. Sponsorship of a pension plan is a way of rewarding employees' service by providing meaningful retirement benefits, thereby increasing morale, productivity, and the quality of the work environment. With a valued pension plan, employees can focus on today, knowing that tomorrow will bring employer-provided, PBGC-insured retirement income no matter how much they are able to save on their own.

In addition, defined benefit plans play a critical role in our national retirement income system. Single-employer defined benefit plans paid benefits in excess of \$120 billion during 1999 (the most recent year for which official Department of Labor statistics have been published). In the absence of defined benefit pensions, it is certain that fewer Americans would be financially prepared for retirement, more American seniors would live in poverty, and many more Americans would be forced to rely even more heavily on already strained federal entitlement programs. These plans also aid our national economy by providing a ready source of professionally managed investment capital with nearly \$2 trillion held by private-sector defined benefit plans.

In spite of the value defined benefit plans provide to employees, employers, our national retirement income system, and the U.S. economy, employers have been exiting the defined benefit system in alarming numbers in recent years. Just since 2001, 23 percent of Fortune 1000 companies announced their decision to either freeze or actively consider freezing their defined benefit pension plans. The primary culprits are volatile and unpredictable funding obligations, expensive and excessive regulation, temporary rules, unnecessary barriers to pre-funding, and legal uncertainty regarding the status of cash balance and other hybrid plans.

Reforms are needed to address these issues and ensure that we continue to have a vital defined benefit system well into the future. That reforms can succeed in supporting and expanding the defined benefit system is clear. Since the Economic Growth and Tax Reconciliation Relief Act of 2001 ("EGTRRA") removed some of the restrictions on benefits that can be provided, defined benefit plan coverage among small employers has grown. Among larger employers, cash balance and other hybrid plan designs hold the promise that defined benefit plans will continue to play a critical role in retirement security. More than 7 million Americans are already covered by hybrid plans and this number would be much greater but for the legal uncertainty surrounding these plans.

Targeted reforms are also needed to address the reported deficits at the PBGC. The PBGC plays an important role in the system. However, we must not lose sight of the fact that the vast majority of plans are funded responsibly and appropriately. The PBGC was set up to strengthen retirement security and reforms to strengthen the PBGC should not weaken the rest of the defined benefit pension system. At the end of the day, the success of any reforms will depend on Congress' ability to find the right balance between protecting the PBGC and encouraging a vibrant voluntary employer-sponsored defined benefit plan system.

A few weeks ago, the Administration released its funding and PBGC premium proposals. The proposals would scrap all of the existing funding rules and create an entirely new funding system. The proposals have some elements that we believe would be good for the system. For

example, we agree that better disclosure to plan participants is needed. Similarly, we support proposals to change the tax rules to permit employers to contribute more to their plans when they have the ability to do so. In addition, we think that safeguards should be considered to protect the PBGC from benefit increases that are unlikely to be appropriately funded.

At the same time, the Administration's proposals have a number of elements that we believe are counter-productive and would reduce workers' retirement security in the future. Our primary concerns are that the proposals would (1) make funding and premium obligations unpredictable; (2) result in unnecessary bankruptcies; (3) involve an inappropriate use of the credit rating agencies; (4) discourage employers from funding more than the minimum; and (5) drive many employers from the system through considerable and unnecessary PBGC premium increases. These additional barriers and added risks and burdens will only force employers to exit the system through plan freezes and terminations and will discourage other employers from establishing defined benefit plans.

The remainder of this testimony describes the reforms that we believe should be enacted and highlights our primary concerns with the Administration's pension reform proposals.

