July 24, 2006

Dear Member of Congress:

As Congress nears the completion of its work on pension reform (H.R.2830, S1783), we thank you for your willingness over the past several months to listen to our views, recommendations, and concerns regarding issues raised by the proposed legislation.

The proposed bill is comprehensive in scope and dramatic in impact – actually several bills in one. As you determine what course to take at this point, we offer the following "check-list" of major and key issues that we strongly believe are critical to producing a bill that both protects participants in voluntary employer-sponsored single-employer plans and makes it possible for employers to establish and maintain retirement plans for their employees in the future.

SINGLE-EMPLOYER FUNDING ISSUES:

1. TRANSITION. The proposed bill increases the short-term funding target for all single employer defined benefit pension plans from 90% of current liability to 100%. If a 10% funding target increase is imposed without a phase-in, many companies will be confronted with immediate and enormous increases in their required contributions. .

Ironically, if the increased target is imposed all at once, the companies most dramatically affected are those that are already well-funded – i.e., those not required to pay a deficit reduction contribution under present law. Not only is this misguided and unfair, it will leave many such companies with no option other than to freeze their pension plan. These companies routinely pay each year's normal cost. Faced with a new and outsized cost, many companies will have only one practical recourse available to them – eliminate the annual normal cost by freezing the plan. Congress owes it to plan participants to provide rules that encourage and enable employers to sponsor defined benefit pension plans. A reasonable transition to the new 100% target, as well as for other provisions that increase a plan's liability, must be included in a final bill.

In addition, understanding the new legislation and providing regulations for the new funding regime in the bill will be a long and arduous task. It is imperative that application of the new rules be delayed until 2008 – or later – and that the composite corporate bond rate in effect for 2004 and 2005 be extended until the bill's new corporate bond yield curve is fully phased in.

2. AMORTIZATION OVERRIDE FOR FULLY FUNDED PLANS. The House bill requires any available credit balance to be subtracted in determining the funded status of a plan and requires any resulting funding shortfall to be amortized over seven years. The amortization payments continue until the plan is fully funded without counting any credit balances. Since credit balances under the bill are market valued and represent real assets that are immediately available to pay benefits, this funding scheme would have the effect of <u>requiring</u> plans to be overfunded whenever the plan sponsor had prudently built up a credit balance by putting money into the plan in advance of the minimum requirements of the law. Ironically, Congress appears to be reluctant to provide retroactive clarification of law with respect to hybrid plans but willing to retroactively change the rules with respect to amounts companies in good faith and full compliance with the law put in their pension plans.

Fortunately, the House bill provided that in any year in which a plan met the applicable funding target while including credit balances in the asset calculation, that plan would not have to start a new amortization schedule for that year. Only amortization payments due from prior years would continue to be required. The House bill's full funding amortization override must be included in the final bill.

3. AMORTIZATION. The bill provides for seven year amortization of each year's funding shortfall. The final bill must provide for amortization of both gains and losses. Otherwise plans will face amortization schedules that are, in fact, one to five years, not seven. Moreover, better funded plans would face the shortest timetable because their experience gains will cover more of the shortfall. This is not reasonable, would have the effect of treating otherwise similar plans differently, and is easily resolved by amortizing both gains and losses.

4. AVERAGING AND SMOOTHING. Assessing the funded status of a pension plan on a "spot" or "near spot" basis reflects the liabilities and assets for that limited period only. But generally no actual plan transactions occur during the time of the spot measurement. By the time an actual transaction occurs, such valuations are out of date and typically inaccurate. Thus, short-term measures of a long-term obligation such as a pension plan fail to provide a meaningful assessment of the plan. Averaging the values of required interest rates and smoothing asset values over some period of time actually provides a more accurate picture of the plan. Averaging and smoothing also (1) allow plan sponsors to predict and plan for their future contributions, (2) reduce the volatility of required minimum contributions, and (3) better enable employers to recover from downturns in the economy.

