The ERISA Industry Committee

"Reportable Events Proposed Regulations"

Testimony of Michael J. Francese
Partner of Covington & Burling LLP

on behalf of The ERISA Industry Committee

Before the Pension Benefit Guaranty Corporation

Tuesday, June 18, 2013
Washington, D.C.

The ERISA Industry Committee
1400 L Street, N.W., Suite 350, Washington, DC 20005-3531
Tel. (202) 789-1400 Fax (202) 789-1120 www.eric.org
Advocating the Employee Benefit and Compensation Interests of America's Major Employers

TESTIMONY BEFORE
THE PENSION BENEFIT GUARANTY CORPORATION
ON PROPOSED REGULATIONS REGARDING REPORTABLE EVENTS

June 18, 2013

Good afternoon. My name is Mike Francese. I am a partner at the law firm of Covington & Burling LLP, and I appear before you today on behalf of the ERISA Industry Committee—also known as "ERIC."

ERIC is a nonprofit association committed to the advancement of the employee retirement, health, and other welfare benefits of America's largest employers. ERIC's members sponsor some of the largest private retirement plans in the country. These plans provide retirement benefits to millions of workers and their families. The great majority of ERIC's members also sponsor defined benefit retirement plans.

ERIC appreciates the opportunity to testify before you and share our concerns about the PBGC's proposal to modify the rules governing Reportable Events. ERIC submitted a lengthy comment explaining its views on the proposed regulations in considerable detail. Today, I will highlight four issues raised in our comment letter:

1. It is not necessary to overhaul the existing regulations' approach to waivers.

2. The proposed regulations essentially eliminate plan funding as a basis for a waiver.

3. The PBGC should focus on the financial soundness of the plan and not the plan sponsor.

4. The proposed safe harbor for financial soundness of a plan sponsor is unworkable and there is no suitable alternative.

1. It is not necessary to overhaul the existing regulations' approach to waivers.

Turning to the first point. ERIC appreciates the PBGC's reconsideration of the 2009 proposed reportable event regulations. Those proposed regulations would have imposed significant burdens on the sponsors of defined benefit plans -- without a corresponding benefit to the defined benefit plan system.

Unfortunately, the 2013 proposed regulations have many of the shortcomings of the 2009 proposal -- at least with respect to plans sponsored by large employers.

The goal of the proposed regulations is for the PBGC to obtain useful information about plans that pose the greatest risk of being terminated when their liabilities exceed their assets. However, the PBGC already obtains or has access to a significant amount of information about at risk plans:

- Plan sponsors are already required to file numerous forms with the PBGC and other government agencies;

- The PBGC has access to SEC filings, bankruptcy court dockets and other public records, which further detail additional information about plans with unfunded liabilities;
- The volume of publicly available information is the greatest for big public companies – these are the same companies that will be disproportionately affected if the proposed regulations are adopted; and
- The "Early Warning Program" allows the PBGC to obtain additional information about plans that pose the greatest risk to the PBGC.

In addition, Congress intended the Pension Protect Act to "strengthen the pension insurance system." And it is doing precisely that:

- According to the Department of Labor, from the 2006 through the 2010 plan years, private plan sponsors increased the annual contributions to their defined benefit plans from $89.8 billion to $131.1 billion.
- And these increases have come during a period in which participation in defined benefit plans actually declined from 42.1 million workers to 41.4 million workers. So more money is being contributed to provide benefits to fewer workers.

There is no reason to impose additional monitoring and reporting requirements on plan sponsors at this time.

The proposed regulations would also add to the costs and burdens of operating a defined benefit plan without any corresponding benefit to the system. The proposed regulations would undoubtedly result in large plan sponsors having to make additional reportable event filings. And these filings are no trivial matter. They can take several weeks and cost thousands of dollars to prepare -- time and money that could better be used to fund plans.

The proposal would also cause business uncertainty for plan sponsors. Most loan agreements or lines of credit that we have reviewed include, as an event of default, the occurrence of a reportable event -- at least to the extent that the potential liability from a reportable event exceeds a certain threshold or could cause a "material adverse effect" on the company. Similarly, many plan investment contracts allow the counter-party to terminate the investment if the plan sponsor engages in a non-waived reportable event.

In these situations, a reportable event -- even a trivial one -- can cause significant adverse consequences to the plan because an investment can be terminated on an unfavorable basis or a lender has an avenue to re-open negotiations about an existing agreement. In either case, the plan or plan sponsor will be significantly worse off, and it is not clear that the defined benefit system is better served by this outcome.

2. The proposed regulations essentially eliminate plan funding as a basis for a waiver.

Turning to the second point: the proposed regulations essentially eliminate plan funding as a basis for a waiver without any showing that such a change is necessary.

Historically, plan funding has been the principal basis for waivers from reportable event filings. This approach is consistent with the overall focus of ERISA and the Code on plan funding and plan solvency.