#### **TOP 10 DEFINED BENEFIT PLAN REFORMS**

1. Permanently Replacing the Obsolete 30-Year Treasury Bond Rate. Pension policy must provide employers with the certainty that will allow them to make new capital investments, to hire new employees, and to make R&D investments. A permanent replacement for the obsolete 30-year Treasury bond rate used for pension calculations is needed now.
2. Making Pension Funding Predictable. It is essential that any reforms reflect the long-term nature of pension promises and smooth liability and asset valuations. Volatility in these calculations makes it impossible for employers to plan and make prudent business decisions, slowing the economy.
3. Avoiding Unnecessary Complexity. The Administration's yield curve proposal would add significant complexity to the system without any real benefit. The long-term corporate bond rate that Congress adopted last year on an interim basis is a simple, appropriate, and transparent measure of liability and should be made permanent.
4. Preventing Unnecessary Bankruptcies. Pension reform should not make it more difficult for struggling companies to recover. We must not lose sight of the fact that the best insurance for plans, participants, and the PBGC is a healthy plan sponsor.
5. Eliminating Prefunding Barriers. Barriers that prevent employers from making contributions to their plans should be eliminated. We strongly support proposals to revise the tax deduction rules that prevent employers from contributing to defined benefit plans during good economic times.

6. Encouraging Advance Funding. The pension system should encourage employers to make contributions to their plans as early as possible. Reform should ensure that there is no disincentive to funding plans in advance of future liabilities.
7. Providing Timely and Appropriate Disclosure. Participants should have the information they need to evaluate their retirement security. Existing funding disclosure requirements should be enhanced to provide timely and useful information about retirement plans, while at the same time avoiding the creation of costly, confusing or misleading new requirements.
8. Funding the PBGC Appropriately. The best way to protect the PBGC is to keep employers in the defined benefit plan system. Rising and uncertain premiums would force many plan sponsors to exit the system.
9. Confirming the Legality of Hybrid Plan Designs. To compete effectively and attract and keep skilled workers, employers must be able to tailor pension plans to the unique needs of their workers and the competitive environment in which they function. The flexibility to utilize varied pension plan designs, including cash balance and other hybrid plans, is imperative if we are to maintain a vital defined benefit system.
10. Making the EGTRRA Improvements Permanent. The EGTRRA improvements have led to increased defined benefit plan coverage among small employers and need to be made permanent.

#### **PERMANENTLY REPLACING THE OBSOLETE 30-YEAR TREASURY BOND RATE**

Since last year, a long-term corporate bond rate averaged over four years has been used on an interim basis to determine “current liability” for the funding and deduction rules and to determine unfunded vested benefits for purposes of PBGC variable rate premiums. However, the measurement rate defaults to the rate on the now defunct 30-year Treasury bond beginning in 2006 if no further action is taken. It is widely agreed that the 30-year Treasury bond is no longer a realistic measure of future liabilities and would inappropriately inflate pension contributions and PBGC variable rate premiums. A return to an inappropriate and inaccurate measure of pension liabilities and the resulting inflated contributions caused by the defunct 30-year Treasury bond rate would be devastating for the ongoing vitality of defined benefit plans and would be enormously disruptive for plan sponsors, and could curtail the strength of economic growth.

We believe the best way to support and enable the defined benefit pension system is to make permanent the four-year weighted average of the long-term corporate bond rate that Congress adopted last year. As Congress has recognized, the long-term corporate bond rate provides a realistic picture of future pension liabilities and is the best measure to ensure the adequacy of pension funds for future retirees. It reflects a very conservative estimate of the rate of return a plan can be expected to earn and thus is an economically sound and realistic discount rate.

The Administration has proposed, as an alternative to both the 30-year Treasury bond rate and the long-term corporate bond rate, a near-spot rate “yield curve” comprised of conservative, high-quality corporate bonds. We agree with the Administration that there is a compelling need

for a permanent interest rate so that employers can project their future contribution obligations and make long-term business plans. In addition, we agree that the permanent interest rate should be based on high-quality corporate bonds. However, we have concerns about four aspects of the Administration's "yield curve" proposal. First, the yield curve interest rate is a "near-spot rate" rather than a four-year weighted average rate. It will saddle employers with unpredictable funding obligations. Second, the yield curve proposal would apply different interest rates to different payments to be made by the plan based on the date on which that payment is expected to be made. This is an unnecessarily complex methodology. Third, we are concerned that the Administration's mechanisms for creating interest rate assumptions would require excessive and unnecessary contributions for some mature plans, which could be very harmful for employers, workers, and the economy. Fourth, the proposed yield curve is opaque and will be difficult for businesses to use in long-term planning and for Congress to oversee. We discuss these concerns in more detail below.

