United States Senate

WASHINGTON, DC 20510

March 27, 2006

The Honorable Charles Grassley
Chairman
Senate Finance Committee
Washington, DC 20510

The Honorable Max Baucus
Ranking Member
Senate Finance Committee
Washington, DC 20510

The Honorable Michael Enzi
Chairman
Committee on Health, Education, Labor, and Pensions
Washington, DC 20510

The Honorable Edward Kennedy
Ranking Member
Committee on Health, Education, Labor and Pensions
Washington, DC 20510

Dear Senate Conferees:

We share your vision of passing legislation that will strengthen the defined benefit pension system. It is a delicate balance, indeed. In striking that balance, however, we must avoid the unintended consequence of driving troubled companies into bankruptcy, which would worsen the financial condition of the Pension Benefit Guarantee Corporation (PBGC) and put more Americans' retirement security at risk.

As you work to reach a consensus between the House and Senate versions of single-employer defined benefit pension plan funding reforms set forth in the Pension Security and Transparency Act of 2005 (S. 1783) and the Pension Protection Act of 2005 (H.R. 2830), please consider our comments below on the following issues: treatment of existing hybrid pension plans, credit rating as a means to determining "at-risk" plans, smoothing time periods, and the phase-in timeframe of these reforms.

(1) Treat existing AND future hybrid pension plans the same.

As you know, both the Senate and House versions of pension reform contain provisions addressing hybrid pension plans (sections 601 and 602 of S. 1783 and section 701 of H.R. 2830). It is our hope that the final conference report will clarify that the design of hybrid pension plans is not now, nor has been, age discriminatory. In making this clarification, we believe the final bill should reflect the following points:

(1) it is neither age discrimination nor a violation of the minimum lump sum rules for a hybrid pension plan to credit an employee's account with a market rate of return, including a market rate of return based on equity investments, and

(2) a hybrid pension plan does not fail to credit a market rate of return merely because, in addition to crediting a variable market rate of return, it also prevents the rate of return in an employee's account from falling below a reasonable guaranteed minimum level.

Numerous employers have converted to hybrid pension plans in response to the changing needs of their workforce. Rather than freezing or terminating outdated plans, employers have voluntarily committed hundreds of billions of dollars to hybrid pension plans to provide continuing pension benefits to their employees. Despite their obvious promise and appeal, hybrid pension plans have been subjected to enormous potential liabilities from lawsuits claiming, on the one hand, that crediting a market rate of return on an employee's hybrid pension account amounts to illegal age discrimination and, on the other hand, that because they credit a market rate of return, hybrid pension plans are required to pay out much larger lump sums to *younger* employees than *older* employees. These claims make no sense and are not supported by federal law, and this is why we must clarify the law to show that crediting interest in a pension plan merely adjusts an employee's benefit to prevent a loss of value due to the passage of time and it does not discriminate on the basis of age.

The House hybrid pension provisions recognize these claims make no sense and clarify current law to reject them. The House provisions can be improved by making them explicitly retroactive to leave no doubt on this issue. The Senate version, while an attempt to address the issue, may expose plan sponsors of past hybrid pension conversions to unwarranted lawsuits.

(2) A company's credit rating should not be used to determine "at-risk" status.

The Senate bill would use an indirect measure, a company's credit rating, rather than the direct measure of a plan's strength, its asset balance, to determine whether the plan is "at-risk." Once defined as "at-risk," the company must use different actuarial assumptions that will require it to put significantly more money into its pension trusts. This provision alone could require companies with soundly-funded plans (but poor credit ratings) to lock away unnecessarily high amounts of additional dollars in their plans. These are dollars that could otherwise be used to boost research and development, create jobs, make other investments needed to compete in a global marketplace, or otherwise fund efforts to strengthen a company's financial condition. Moreover, increasing companies' funding requirements specifically during times of financial difficulty could further push troubled companies toward bankruptcy, adding to job losses and reducing the likelihood that the companies make good on their promises to provide these long-term benefits over time.

(3) Twelve-month "smoothing" is too short.

Under current law, the amount of money companies have to put into their plans is determined by valuing their pension liabilities using a four-year weighted average; pension assets may be similarly smoothed over a five-year period. This prevents companies from having short-term drastic and unpredictable fluctuations in the amounts they are required to contribute to their pension plans. The House bill reduces both "smoothing" periods to a three-year average; the Senate bill reduces them further to a 12-month average. Using a 12-month timeframe could mean drastically increased contributions during stock market downturns and generally increase the volatility and unpredictability for employers. Three years is a fair approach that would tighten current law but still give employers some necessary cushion against volatility and provide needed predictability to allow companies to plan contributions prudently. We do not want to create so much unpredictability that companies leave the defined benefit plan system because it is too difficult to plan for their pension costs. Doing so would undermine retirement security for millions of Americans.

(4) Phase-in to 100% funding should be a <u>minimum</u> of five years.

A longer phase-in period is necessary to avoid a mass withdrawal by sound companies from the defined benefit system. An increase in the funding target from 90% to 100% is an increase of hundreds of millions of dollars for many plans, and billions for others. Many companies will need between 7-10 years to adjust their long-range business plans or face an immediate decision to abandon defined benefit plans. Shorter phase-in periods will place inordinate restrictions on capital allocation required to remain competitive in the market place, forcing this choice. An inappropriately short phase-in period will chase good companies away and further jeopardize the insurance pool supporting the PBGC.

We understand the main goal of pension reform is to safeguard the pensions of millions of Americans while at the same time protect the PBGC from further financial exposure. We appreciate your efforts in working to reach this goal. We are concerned, however, that these provisions tip the balance toward endangering the defined benefit system, and this is the very thing we are trying to avoid. In an attempt to help level the balance, we hope you will consider implementing our suggestions.

Sincerely,

Kit Bond
Christopher S. Bond

Jim Talent
James M. Talent