The Honorable Charles B. Rangel
Chairman,
U.S. House of Representatives
Committee on Ways and Means

The Honorable Jim McCrery
Ranking Member,
U.S. House of Representatives
Committee on Ways and Means

The Honorable George Miller
Chairman,
U.S. House of Representatives
Committee on Education and Labor

The Honorable Howard P. "Buck" McKeon
Ranking Member,
U.S. House of Representatives
Committee on Education and Labor

December 4, 2008

Dear Chairmen Rangel and Miller and Ranking Members McCrery and McKeon:

We are writing regarding the need for prompt relief from the recession's impact on pension funding requirements in order to prevent irreparable harm to the economy, pension plans, and plan participants. We would also like to address certain questions that have been raised in connection with proposed funding changes for single employer plans[1].

The recent and unprecedented market declines have led to huge, unpredicted increases in required pension contributions for 2009 at a time when tight credit markets and a slowing economy have already forced many companies to tap cash reserves. These unexpected new cash demands come at a time when cash is desperately needed to preserve jobs, continue business operations, and recover from the downturn in the economy. For many companies, these short-term funding increases will compel pension plan freezes, force layoffs, and tie up huge amounts of cash. Thus, workers will be directly harmed and the economic recovery will be very adversely affected.

The undersigned organizations represent thousands of businesses that sponsor pension plans covering millions of workers and retirees. We have been joined in the effort to address this issue by labor organizations (including the AFL-CIO and SEIU), charitable organizations (including the Independent Sector), and participant groups (including the AARP). The pension contributions that will be due for the 2009 plan year will be a massive increase over the amount due for 2008 and that increase is not appropriate under the current economic conditions.

Earlier this month, extraordinary bipartisan efforts were initiated in the Congress to begin dealing with this problem. We understand that three critical steps are being considered : asset smoothing, making the Pension Protection Act transition relief available to the plans that need it, and protecting employees from mandatory plan freezes. These important changes will only address a portion of the problem, but they are a great start.

[1] We expect that groups representing multiemployer plans will address their issues separately, as needed.

Our goal is to provide companies and plans with a temporary means of surviving this economic crisis, while at the same time ensuring the long-term solvency and strength of pension plans. There are many different ways to achieve this goal, but the end result needs to provide companies with near-term contribution obligations that are not significantly above those applicable prior to the market downturn.

We understand that certain executive branch representatives have raised some concerns regarding workers' benefits and the Pension Benefit Guaranty Corporation ("PBGC") in a document entitled "Concerns about the Pending Pension Funding Relief Bill"("Concerns Paper"). However, it is actually because of concerns for workers and the PBGC that we strongly urge Congress to immediately pass legislation that would address the current crisis. Workers and the PBGC will only be protected if we protect companies from massive unforeseen contribution increases that can trigger plan freezes, layoffs, and, in some cases, company bankruptcies.

Summary of Response to Concerns Paper

- The Concerns Paper indicates that the PBGC and workers would suffer losses if the proposed funding changes were enacted. On the contrary, based on information flooding from companies across the country, the PBGC and workers would suffer the greatest losses if no relief is provided. In that case, there will very likely be massive plan freezes, widespread job loss, and, in some cases, company bankruptcies, as well as a deepening of the recession.

- The Concerns Paper indicates that contributions attributable to the economic downturn are not due until September of 2010 and therefore there is no urgency. As discussed in more detail below, this indication is incorrect in a number of respects. For example, as explicitly recognized by the PBGC in a written statement to Congressman Earl Pomeroy, many companies fund to avoid benefit restrictions. For 2009, such contributions are due either April 1, 2009 or September 15, 2009 (depending on the plan's 2008 funding status). Moreover, companies cannot wait until late or even mid-2009 to make decisions about the steps they need to take to meet drastically increased pension liabilities. They will take those steps early in 2009. The real proof of the immediacy of this issue is the level of urgency being expressed by companies. In the midst of an economic crisis, companies across the country are focusing on pension obligations, a clear sign that this is an immediate issue from a planning perspective.