### **PREVENTING THE VOLATILITY THAT WOULD BE CREATED BY SPOT VALUATIONS**

Our primary concern with the Administration's yield curve proposal is the use of spot valuations. Companies need to be able to make business plans based on cash flow and liability projections. Volatility in pension costs can have dramatic effects on company projections and thus can be very disruptive. It is critical that these contribution obligations be predictable. The essential elements facilitating predictability under current law are use of the four-year weighted average of interest rates and the ability to smooth out fluctuations in asset values over a short period of time (subject to clear, longstanding regulatory limitations on such smoothing). The Administration's yield curve proposal would, however, eliminate both smoothing elements dramatically increasing the volatility and unpredictability of the funding rules.

Let us be clear -- spot valuations do not mean tighter funding standards. The spot or smoothed rate only relates to when contributions are due. As interest rates rise, a spot rate will result in smaller contributions and vice versa. Over the long-term, contributions will essentially be the same regardless of whether a spot or smoothed rate is used.

Further, spot valuations would not add any appreciable accuracy. Pension liabilities span many years and spot valuations are not meaningful for these liabilities. A spot interest rate for 90 days is simply not a particularly accurate measure of liabilities that in many cases span more than 40 years.

Spot rates would also have very negative implications for the U.S. economy. Spot valuations likely would require larger contributions during economic downturns and smaller contributions during economic upturns. Larger contributions reduce capital spending. This exaggerates downturns and upturns. The result is that the economy overheats during upturns and has deeper recessions during downturns. The two key elements of smoothing under the current rules provide a significant counter-balance to this phenomenon, and should be preserved.

Some have suggested that defined benefit plans can manage the spot rate by investing in bonds and financial derivatives that hedge against interest rate movements. Hedging in this way would be very expensive. Plans should not be effectively forced to incur this cost. Over time, pension

plans earn more on investments in equities than in bonds. If plan earnings decline because plans are compelled to invest in bonds or other low-yielding instruments, plans' overall costs will rise. As plans become more expensive, it goes without saying that there will be fewer plans remaining and that the heightened cost will discourage employers from increasing benefits in the plans that do remain.

Further, if a fundamental change in the pension funding rules should force a movement of pension funds out of equities and into bonds or other low-yielding instruments, it could have a marked effect on the stock market, the capital markets, and capital formation. At the end of 2003, private-sector defined benefit plans held equities worth about \$900 billion and the market impact of a portfolio shift of this magnitude is extremely difficult to predict.

Moreover, it is far from clear that plans can insulate themselves from both volatility and liability by investing in bonds. First, it is doubtful that there could ever be enough high-quality corporate bonds, particularly at the long durations that characterize pension liabilities. Second, even if there were enough high-quality bonds to go around, it is not possible to immunize all risks. Even the staunchest bond proponents acknowledge that there are numerous pension liabilities that cannot be immunized. For example, because mortality cannot be predicted with precision, it is not possible to immunize a plan that makes life annuity payments. Similarly, the number of people who retire and take available subsidies can only be estimated and thus that liability cannot be immunized.

#### **AVOIDING UNNECESSARY COMPLEXITY AND LACK OF ACCOUNTABILITY**

We are also concerned that the Administration's yield curve would add significant complexity without providing any real benefit. The proposal would generate numerous different interest rates for each participant. This level of complexity could be managed by some large companies but it will impose an unjustifiable burden on small and mid-sized companies across the country.