However, the two ways in which a plan can satisfy the proposed plan funding safe harbor are virtually unachievable:

- The law does not require plans to be funded on a termination basis. Plan sponsors don't bother doing calculations to see if their plans are fully funded on a termination basis because they don't have to know. Having these calculation performed is expensive, time-consuming and unnecessary -- yet the proposed regulations would require companies to have this calculation performed every year.
- The other way for a plan to satisfy the plan funding safe harbor -- being 120% funded on an ongoing basis -- sets a threshold so high that it makes the safe harbor essentially meaningless. According to a 2012 study of the 100 largest pension plans, approximately 2-3% of large plans would meet this standard. That same study shows

that, even if standard were dropped to 105%, only approximately 5% of large plans would meet it.

Under the current regulations, somewhere between 60-75% of large plans satisfy the funding-based waiver standard -- the proposal would reduce that number to around 2-3%. The funding-based safe harbor will, for all practical purposes, have been eliminated and replaced with the company financial soundness safe harbor.

3. The PBGC should focus on the financial soundness of the plan and not the plan sponsor.

Turning to the third point: the financial soundness of a plan sponsor is not an appropriate measure of the risk that a plan places on the defined benefit plan system.

As noted earlier, the existing approach to reportable event waivers has been based on plan funding. This is consistent with the historical focus on plan funding in ERISA and the Code. Companies have been required to fund at least to the minimum -- and discouraged from contributing much more than the minimum -- and plan fiduciaries have been charged with investing those assets prudently. Never has the solvency of the plan sponsor come into play. Indeed, Congress considered and rejected this approach when it enacted the PPA.

The proposal would effectively change the approach companies must take to their plans. More importantly, the proposal to use the plan sponsor's financial condition as the basis for a safe harbor will require companies to take reportable events into account when making decisions relating to their core business.

For example, if the proposal is adopted, plan sponsors that have leverage to negotiate more favorable payment terms with their vendors might not want to do so -- even though it would help their core business -- because Dun & Bradstreet might misconstrue the new payment terms and lower the company's score, causing a reportable event (or at least causing an error in the D&B report that can take months to correct).

Similarly, plan sponsors might have to turn down favorable financing arrangements because they would be required to secure some of the debt with their inventories, receivables or some other valuable asset. All because they do not wish to spend the time and money worrying about whether they will have to make a reportable event filing.

4. The proposed safe harbor for financial soundness of a plan sponsor is unworkable and there is no suitable alternative.

Finally, to the fourth point: the proposed test for financial soundness won't work. And it is impossible to think of an alternative test that would be any better.

Because this regulation sweeps across all industries, it is not possible to develop a standard of "financial soundness" that works for all segments of the market. Different industries and different size companies have different business cycles and differing measures of soundness that will be appropriate at any given time.

For example, Dun & Bradstreet is perhaps the most well-known credit reporting company. However, large companies don't get Dun & Bradstreet reports: they use ratings agencies instead and give those agencies access to management and financial forecasts.

And it would not be appropriate to use Dun & Bradstreet reports as the basis for a safe harbor. These reports are based on dated information, not vetted by the company, and would require considerable effort on a company's part to provide D&B with the necessary information and to monitor the reports on an ongoing basis. In addition, largely because these reports are not vetted by the company, they often contain mistakes that cannot easily be corrected. Even under optimum circumstances, it can takes <u>months</u> to correct a mistake in a D&B report -- and that is if the company is monitoring the report constantly. These reports are also not good indicators of <u>future</u> financial risk because they are not intended to be a forecast of the company's future prospects, but instead are backward-looking -- so they will not provide a reliable basis for determining whether a <u>plan</u> poses a significant risk to the PBGC in the future.

Another example of a flaw with the proposed test is its use of secured debt as a proxy for financial strength. Financially sound companies often have secured debt. It is a common practice to have secured debt to obtain better financing rates: receivables and inventory, as well as other valuable assets, are often used as collateral by financially healthy companies. This is a sound business practice, not an indication of financial weakness.

Finally, a comment about timing. The proposed regulations would require plan sponsors to monitor: (a) the company's credit score from a commercial credit reporting company; (b) PBGC's threshold credit score; (c) the company's secured debt and how that debt is secured; (d) the company's net income for past two years; (e) loan defaults; and (f) potential missed pension contributions. This proposed regulation would require this information to be current <u>as of the date of a potential reportable event</u> -- meaning that companies would be required to monitor this information on a <u>constant basis</u>.

This simply is not practical. If the PBGC were to adopt a variation on the proposed safe harbor, it would have to allow plan sponsors a "look back" period -- that is, have the financial status based on information available as of a date substantially in the past -- to avoid putting plan sponsors in the impossible position of having to monitor the safe harbor on a real-time basis.

* * * * *

In conclusion, while we recognize that the PBGC needs to make some changes for the PPA, ERIC strongly supports the current regulatory framework and believes that the PBGC has the tools it needs to protect the system without unduly burdening those employers who choose to continue to sponsor defined benefit plans.

That concludes my prepared remarks. I would be happy to answer any questions that the panel might have.