Single Employer Funding Provisions Under Consideration

As noted, three modest, but significant provisions regarding single employer pension funding are under consideration:

- Consistent with clear Congressional intent in the Pension Protection Act ("PPA"), the Congressional proposal would allow pension plan asset values to be smoothed over a 24-month period. The Administration states that it has "no objection to the bill's smoothing provisions."

- The Congressional proposal would eliminate a cliff effect incorporated into the PPA's key transition rule. Under the transition rule in the Pension Protection Act of 2006, the funding target for pension plans is phased up from 90% of plan liabilities to 100%: the phase-in level is 92% in 2008, 94% in 2009, 96% in 2010, and 100% thereafter. For example, if a plan is 92% funded in 2008, the plan is treated as not having a shortfall that needs to be funded. But, pursuant to the cliff impact of the rule, if the plan is funded at 91% in 2008, the plan has a 9% shortfall for funding purposes, not a 1% shortfall. In other words, for the many companies across the country that will have fallen below 94% for 2009 because of asset value declines, there is no transition rule. The proposal would eliminate the cliff, so that the transition rule applies to plans below the phase-in level, as well as above. Obviously, with the great majority of plans likely to be falling below 94% for 2009, this correction of the transition rule is keenly needed. Otherwise, the desire to avoid the cliff will raise the pressure on companies to fund to increase their funded percentage for 2009 to 94% at a time when they are facing significant business pressures and difficulty in raising cash. Regardless of how one felt about the efficacy of the rule in 2006, Congress did not anticipate the current recession or its effect.

- Under the PPA, if a plan is less than 60% funded, all benefit accruals must cease. The recent severe market downturn will cause some plans to fall below 60% funded for 2009. In order to protect workers' benefits, the Congressional proposal provides that the 60% rule is applied for one year based on the plan's funded status before the market downturn.

These three modest changes will provide relief that is desperately needed. More will still be needed, but taking these actions this year will benefit the pension system and the economy. Specifically, the other needed changes include:

- On a temporary basis, allowing asset smoothing without limitations based on current depressed asset values (or with higher limits than apply under current law).
- Permitting employers the flexibility to make new funding method elections for 2009 and 2010 without being locked into those elections.

Data Regarding 2009 Funding Obligations

Data from a study published by the Center for Retirement Research at Boston College[2] indicates the following as of October 9, 2008 (but does not reflect worsening market downturns):

- In the 12-month period ending October 9, 2008, equities held by private defined benefit plans lost almost a trillion dollars ($.9 trillion).

- For funding purposes, the aggregate funded status of defined benefit plans has unpredictably fallen from 100% at the end of 2007 to 75% (see footnote 5 of the study).

- Aggregate contributions that employers will be required to make to such plans for 2009 could almost triple, from just over $50 billion to almost $150 billion. Milliman has

[2] The study is entitled "The Financial Crisis and Private Defined Benefit Plans" (November 2008, Number 8-18) and was written by Alicia H. Munnell (Director of the Center), Jean-Pierre Aubry, and Dan Muldoon.

similarly estimated, based on its extensive database, that funding contributions will almost triple in 2009 if no relief is provided. It is, of course, theoretically possible that the markets will fully recover by the end of 2008, and such level of contributions will not be necessary for 2009, but the likelihood of that is extremely low.

The Boston College study goes on to state:

> The incidences of underfunding raise the possibility that some companies may not be able to meet their obligations without placing enormous pressure on the firm. ***This challenge raises the question of firms laying off workers, freezing their pensions, or going bankrupt.....[R]equiring firms to increase their funding dramatically just as the economy slips into recession also does not make sense***. [Study at 3,5.] [Emphasis added.]