Further, we are concerned that the interest rate constructed by the Treasury Department would be opaque. The markets for corporate bonds of many durations are so thin that the interest rates used would actually need to be "made up", i.e., extrapolated from the rates used for the other bonds. Considerable discretion is exercised in creating a yield curve and, in some respects, it appears to be as much art as science. This type of a discretionary, non-market interest rate would be virtually impossible for employers to model internally as part of corporate planning and would also be particularly difficult for Congress to oversee.

#### **ENSURING APPROPRIATE FUNDING**

We are also deeply concerned that the yield curve aspect of the proposal could produce an effective interest rate for some plans that is too low and therefore will overstate liability. Relative to the weighted long-term corporate bond rate in effect this year, the Administration's proposal could increase pension liabilities for some mature plans by 10% or more. In some cases, the immediate liability increase could be even greater. These dollars are far in excess of what is needed to provide a high degree of certainty that plans have enough to pay benefits.

The consequences of excessive contribution obligations are painfully clear. This is precisely what happened when inflated pension contributions were mandated by the obsolete 30-year Treasury bond rate. Employers that confront inflated contribution obligations will have little choice but to stop the financial bleeding by freezing or terminating their plans. Both terminations and freezes have truly unfortunate consequences for workers -- current employees typically earn no additional pension accruals and new hires will not have a defined benefit plan whatsoever. Government data reveals that defined benefit plan terminations accelerated prior to the temporary long-term corporate bond rate fix in the Pension Funding Equity Act of 2004, with a 19% drop in the number of plans insured by the PBGC from 1999 to 2002. Just as troublesome, the statistics above do not reflect plans that have been frozen. While the government does not track plan freezes, reports make clear that these freezes were on the upswing.

Further, inflated pension contributions divert precious resources from investments that create jobs and contribute to economic growth. Facing pension contributions many times greater than they had anticipated, employers will not hire new workers, invest in job training, build new plants, and pursue new research and development. Furthermore, inflating pension liabilities and forcing unnecessary contributions would drive up the cost of doing business and will put U.S. companies at a competitive disadvantage relative to foreign corporations that do not have similar obligations. For these reasons, it is important for funding to remain rational, predictable, and stable. These are precisely the steps that would help lower our nation's unemployment rate, spur individual and corporate spending, generate robust economic growth, and keep U.S. companies competitive in the global marketplace.

#### **PREVENTING UNNECESSARY BANKRUPTCIES**

It is important to recognize that an employer's credit rating is not directly tied to the plan's ability to provide the promised benefits. The plan is a separate entity and one of the hallmarks of U.S. pension law is that pension assets must be held in a separate trust or similar dedicated vehicle. A plan that has assets sufficient to pay benefits will pay those benefits even if the plan sponsor does not have adequate assets to pay its debts or otherwise has debt that is rated below investment grade.

The Administration's package of proposals creates a serious risk of forcing unnecessary bankruptcies. Its proposals trigger variable funding rules based on the determination of the creditworthiness of the plan sponsor and the members of the sponsor's controlled group as well as to base PBGC premium taxes and benefit guarantees on credit ratings are wrongheaded. In effect, the employer's liability is treated as increasing when the employer's credit rating slips, even though the plan's benefit payment obligations remain unchanged.

The use of credit ratings to determine funding or PBGC premium obligations could have significant macroeconomic effects. Such use would put severe additional pressures on employers experiencing a downturn in their business cycle. If the lower credit ratings create additional funding burdens and business pressures, that could lead to further downgradings, creating a vicious circle that drags a company down. This could well happen to a company that today is able to fund additional contributions to pull itself out of the underfunding problem and



thus raise its credit ratings. In short, a creditworthiness test would make it more difficult for a struggling company to recover. That is not in anyone's interest, including the PBGC, which could be forced to assume plan liabilities if the company does not recover. We must be careful not to lose sight of the fact that the best insurance for plans, participants and beneficiaries, and for the PBGC is a healthy plan sponsor. The best way to protect the PBGC is to ensure that plans are appropriately funded, regardless of the plan sponsor's credit rating.

