June 29, 2005

The Honorable John A. Boehner
Chairman
Committee on Education and the Workforce
U.S. House of Representatives
Washington, DC 20515

Dear Mr. Chairman:

I am writing in support of the legislative process your Committee has initiated in marking up H.R. 2830, the Pension Protection Act of 2005. The Administration commends your leadership in recognizing the importance of fundamental reform in the defined benefit pension system, and we applaud your Committee's timely consideration of reform legislation.

H.R. 2830 is consistent in several important respects with the Administration's single employer defined benefit pension reform proposal, but we are concerned that the legislation does not address fully the problems facing the defined benefit pension system identified and addressed in the Administration's proposal.

We are pleased that H.R. 2830 adopts the Administration's framework for fully funding accrued liabilities in defined benefit plans. Your legislation comports with the Administration's view that pension reform legislation must eliminate the multiple measures of plan liabilities and assets and replace them with a single meaningful measure and funding target; and that plan sponsors should have seven years to make up shortfalls in plan funding, and should be able to make larger deductible contributions in good economic times.

We are encouraged that H.R. 2830 seeks to prevent companies from making empty pension promises to workers and retirees by restricting the ability of plan sponsors with significantly underfunded pension plans to promise additional benefits unless they pay for those promises immediately. As we have seen with recent plan terminations, workers and retirees can lose significant benefits they expected, and these provisions will prevent workers from relying to their detriment on promises plan sponsors are unlikely to be able to keep.
H.R. 2830 and the Administration's plan share common goals in preserving the integrity of the pension insurance system, by increasing and indexing per-participant premiums to reflect wage growth, and requiring all underfunded plans to pay a risk-based premium based on the amount of their underfunding. Adequate premium payments are essential to prevent a taxpayer bailout of the PBGC.

We also are pleased that H.R. 2830 protects the pension insurance system from large liabilities resulting from so-called "shutdown" benefits and other contingent benefits that cannot be funded prior to their occurrence by the plan sponsor.

We also commend the Committee for recognizing the need for reform to protect workers and retirees in multiemployer defined benefit pension plans. We are committed to working with the Congress in a bipartisan fashion to improve the security of benefit promises made to participants in these plans.

The Administration also supports the additional provision in H.R. 2830 that would help American workers to better manage their retirement savings by expanding the availability of investment advice. We must ensure that workers have the tools they need to make informed decisions about their retirement futures.

Finally, the Administration agrees that pension reform should apply to all plans, and that industry specific exemptions from pension funding rules are neither necessary nor desirable. A strong defined benefit system requires uniform rules that protect all workers equally.

We believe, however, that the bill should be improved to better protect the retirement security of American workers, retirees and their families. In particular, we are concerned about accurate measurement of the financial status of plans and of their termination risk, credit balances, and enhanced disclosure.

Meaningful and Accurate Measures of Assets and Liabilities

The Administration remains convinced that the new rules put in place by comprehensive pension reform must accurately measure both the assets and liabilities of pension plans. In our view, the best and most sensible approach, and the one that is most likely to ensure that pension promises will be kept, is one that accurately reflects the current market value of both assets and liabilities, and uses appropriate assumptions to measure liabilities. Smoothing mechanisms mask the true value of assets and liabilities and the true funded status of the plan and should not be adopted.
We are also concerned that the mortality table adopted in H.R. 2830 does not reflect future improvements in life expectancy and thus understates liability. Also, the use of lower quality bonds to compute the discount rate will increase the effective interest rates, resulting in an understatement of the true cost of annuity benefits.

Taking Account of Plan Termination Risk

Comprehensive pension reform must take into account the financial health of the plan sponsor in setting funding targets, calculating premiums, and imposing restrictions on new, unfunded benefit promises. The Administration’s proposal would accomplish this through the use of credit rating agencies to identify high risk companies. The financial health of the plan sponsor is a key factor in assessing the risk of termination posed by a pension plan, and should be used in combination with the funding status of the plan to judge the risk workers face in losing their promised benefits.

Elimination of Dangerous “Funding Holidays”

As several recent plan terminations have demonstrated, “credit balances” are used as a means to forgo actual plan funding, and create funding holidays. The result is to prolong the amount of time a plan remains underfunded, exposing plan participants to greater risk of lost benefits and increasing the risk to the pension insurance system. The Administration’s proposal gives full credit for all contributions made to the plan, but it does not allow companies with underfunded plans to skip needed annual contributions. H.R. 2830 attempts to minimize the distortions caused by credit balances by requiring that they be marked to market, restricting the purposes for which they can be used, eliminating double counting of the credit balance, and restricting their use by severely underfunded plans. While these limitations are a move in the right direction, eliminating credit balances altogether would ensure that underfunded plans stay on a path to fully meeting their pension obligations.

Giving Workers Useful and Timely Plan Funding Information

Finally, we believe workers will benefit from enhanced disclosure about the financial status of their pension plans. We agree with accelerating disclosure of information to participants through the Summary Annual Report, but believe it should also include the funded status of the plan for the current reporting year and the previous two years, allowing workers to see whether their plans are becoming more or less funded and giving them the information they need to make informed decisions about their retirements. We also have proposed accelerating the due date of Schedule B of the Form 5500 to ensure timely reporting regarding the assets and liabilities of the plan.
We are concerned that H.R. 2830 significantly weakens the criteria for determining which companies are required to file critically important 4010 information with the PBGC. These reports are the most timely source of information available to the PBGC to monitor risks to the insurance program. Many of the plans posing the greatest risk to PBGC would be exempt from filing under this standard, including several plans in the automotive and airline industries. Losing this critically important information would greatly hinder the PBGC's ability to monitor at-risk companies and decrease the accuracy of PBGC’s calculation of its financial position.

We are committed to working with you and your colleagues in the Congress as you consider comprehensive pension reform legislation, and we commend you for taking this significant first step in marking-up legislation in the Education and the Workforce Committee. We look forward to working with the Committee and the Congress to further strengthen H.R. 2830.

Sincerely,

Elaine L. Chao
Chair,
PBGC Board of Directors