May 8, 2007

The Honorable Henry M. Paulson, Jr.
Secretary of the Treasury
Main Treasury Building, Room 3330
1500 Pennsylvania Avenue, NW
Washington, DC 20220

Dear Secretary Paulson:

We appreciate the Treasury Department’s hard work in issuing guidance under the Pension Protection Act. This guidance is needed by employers and employees so that their retirement plans can be operated in accordance with the critical reforms we enacted last year.

Among the most important reforms in the legislation were those affecting hybrid defined benefit plans such as cash balance plans and pension equity plans. As traditional defined benefit plans have declined, hybrid plans have been the main source of vitality within the defined benefit plan system. Our reforms will ensure that these plans can continue in existence and will operate in a way that enhances participants’ retirement security.

There are a number of very important guidance issues with respect to hybrid plans. It is critical that these issues be resolved in a manner consistent with Congressional intent. First, the legislation was intended to permit a broader array of interest crediting rates under cash balance plans than were previously permitted. In that regard, the legislation generally permits plans to use any interest crediting rate as long as that rate is not greater than a market rate of return. In determining whether an interest crediting rate is above market, the law is very clear that any “reasonable minimum guaranteed rate of return” is disregarded. Thus, for example, assume that a plan provides an interest crediting rate equal to the greater of the long-term investment grade corporate bond rate or 4%, and assume further that the long-term investment grade corporate bond rate is by itself a market rate. In this case, the existence of the 4% floor does not cause the long-term investment grade corporate bond rate to be above market. And this same analysis applies to permit an equity-based crediting rate not to be reduced by reason of the application of a reasonable minimum guaranteed rate of return. Any contrary guidance would be inconsistent with the statute and the legislative history. And any contrary guidance would be very harmful to participants, since it would require plans across the country to reduce their interest crediting rate.
There is another special interest crediting rule: interest credits cannot result in an account balance being less than the aggregate contribution credits. The intent, reflected in a Senate colloquy, was that that special rule would be applied at the date of benefit distribution, not annually. If the rule were to be applied annually, that would effectively preclude a host of interest crediting rates - such as those based on equity returns - that Congress intended to permit.

Congress also envisioned a cash balance plan system where employers could, without undue administrative burdens, offer participants a choice of different interest crediting rates, and participants could elect to move freely from one rate to another. We urge you to confirm this in Treasury guidance.

Congress clearly resolved the "whipsaw" issue for all future distributions, and it is critical that this be confirmed, particularly in light of a recent court decision holding to the contrary. Regardless of whether a participant received a distribution prior to the date of enactment of the pension bill, no post-enactment distributions should be required to include the artificial whipsaw amount that burdens plans and takes precious plan assets away from future participants.

We also urge you to facilitate flexibility for employers with respect to their plan conversion approaches. We hear too much about Treasury rules that preclude favorable treatment of participants in a conversion from a traditional defined benefit plan to a hybrid plan. Treasury rules should support flexibility in allowing employers to offer a variety of conversion techniques. For example, these might include, at an employer's option, "grandfathering" (preserving the old formula for certain older, longer-service employees) or "greater of" (giving employees the better of the two formulas) or "choice" (giving employees a choice between the old benefit formula and the new one), which protect the interests of older participants at conversion. Such conversion techniques should not be considered as discriminating in favor of highly compensated employees solely because older employees tend to be higher paid. In keeping with those examples, Treasury rules should indicate that the backloading rules are not violated by a "greater of" approach, and should clarify that these techniques satisfy the age discrimination rules. Similarly, guidance should, consistent with the pension bill, ensure that wear-away with respect to a participant's accrued-to-date benefit is not permitted in conversions, but should do so in a way that accommodates reasonable, participant-protective plan designs, so as to not discourage the maintenance of hybrid plans. Finally, Treasury rules should clarify that the law does not preclude employers, at their option, the flexibility to give employees extra credits in their hybrid plan account to make up for the loss of early retirement subsidies.
Within 12 months of the date of enactment, the new law requires regulations to be issued with respect to hybrid plans adopted in connection with a merger, acquisition, or similar transition. What is needed here is flexibility regarding conversion methods, as well as clarity. It is essential that the corporate transactions that invigorate the economy not be burdened by inflexible conversion rules.

We look forward to Treasury guidance on these critical issues.

Sincerely,

Michael B. Enzi
United States Senator

Howard P. "Buck" McKeon
United States Congressman

Judd Gregg
United States Senator

John P. Kline
United States Congressman

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