It is also clear that the PBGC's proposal would classify many plans as at risk that will never be terminated. The mere fact that a company's debt is not rated as investment grade does not mean that it will terminate its plans. However, the consequence of these "false positives" could well be self-fulfilling, with employers forced to terminate as a result of a downward spiral. Moreover, employers that have non-investment grade debt but are improving their situation would get no credit for such improvement.

In addition, there are only a handful of credit rating entities and we are also concerned that a creditworthiness test would inappropriately vest these entities with enormous power. This is particularly troubling at a time when the credit rating agencies, and the credit rating process itself, have been the subject of significant criticism. These criticisms have raised questions about the credibility and reliability of credit ratings. In this context, a creditworthiness test is ill-conceived.

Finally, we also note that a creditworthiness test would inevitably result in the government determining the creditworthiness of at least some American businesses. Many privately held employers are not rated by any of the nationally recognized agencies and the PBGC has recommended conferring regulatory authority to develop guidelines for rating private companies. This would be disturbing.

## **ELIMINATING PREFUNDING BARRIERS**

One aspect of the Administration's proposal that we strongly support is the proposal to reform the tax rules governing the deductibility of pension plan contributions. Specifically, we support the Administration's proposal to increase the deduction limits from 100 percent of current liability to 130 percent. In fact, we would recommend increasing the 130 percent figure to 150 percent to ensure that there is an adequate cushion. For deduction purposes, current liability is today based on the 30-year Treasury bond rate, not the long-term corporate bond rate. Under our proposal, current liability would in the future be based on the long-term corporate bond rate for all purposes. This would, in isolation, actually decrease the deduction limit for many plans by 10 percent or 15 percent (and by more for a few plans). Accordingly, to ensure that the deduction limit for most plans is increased by 30 percent compared to current law, the limit should be increased to approximately 150 percent.

We also support repealing the excise tax on nondeductible contributions with respect to defined benefit plans. The excise tax on nondeductible contributions only discourages employers from desirable advance funding. Finally, we support repealing the combined plan deduction limit for any employer that maintains a defined benefit plan insured by the PBGC. Under present law, if an employer maintains both a defined contribution plan and a defined benefit plan, there is a

deduction limit on the employer's combined contributions to the two plans. Very generally, that limit is the greatest of:

- (1) 25 percent of the participant's compensation,
- (2) the minimum contribution required with respect to the defined benefit plan, or
- (3) the unfunded current liability of the defined benefit plan.

Without repeal of this provision, the sponsor of a plan with large numbers of retirees might lose its ability to make deductible contributions to its defined contribution plan because, in a mature plan, the number of active participants is small compared to the number of retired participants. This deduction limit can also cause very significant problems for any employer that would like to make a large contribution to its defined benefit plan. There is no supportable policy reason for preventing an employer from soundly funding its plan. Defined benefit plans and defined contribution plans are each subject to appropriate deduction limits that are based on the particular nature of each type of plan. There is no policy rationale for an additional separate limit on combined contributions.

#### **ENCOURAGING ADVANCE FUNDING**

We are also concerned about elements of the Administration's funding proposal that could discourage employers from contributing more than the minimum required contribution. Under current law, if a company makes a contribution in excess of the minimum required contribution, the excess plus interest can be credited against future required contributions. This credit for prefunding ("credit balances") helps to mitigate volatile and unpredictable funding requirements by allowing and encouraging a sponsor to increase funding during good times. The proposal, however, does not give employers who prefund direct credit for their excess contributions.

There have been suggestions that the current law credit balance system has been a factor in terminating plans assumed by the PBGC. These suggestions ignore the fact that but for the credit balance system, companies would have contributed less, resulting in more underfunding and more liabilities assumed by the PBGC.

