ERIC

*Representing the Employee Benefits Interests of America's Largest Employers*
1400 L Street N.W., Suite 350, Washington, D.C. 20005
phone 202-789-1400 / fax 202-789-1120 / e-mail eric@eric.org

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## RE: CURRENT NEGOTIATIONS REGARDING PENSION FUNDING LEGISLATION

Dear Senator:

The Senate is expected soon to consider legislation that re-writes long-standing funding rules for pension plans. The legislation is expected to combine aspects of bills approved by the Finance Committee and the Health, Education, Labor and Pensions Committee. This is a complex process that will have a dramatic impact on the ability of employers to sponsor pension plans in the future and on the retirement security of tens of millions of workers.

We believe that the final Senate bill must meet the criteria and follow the recommendations outlined below if it is to encourage companies to establish and maintain pension plans in the future while also protecting participants in those plans through sound funding practices.

**Funding rules must result in predictable, rational and stable funding over time.**

Funding proposals put forward by the Administration were focused primarily on building a wall around the Pension Benefit Guaranty Corporation (PBGC). Dramatic and unpredictable upticks in funding would be required any time a plan's funded status dropped below 100% based on spot calculations. This is a very short-sighted approach. The vast majority of pension plans are not a threat to the PBGC – but harsh and volatile rules are a threat to the vast majority of plans and to the businesses that sponsor them. An employer must be able to anticipate required pension contributions several years into the future in order to plan its business investment and operations. Required contributions also cannot be too volatile; otherwise they will be too difficult to accommodate in cash flow operations of the business. Many Senators have focused not just on protecting the PBGC but also on ensuring the future ability of employers to sponsor pension plans, and we applaud them for their foresight.

PROPOSED ACTION: Delay changes in required funding rules until 2007.
It is already too late in 2005 to expect plan sponsors to know what is expected of them by 2006 under a complex new law, much less execute any changes required. Wisely, both committees' bills already delay changes in the required funding rules one year, retaining the present law corporate bond rate in the interim.

PROPOSED ACTION: Regarding required contributions to a pension plan, the Senate should adopt the provisions of the HELP Committee bill.
The HELP Committee bill provides for
* an interest rate based on a three-year weighted average;
* actuarial value of assets over a three-year period;
* amortization of funding shortfalls over 10 years.

These provisions will both provide predictability and lessen volatility of required funding. By contrast, NESTEG requires use of a near-spot interest rate and market value of assets, which would impose unpredictable and very volatile cash requirements on companies. The bill also would amortize funding shortfalls over a shorter period (7 years). Although NESTEG attempted to address volatility problems through "collars" on how much contributions can go up or down from year to year, under NESTEG many ERIC members would still face potential unpredictable contribution swings of hundreds of millions of dollars in a single year. In short, the "collars" do not provide predictability and allow far too much volatility. This will be a significant impediment to the maintenance of many pension plans. Only retention of meaningful (at least three year) averaging and smoothing provisions can provide both predictability and effective volatility protection. A longer amortization period also will successfully dampen volatility.

**Increased funding requirements must be phased in gradually.**

Under current law, plans that are funded at a 90% or higher level are not required to make deficit reduction contributions in recognition of the facts that (1) plans funded at this level are well able to meet their benefit obligations and (2) some fluctuation in the funded status of plans is entirely normal. The Senate committee bills set a new, 100% funding standard. If companies are asked to meet this new standard too quickly, they will be faced in the near term with sharp, unrealistic, and – since these plans are solid and well funded – entirely unnecessary cash calls, just as the nation's economy is attempting to recover from the recent downturn and new economic shocks. Pension plans will be frozen and jobs lost due to an unsound national policy. The Finance Committee's three-year phase-in is insufficient to avoid these unnecessary and harmful consequences.

PROPOSED ACTION: Adopt the transition rules as in the HELP Committee bill.
The HELP Committee bill provides for:
* 10-year phase-in of the 100% funding target for well-funded plans (i.e., plans not paying a deficit reduction contribution in 2006).

The HELP Committee bill also mandates a new mortality table. If the new table is included in the Senate bill, it should be phased in over five years, as provided in the HELP Committee bill. The Committee bills also include the value of lump sums in the plan's current liability calculation. The HELP Committee bill would phase in this new requirement over five years -- a transition provision that also should be included in the Senate package.

