



AMERICAN BENEFITS  
COUNCIL

September 24, 2008

The Honorable Nancy Pelosi  
Speaker of the House  
U.S. House of Representatives

The Honorable Harry Reid  
Majority Leader  
United States Senate

The Honorable John Boehner  
House Republican Leader  
United States House of Representatives

The Honorable Mitch McConnell  
Senate Republican Leader  
United States Senate

Dear Speaker Pelosi, Majority Leader Reid, Minority Leader Boehner and Minority Leader McConnell:

As we all know, in recent weeks, there have been wild market fluctuations and almost unprecedented economic uncertainty. As efforts intensify to find solutions to these challenges, it is critical to recognize the broad effects of our economic troubles. Specifically, the market fluctuations can have a devastating effect on our nation's pension system and our retirement security. Without Congressional action on two issues, we could be permitting the recent market events to undermine our retirement security by triggering another wave of pension plan freezes. The failure to correct these two issues could also place large unexpected burdens on companies and thereby significantly hinder our economic recovery.

**Asset smoothing.** In the context of the Pension Protection Act (the "PPA"), Congress focused very squarely on the issue on how to value plan assets for purposes of the defined benefit plan funding rules. Congress decided to retain asset smoothing but limit it to two years, instead of four years as under prior law. However, Treasury has not followed Congressional intent and has effectively repealed asset smoothing in its regulations, forcing companies to use spot asset valuations. Correction of this problem – restoration of asset smoothing over a two-year period – has been included in technical

corrections legislation passed separately by the Senate and the House. As discussed further below, if companies cannot use asset smoothing for 2009, the use of spot asset valuations for 2009 could well make funding obligations both enormous and unpredictable.

**Transition rule.** Before the PPA, the funding target for a plan was generally 90% of the plan's liabilities. PPA increased that target to 100%, so that all employers must fund their defined benefit plans toward a target equal to 100% of the plan's liabilities. This increase to 100% was, however, subject to a phase-in: 92% in 2008, 94% in 2009, 96% in 2010, and 100% thereafter. However, if a plan is below the phase-in level in any year, it is not eligible for the phase-in thereafter. For example, if a plan is at 94% funded in 2009, it has no shortfall to fund. But if a plan is at 92% funded in 2009, it is ineligible for the transition rule and must fund based on an 8% shortfall, not based on the 2% shortfall needed to get to 94% funded. This is a very limited transition rule with a cliff-like effect; if a plan's funded status falls slightly, the company can lose the transition rule and find itself facing a deficit much larger than its loss.

The lack of asset smoothing and the extremely limited nature of the PPA transition rule will combine to create huge problems for sponsors of defined benefit plans. At the beginning of the year, almost 2/3 of the 100 largest private defined benefit plans were overfunded. That number could easily fall to less than 1/3 by the end of 2008. And the plans that were already underfunded will face far bigger deficits than expected.

The absence of any asset smoothing means that companies will be required to take into account the entire loss immediately, creating unexpected funding obligations equal to at least 17% of that loss in one year. For plans that have lost \$2 billion in assets, for example, that translates into an unexpected obligation of over \$300 million. Companies cannot afford that type of unexpected expense at this time.

And the data indicates that almost half of the top 100 plans could easily fall below 94% funded by the end of the year. That means that none of those plans will qualify for the PPA transition rule in 2009, forcing them to suddenly fund to a higher target.

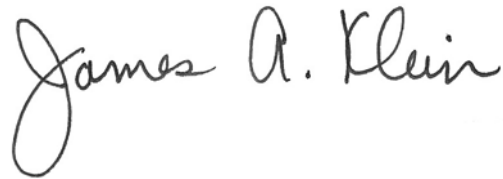
And finally, employees across the country will suffer, too. The inability to use asset smoothing will force large numbers of plans into the benefit restriction rules, whereby employees may lose the right to receive their full lump sum benefits and may even lose the right to future benefits.

We strongly believe that companies should fund their promised benefits, as contemplated by the PPA. However, contrary to clear Congressional intent, Treasury has blocked the application of asset smoothing, thus eliminating companies' ability to take unexpected asset gains or losses into account over 24 months. And the PPA transition rule is inconsistent with the intent underlying the PPA: an orderly transition to a new funding regime.

The asset smoothing rule intended by Congress needs to be restored. And the PPA transition rule needs to be broadly available, so that it is not denied to the very companies who most need it. And both of these changes need to be included in the economic relief legislation currently being considered.

Without these fixes, companies with defined benefit plans could be faced with staggering unexpected funding obligations. These obligations could force many companies to freeze their plans and could create significant business hardships for companies across the country. This is not the time for these unintended glitches in the pension law to derail companies from the road to economic recovery. And this is not the time to undermine pension plans, which play a vital role in our economy as a source of long-term investments, thus stimulating growth.

Sincerely,

A handwritten signature in black ink that reads "James A. Klein". The signature is written in a cursive style with a large, looping initial "J".

James A. Klein  
President

CC: U.S. House of Representatives  
U.S. Senate