Critics have also pointed out that credit balances are not immediately adjusted if the underlying value of the assets decreases. Consequently, plans with poor investment results have been able to use credit balances that are larger than the assets they represent. We support carefully targeted reforms that address this investment result problem. These reforms must be administrable and need to be applied prospectively. It would be fundamentally unfair to change the rules retroactively for employers that made contributions in reliance on current law credit balance rules. It is critical, however, that we preserve appropriate incentives to advance fund. Without these incentives, there is a significant risk that employers will only pre-fund to the minimum required by law. The result would be a less well-funded system, which is in no one's interest.

## **PROVIDING TIMELY AND APPROPRIATE DISCLOSURE**

We believe that participants should have timely and high-quality data regarding the funded status of their plans. It is important that participants have the information they need to evaluate their retirement security. These rules should be structured to provide full and fair disclosure without creating undue administrative burdens on plans or causing unnecessary concerns among participants.

In this context, existing disclosure requirements should be enhanced, while at the same time avoiding the creation of costly and confusing new requirements. A starting point might be the Administration's general proposal to improve the summary annual report ("SAR"), but with significant modifications that would make the information disclosed more immediate and more meaningful. One of the problems with the SAR under current law is that the information disclosed is not timely, a problem which is not addressed by the Administration's proposal. In fact, currently, the information provided can be almost two years old. Accordingly, we would propose stronger changes.

One possible solution would be to require plans to disclose in the SAR their funded percentage. However, instead of reporting percentages as of the first day of the plan year for which the SAR is provided (information that is almost two years old), the percentage could be reported as of the first day of the subsequent year, using (1) the fair market value of assets as of that date and (2) the liabilities as of that date based on a projection from the preceding year. This would mean more timely disclosure. A plan maintained by a public company could also be required to disclose the year-end funded status of the plan as determined for purposes of financial accounting for the two most recent years available. This approach would provide much more information than under present law or under the Administration's proposal. In addition, unlike the Administration's proposal, financial accounting information that is already circulated and disclosed for the company as a whole could be disaggregated into the amounts for individual plans and provided to participants. By using information available to employees through financial reports and media statements, the possibilities for confusion would be greatly reduced.

## **FUNDING THE PBGC APPROPRIATELY**

The PBGC has proposed dramatic increases in premiums in order to address its deficit. This proposal gives us great concern for several reasons. First, the proposed increase in the flat dollar premium from \$19 to \$30 and its indexing is strikingly inappropriate. This is a substantial increase on the employers that have maintained a well-funded plan through a unique confluence of lower interest rates and a downturn in the equity markets. It is wrong to require these employers to pay off the deficit created by underfunded plans that have transferred liabilities to the PBGC. Second, the unspecified increase in the variable rate premium will become a source of great volatility and burden for companies struggling to recover. This could well cause widespread freezing of plans by companies that would otherwise recover and maintain ongoing plans. Many of these plans are well-funded by any other measure, but under the proposal might be deemed "underfunded" and now be required to pay variable rate premiums on top of this higher base premium. This would only be exacerbated by the fact that the PBGC has proposed an unprecedented delegation of authority to its Board, rather than Congress, to determine the

required premiums. Third, a premium increase misses the point. The solution to underfunding is better funding rules, not higher premiums.

We are also very concerned that PBGC premium increases not become a tool that is used to reduce the Federal budget deficit. The Administration's FY 2006 budget reflects a \$26 billion increase in revenue attributable to the PBGC's premium increase. Proper pension policy should be driven by what is best for American workers and retirees, not by the need to fill an arbitrary hole in the federal budget.