The proposed conference agreement reportedly provides for 24-month averaging and smoothing. While this will help to reduce interest rate volatility, it (a) fails to provide enough data points for an employer to predict future contribution requirements in time to integrate them into the company's business plan, (b) fails to protect plans from oversized contribution requirements attributable to short term swings in asset values, and (c) fails to provide sufficient counter-cyclical protection for the employer and the economy. A final bill should, at a minimum, provide the 36-month averaging and smoothing included in the House bill, especially for asset values.

5. AT RISK LIABILITY. The bill provides that substantially underfunded plans must assume and fund for a larger – or "at risk" – liability. The reported compromise bill correctly triggers such liability based on the plan's funded status and not on extraneous factors such as the sponsoring employer's credit rating. Nevertheless, imposing such a liability is a serious matter and it must be reserved for egregious circumstances. Companies must also be provided a reasonable time to fund up so that they will not face the extra burden of their plans being deemed "at risk."

We understand that the proposed bill provides a two-pronged test: whether the plan's ongoing liability is more than 80% funded and whether the plan's "at risk" liability is more than 70% funded. There are several important issues raised by the imposition of this test, all of which are important: (1) The bill subtracts credit balances to determine the plan's funded status. Because credit balance assets are immediately available to pay benefits, they should be included, not excluded, from these calculations. Failure to do so will sweep into the harsh "at risk" rules plans that are, in fact, very well funded. (2) Immediately imposing an 80% test, especially with the subtraction of credit balances, would be far too harsh. It must be phased in. (3) A plan should fail both tests before being deemed "at risk." (4) The "at risk" calculation must reflect reality. The House and Senate bills require "at-risk" plans to assume that, for at least some period of time, 100% of employees eligible for subsidized benefits retire at the time they could receive the most expensive benefit. This required assumption bears no relationship to actual retirement patterns in the real world and is, therefore, a wholly inaccurate assumption. A survey of actual plans reveals that the average retirement rate at the "most valuable age" was approximately 20%. In no case did it exceed 45%. It is thus arbitrary, unfair, and inaccurate to require assumed retirement rates of 100%, as well as to impose additional arbitrary "load factors" on the calculation as was done in the House bill.

6. ADVANCE CONTRIBUTIONS. Sound pension rules will allow a company to make contributions in advance of when they otherwise would be required. The Senate bill increased the amount of contributions the employer could make on a tax deductible basis to 180% of liability and repealed the combined plan limit deduction. If these proposals had been in place during the 1990s, many companies would have been able to better withstand the downturn that occurred in the early 2000's. These provisions should be enacted and should not be reduced.

Sound pension rules also will encourage a company to make advance contributions during good times that can be used to reduce contribution requirements that fall during economic downturns. The bill's rules for credit balances must achieve this objective if participants' benefits are to be secure over the long term. We endorse the bill's proposal to reflect actual gains and losses in the value of available credit balances. This ensures that the credit balance represents actual cash that is immediately available to pay benefits. However, since with this reform the credit balance will represent actual assets, it should be treated as such in all instances except when it is offsetting a required contribution.

7. REQUIRED ASSUMPTIONS. The bill imposes a new, untested, and controversial segmented yield curve as the prescribed interest rate for funding purposes. The following measures are required for the new rate accurately to reflect pension liabilities: (1) The yield curve must primarily reflect A and AA bonds that do not have puts or calls without make whole provisions; it should not overweight AAA bonds relative to their volume in the market. If AAA bonds are included, BBB bonds also should be included. (2) The methodology for constructing the yield curve must be promulgated through regulations subject to advance notice and comment. (3) The bill's statutory language should require the segments to replicate the yield curve rather than referring to bond maturities, which will not replicate the full yield curve.

Where large active or frozen plans that have quantifiable mortality experience that is significantly different from standardized mortality tables, the bill provides for plan-specific assumptions. This is an important provision to ensure the accuracy of liability calculations. The final bill should, however, not include the Senate provision that required the plan-specific assumption to apply to all plans of the employer. Instead, the bill may require that if an employer requests the use of plan-specific mortality assumptions, separate assumptions must apply to each plan of the employer that is large enough to qualify for Treasury approval. In addition, it should be clear that projections under the newly prescribed mortality table are made up to the valuation date and not beyond it.