**A plan's liability must not be linked to the credit rating of the sponsoring employer.**

The Administration's proposal to impose a higher liability calculation on plans sponsored by an employer with a below investment grate credit rating, included in modified form in the Finance Committee bill, is off point and likely to set off the death-spirals and plan terminations it seeks to avoid. For a company who drops below investment grade, the proposals will impose sharp cash calls on a company at precisely the wrong time – endangering both the plan and the company. The company's credit rating does not determine whether the company's pension plan is adequately funded. Most companies that are below investment grade never pose any threat to the PBGC. In some instances, a company's credit rating reflects the rating companies' views of the industry and does not reflect the soundness of a particular company. Moreover, the methods used by the credit companies to set their ratings are far from transparent and are under scrutiny in Congress and elsewhere in the government. Pension plans should not be held hostage to a measuring mechanism that is both unrelated to the plan and under scrutiny. If an "at risk" liability is to be imposed, it should be based solely on the funded status of the plan, should be reasonably constructed, and should avoid excess charges of any sort.

PROPOSED ACTION: If an "at risk" liability is included in the Senate bill, it should follow the provision in the HELP Committee bill.

The HELP Committee bill
* imposes "at risk" liability on plans that are less than 60% funded;
* bases the increased liability calculation on participants eligible to receive benefits in the current or next 5 plan years (i.e., assumes that these individuals will elect to receive their benefits in the form that produces the highest liability).

**Plans should be able to fund up in good times.**

Present law imposes low ceilings and other restrictions on the amount of contributions that an employer can make to a pension plan on a tax-deductible basis. Credit balances (which allow previous contributions to be credited against current funding requirements) are a necessary mechanism that makes it economically possible for employers to pre-fund their plans. The Administration proposed to eliminate, rather than modify, this key mechanism. The Finance Committee bill took the lead in allowing substantially larger deductible contributions, in eliminating a funding cut-off imposed only on employers that sponsor both DB and DC plans, and in providing a workable pre-payment (credit balance) mechanism for plan sponsors. The committee bill appropriately would modify the rules relating to pre-payments by adjusting the available credit balance values in accordance with the performance of the underlying assets. This change addresses issues that surfaced in some recent plan terminations. The HELP Committee bill generally adopts these provisions.

PROPOSED ACTION: Adopt the allowable funding provisions of the Finance and HELP committee bills.

These bills:
* allow deductible contributions up to 180% of current liability;
* eliminate the 25% of compensation limit on contributions where an employer sponsors both a DB and a DC plan; and
* provide a revised and workable mechanism for employers to pre-pay pension contributions during good times in order to be able to offset contributions required in down cycles.

**The following provisions also should be included in the Senate package:**

* Segmented Yield Curve: If, contrary to our recommendations, the mandated interest rate included in the Senate bill is a yield curve, it should follow a simplified, segmented approach and Treasury should be explicitly directed regarding how the segments are to be calculated.

* PBGC Premiums Not Indexed: Under no circumstances should the amount of premiums an employer pays to the PBGC be indexed. ERISA (sec 4002) requires premiums to be kept at the lowest possible level. Only Congress should decide when a premium increase is needed. The HELP Committee bill accomplishes this objective and requires the PBGC to report to Congress every five years regarding any recommended adjustments.

* Benefit Restrictions Limited: Both committee bills appropriately reject the Administration's elimination of shut down benefits and provide a mechanism that will fund these benefits in an orderly manner while also protecting the PBGC against sudden increases in unfunded guaranteed benefits in a plan it is taking over. In general, restrictions on benefit accruals and distributions will be highly disruptive to participants and impede sound workforce management. Any such restrictions should be strictly limited to egregious circumstances.

* Plan Specific Mortality Assumptions: As in the HELP Committee bill, the Senate bill should allow companies that have mortality experience significantly different from the prescribed table to use more accurate assumptions with the approval of the IRS.

* Lump Sum Distributions: Under the committees' bills, lump sum distributions would be calculated using the yield curve instead of the 30-year Treasury bond. It should be clear, as under present law and long-established practice, that rates producing a larger lump sum could also continue to be used. Failure to do so will result in employees eligible to retire leaving a company earlier than they otherwise would.

* Reporting to the Government: The HELP Committee bill more accurately targets which plans must supply information to the PBGC under section 4010, a vast improvement over the current scatter-shot structure. Both bills require additional information to be provided through the Form 5500, the primary source of government information on benefit plans.

* Reporting to Participants: Both bills require additional reporting to participants. While we agree that additional information can and should be provided on an expedited basis, we remain concerned that the bills add layer upon layer that will increase administrative costs and confuse plan participants. We propose to work toward a more simplified structure before Congress completes work on the bill.

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

Sincerely,

Janice M. Gregory
Senior Vice President

[Note: A separate letter will outline concerns and recommendations regarding hybrid plan legislation.]