Since October 9, 2008 the market has fallen: for example, the NASDAQ Composite Index has fallen over 9% from 1,645 as of October 9, 2008 to 1,492 as of December 3, 2008. Thus, all of the dire conclusions in the Boston College study <u>understate</u> the problem.

And the above figures just provide average effects. Obviously, many plans will experience worse effects. One mid-sized company reports a projected and unexpected increase in required contributions from $673,000 in 2008 to an estimated $15,186,000 in 2009. Another company funds to satisfy the funding target transition rule. That company had budgeted $36 million in contributions for 2008-2010. Based on the market downturn, that figure would increase by almost 6000% to $2.18 billion. And since those estimates were done, there have been dramatic equity losses both in equities and in fixed income securities (other than Treasuries).

It is important to note that the excessive funding burdens are not materially affected by freezing a plan; freezing generally just avoids having the problem grow in the future. Thus, there is no current-law mechanism to avoid these unexpected huge obligations.

In this context, we examine each of the questions raised by the Concerns Paper.

<u>Arguments in the Concerns Paper</u>

<u>**Statement in the Concerns Paper:**</u> "PBGC estimates that provisions to reduce pension contributions would add approximately $3 billion in claims on the pension insurance system over the next 10 years."

The PBGC offers no explanation of its analysis and it is impossible to evaluate this statement. However, as noted in the Boston College study, if funding relief is not provided, a large number of companies will likely be forced into bankruptcy by enormous pension obligations. This would likely add far more than $3 billion to claims on the PBGC. Policymakers need to consider the staggering claims PBGC would face if no relief is provided.

No healthy company has ever turned over liabilities to the PBGC. It is unhealthy companies that are the one and only threat to the PBGC. By preventing the recovery of ailing companies, the current requirements are by far the biggest threat to the PBGC.

Moreover, requiring massive contributions in the midst of a recession will lead to greater job loss, including permanent job losses in the case of bankruptcies, and a slower and diminished economic recovery. In addition to the human suffering that would be caused, in the end the PBGC would suffer greater losses as more companies are forced to abandon their pension plans as a result of an unnecessarily prolonged economic malaise.

Statement in the Concerns Paper: "[W]orkers would lose billions in unfunded pension benefits not guaranteed by the pension insurance system."

Again, there is no explanation of PBGC's analysis and it is impossible to evaluate this statement. In fact, if no relief is provided, workers would likely, over time, lose enormous amounts of pension benefits for the following reasons:

- A large number of companies will likely be forced into bankruptcy. The workers at those companies will lose their jobs and all unfunded non-guaranteed pension benefits.

- Pension funding obligations will very likely trigger large layoffs. Robert Wescott, Ph.D., former Chief Economist at the Council of Economic Advisors, has stated that:

> "[The] additional [pension] contributions are likely to be required at the worst possible moment from a U.S. macroeconomic point of view and to result in a deeper and more prolonged U.S. recession in 2009 and maybe 2010 than would otherwise be the case. Furthermore, job losses are likely to be greater and the unemployment rate is likely to be higher…. [E]ven if U.S. equity markets rebound some in 2009,…pension contributions could serve to reduce investment spending by $60 or $70 billion or by 4 to 5 percent of total business investment. Such reductions in investment spending would have multiplied effects on the overall economy and would likely result in the loss of tens of thousands of payroll jobs." *November 14, 2008 Memorandum to Business Roundtable Pension Working Group*.

- Pension plans will very likely be frozen on a scale never seen before, involuntarily as well as in response to the abruptly increased contribution requirements. These benefits will never be earned, and it is unlikely that these plans will be unfrozen. Workers' benefits losses over time will be staggering, far exceeding anything the PBGC could be envisioning. Because traditional pension plans provide such a large portion of their benefits toward the end of an employee's career, even a plan freeze late in an employee's career can have extremely adverse effects on the employee's benefits. This reduction in future benefits will occur at a time when workers' 401(k) plan balances have dramatically shrunk, leaving millions of Americans with far less retirement security. Moreover, the magnitude of the pension funding obligations will likely trigger widespread reduction or elimination of 401(k) plan matching contributions.