8. OTHER FUNDING ISSUES. The Conference agreement must reject Senate bill provisions that require cash contributions (as opposed to use of a credit balance) to avoid benefit restrictions in

union plans   The Conference agreement should similarly reject the Senate bill provision that effectively forces many defined benefit plan fiduciaries to sue constantly with respect to nonqualified deferred compensation in order to protect themselves against being sued . The Senate bill results in this anomaly by tying the nonqualified deferred compensation funding to the level of defined benefit plan funding and creating a fiduciary claim in this regard. The level of defined benefit plan funding is determined based on a number of judgments and assumptions all of which a fiduciary will feel compelled to second guess in court. The Conference agreement should include the House proposal for a more reasonable trigger for filing “4010" information with the PBGC and must also preserve current law protections against disclosure by the PBGC or other parties of proprietary company financial information provided to the PBGC.

HYBRID PLAN ISSUES:

1. VALIDATION OF PLAN DESIGN. In order to protect the 9 million current participants in cash balance and other hybrid plans and to ensure that defined benefit plans such as hybrid plans will be available in the future in companies and industries where traditional plans do not meet the needs of the workforce, it is critically important that Congress provide legal certainty to hybrid plan designs. At the same time, Congress’s actions must not jeopardize the many other types of defined benefit plans that also include indexing features. To do this, the conference report must follow the House bill, which clarifies age discrimination standards for defined benefit plans generally. The final bill must also impose a workable rule by testing a plan on the basis of the employees' total accrued benefits. It must also accommodate offsets permitted under law.

2. CONVERSIONS. Every conversion from a pre-existing defined benefit plan into a hybrid plan entails unique and different practical and compliance issues. Such issues should be left to current law and the courts. Moreover, in keeping with a voluntary system, the final bill must not enact conversion requirements that create rights to benefits that employees have not yet accrued.

3. WHIPSAW: The so-called “whipsaw” issue has forced many employers to lower the interest rate they credit on employee cash balance accounts. In fixing this problem, the conferees should follow the House bill, applied to “distributions” after the effective date. In addition, the conference agreement should include an explicit statement that providing a minimum guaranteed interest rate will not cause an interest crediting rate to be treated as above market. The absence of such a statement will actually require many, many plans to reduce their crediting rate, hardly a result favorable to participants.

4. INTEREST CREDITING RATES. The Senate bill’s mandated crediting rates are inappropriate and should be rejected in a final bill. Such a mandate would interject Congress into the design and level of pension benefits in an unprecedented manner. Moreover, the provision is inapplicable in the context of pension equity plans.

GENERAL PENSION REFORMS:

1. EGTRRA PERMANENCE. Widely-supported bi-partisan pension reforms enacted in 2001 as part of EGTRRA should be made permanent <u>now</u> in a final bill. Retirement savings is a long-term commitment on the part of participants, companies, and providers. Few issues are more urgent for our nation than acting now to stabilize the law in order to encourage and increase retirement savings

to accommodate our aging population. Waiting until the 2001 provisions expire will cause chaos in plan administration, prevent plan formation, and unnecessarily curtail retirement savings. This must not be allowed to happen, and the present opportunity to settle the law is too important to let pass.

2. AUTOMATIC ENROLLMENT & DEFAULT INVESTMENTS. Both bills provide rules for plans that automatically enroll employees in retirement savings plans. Auto-enrollment is a proven method of increasing participation in retirement plans otherwise dependent on proactive action by employees. We strongly believe the law should support employers who choose to install automatic enrollment provisions in their plans, and strongly supports the bill's preemption of state garnishment laws. However, many of the design mandates in the bills will be counterproductive. We support provisions in the bills regarding default investments and encourage the clarification that long-term growth options as well as capital preservation options are acceptable.

You face a grave responsibility in crafting a workable and effective pension bill that both protects participants and encourages employers to provide retirement plans for their employees. We thank you, therefore, for your attention to our concerns and recommendations.

Sincerely yours,

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