More generally, there has been a striking lack of clarity about the real nature of the PBGC deficit. The PBGC has reported a \$23 billion deficit as of the end of FY 2004 but there are a number of questions about the PBGC's situation. First, nearly three quarters (\$17 billion) of the PBGC's reported deficit represents "probable" terminations rather than claims from plans already trusted by the PBGC. Second, the PBGC's numbers are based on a below-market interest rate and the deficit would be substantially less using a market-based interest rate. Third, swings in the PBGC surplus-deficit do not provide Congress with an accurate picture of the PBGC's ability to pay benefits. In fact, the PBGC can pay benefits for many, many years into the future. Finally, it is not clear why the PBGC has unilaterally moved away from equities to lower-earning investments that hinder its ability to reduce its deficit. No one denies that the PBGC faces a serious situation, and our comprehensive proposals for funding reform are evidence that the employer community is serious and committed to shoring up the PBGC's financial condition. However, these are troubling questions that should be addressed before taking the very harmful step of increasing PBGC premiums.

### **CONFIRMING THE LEGALITY OF HYBRID PLAN DESIGNS**

Hybrid defined benefit pension plans, such as cash balance and pension equity plans, were developed to meet the needs of today's mobile workforce by combining the best features of traditional defined benefit plans and defined contribution plans. Nearly a third of large employers with defined benefit plans maintain hybrids and, according to the PBGC, there are more than 1,200 of these plans providing benefits to more than 7 million Americans as of the year 2000. These plans are defined benefit plans and many of the same funding issues described above are relevant. They also face unique issues.

Despite the significant value that hybrid plans deliver to employees, current legal uncertainties threaten their continued existence. As a result of one court decision, every employer that today sponsors a hybrid plan finds itself in potential legal jeopardy. It is critical that this uncertainty be remedied. Pension reform legislation needs to clarify that the cash balance and pension equity designs satisfy current age discrimination and other related ERISA rules. In addition to clarifying the age appropriateness of the hybrid plan designs, we believe it is essential to provide legal certainty for the hybrid plan conversions that have already taken place. These conversions were pursued in good faith and in reliance on the legal authorities in place at the time.

Some in Congress are seeking to impose specific benefit mandates when employers convert to hybrid pension plans. For example, some would require that employers pay retiring employees the greater of the benefits under the prior traditional or new hybrid plan. Others would require employers to provide employees the choice at the time of conversion between staying in the prior

traditional plan or moving to the new hybrid plan. We strongly urge you to reject such mandates. Mandates are fundamentally anathema to the voluntary nature of our employer-provided retirement system. Inflexible mandates will only drive employers from the system and reduce the competitiveness of American business. Employers must be permitted to adapt to changing business circumstances while continuing to maintain defined benefit plans.

#### **MAKING THE EGTRRA CHANGES PERMANENT**

As mentioned above, EGTRRA included provisions that increased a number of the defined benefit plan limits. We appreciate that this Committee played an important role in enacting EGTRRA and we believe these improvements have led to growth in defined benefit plan coverage among small employers. These improvements will expire in 2010 unless extended by Congress. These changes have been an enormous success and we strongly support making these provisions permanent.

#### **CONCLUSION**

The myth that defined benefit plans are lumbering towards extinction is exactly that – a myth. Defined benefit plans are a vital part of our national retirement income security system today and they can continue to be part of our future. In recent years, the defined benefit system has been burdened by expensive and excessive regulation, temporary rules, unpredictable and volatile contribution obligations, unnecessary barriers to pre-funding, and legal uncertainty regarding the status of cash balance and other hybrid plans. Reform needs to address these issues and allow the defined benefit system to grow and regain its vigor.

Other reforms are needed to address the reported deficits at the PBGC. We support targeted reforms, including enhanced disclosure, restrictions on benefit increases in appropriate circumstances, and increased opportunities to make contributions during good economic times. The Administration's reform proposal would, however, tear down the entire funding system, build a new system from scratch, and create considerable barriers to sponsoring a defined benefit plan. We believe the system can be strengthened without tearing down a system that is a core part of how employers provide, and millions of Americans receive, retirement income security.