- Plans that could have recovered will likely be forced to freeze, leaving fewer companies actively engaged in the system and undermining PBGC's statutory mission "to encourage the continuation and maintenance of voluntary private pension plans".

- At some point, more and more plans will probably be terminated, further eroding PBGC's premium base.

<u>Statement in the Concerns Paper:</u> "[T]he proposed provisions would add to PPA's near-term reductions in pension funding and thereby increase near-term strains on the pension system."

As clearly demonstrated above, the real strain on the system would be caused by not providing relief.

<u>Statement in the Concerns Paper:</u> "The current market downturn need not be reflected in higher pension contributions by employees until September 2010. Current law permits quarterly contributions throughout 2009 that are 25% of the amount the employer paid in 2008. It remains to be seen what level of pension contributions will be required in September 2010 under current law…"

Here are the facts:

- By law, for all calendar year large plans, funding obligations for 2009 are set in stone as of January 1, 2009. So any market recovery after January 1, 2009 would be disregarded in determining 2009 funding obligations.

- The general rule is that contributions to meet the 2009 funding obligation must be paid by September 15, 2010. There are, however, a number of important exceptions to this general rule. First, as noted above, and as explicitly acknowledged by the PBGC in a written response to Congressman Earl Pomeroy, many companies will feel compelled to fund to avoid the benefit restrictions that would deny employees promised benefits. Especially with 401(k) balances having shrunk so much, companies do not want to deny their employees half or all of the benefit payment that has been promised and relied on. These companies will need to come up with the cash needed to avoid 2009 benefit restrictions by either April 1, 2009 or September 15, 2009, depending on the plan's 2008 funded status.

- Many companies will fund to avoid the cliff effect of the transition rule described above. For those companies, contributions are due by September 15, 2009.

- If a plan was less than 100% funded as of January 1, 2008, the company cannot wait until September 15, 2010; quarterly contributions must be made to the plan starting April 15, 2009. Those quarterly contributions may be based on 2008 obligations, as noted in the Concerns Paper. However, 2009 quarterly contributions may alternatively be based on

2009 funding obligations. In many cases, if asset returns had been normal in 2008, quarterly contributions based on 2009 obligations would be materially lower than quarterly contributions based on 2008 obligations. Thus, in this way, companies will feel some effects of the 2008 market downturn throughout 2009.

- Even for those companies that do not have to make payments until September 15, 2010, the issue is of immediate concern due to the need to make business plans. In this economy, given the scarcity of credit, if a company knows that it must come up with, for example, a previously unexpected $400 million cash payment by September 2010, it is already too late to start planning for that. Layoffs, cutbacks in capital investment, and other cost-cutting actions need to begin immediately.

In conclusion, we share the Administration officials' concerns regarding protecting the PBGC and workers. However, those concerns clearly lead to the need to provide temporary transition relief immediately, the opposite of what the document recommends. To avoid pension plan freezes, job losses, company bankruptcies, and severe harm to the PBGC and plan participants, we need the relief provided by the Congressional proposal and much more.

Sincerely,

American Benefits Council
American Chemistry Council
American Council of Life Insurers
American Forest and Paper Association
American Institute of Certified Public Accountants
American Public Power Association
ASPPA College of Pension Actuaries
Association for Financial Professionals
Business Roundtable
Committee on Investment of Employee Benefit Assets
The ERISA Industry Committee
Financial Executives International's Committee on Benefits Finance
Financial Services Roundtable
HR Policy Association
National Association of Manufacturers
National Council of Chain Restaurants
National Retail Federation
Newspaper Association of America
U.S. Chamber of Commerce

CC: House leadership
All members, House Committee on Ways and Means
All members, House Committee on Education and Labor