

March X, 2006

RE: Include Comprehensive Hybrid Plan Clarification in Pension Reform Conference Agreement

Dear Senate Conferee:

We are writing to draw your attention to one of the most critical issues that must be resolved during the pension conference – giving legal certainty to both existing and future hybrid pension plans. As part of the defined benefit pension system, hybrid plans play an invaluable role in delivering retirement security to millions of Americans and their families.

Nearly 30 percent of the nation's largest companies with defined benefit plans have moved to a hybrid plan (cash balance or pension equity) design. As of 2003, the Pension Benefit Guarantee Corporation (PBGC) reported that there are more than 1,500 of these plans providing benefits to more than 8 million Americans and their families. If strengthening the defined benefit system is the basic premise behind pension reform, it is critical that the final conference report not have the unintended consequence of driving companies with hybrid pension plans out of the voluntary defined benefit system once and for all.

As you know, alternatives to the voluntary defined benefit system – which includes hybrid pension plans – do exist for employers. One leading and appealing alternative for employers and employees is the defined contribution system and its 401(k) plans. However, the personal savings rate of Americans remains one of the lowest among industrialized nations and the average balances in 401(k) accounts are quite modest. There is no question that without defined benefit plans fewer Americans will be able to retire comfortably. Sadly, we have seen a rapid decline in defined benefit plan sponsorship. Employers are leaving the system for many reasons. Among these reasons is legal uncertainty regarding hybrid pension plan designs.

Although hybrid plans provide workers with guaranteed, insured, employer-funded benefits that are both transparent and portable, current legal risks threaten their continued existence. An isolated court case (*Cooper v. IBM*) has placed all hybrid pension plans (both cash balance and pension equity plans) into doubt by holding that the plans' use of compound interest is age discriminatory. Four other courts, in decisions both before and after *Cooper*, have found to the contrary -- that hybrid pension plans do not violate the age discrimination rules.

Unfortunately, because of the scale of damages potentially required to “cure” the effects of compound interest, the *Cooper* case has led to "copycat" lawsuits across the nation. These copycat suits have had a chilling effect on the plan sponsor community. Concerns over potential damages from these suits are causing CEOs and CFOs to have very difficult discussions regarding the future of their pension plans. There is a slow, but steady, freezing of hybrid pension plans as a result of concerns over potential liability stemming from *Cooper* and these copycat lawsuits. We fear that if Congress fails to validate the hybrid pension plan design in short order, these voluntary plans could all become frozen. Therefore, to preserve the retirement security of millions of Americans, it is essential that Congress comprehensively clarify for both existing and future pension plans that the design of hybrid plans is not age discriminatory. Such

comprehensive clarification must address each of the parallel provisions found in ERISA, the Internal Revenue Code, and the Age Discrimination in Employment Act.

Clarifying the legality of hybrid plans on a prospective basis only does not address these problems; it does nothing to eliminate the potential for devastating suits directed at the prior operation of hybrid plans. The liabilities that existing hybrid plans face could triple if the *Cooper* theory were to hold, and total additional national liability faced by employers under this theory exceeds \$100 billion. These liabilities would impose such enormous costs on employers that large numbers of them may have no choice but to eliminate future benefits in their defined benefit plans. Indeed, some companies would not be able to absorb these additional liabilities, causing business declines, potential bankruptcies, and the shift of pension liabilities to the PBGC. The plan terminations that would likely result would erode the PBGC's premium base, where 25% of the current flat rate premium payments come from hybrid plans. This will only increase the likelihood of a future taxpayer bailout of the PBGC, which is something we must avoid.

We also wish to raise two additional issue regarding hybrid pension plans:

- **Conference Agreement Should Address Pension Equity Plan Issues.** While the cash balance pension design has been at the center of discussion about the need to provide legislative clarity for hybrid plans, another leading variety of hybrid plan, called the pension equity plan, is in equal need of Congressional attention. In a pension equity plan, employers provide credits for each year of employee service and these credits are multiplied by an employee's final pay to produce a lump sum figure. Typically, the benefit credits given to employees increase with age and/or years of service, making this design attractive for older and long-service workers. Dozens of large employers around the country offer pension equity plans. The sponsors of and participants in these plans face the same risks and are in need of the same legislative clarification as cash balance plans – that their basic design is not, in fact, illegal and does, in fact, satisfy our age discrimination rules. To achieve this objective, the final legislative provision clarifying the age discrimination rules for hybrid plans must specifically reference pension equity plans in the statutory language. In addition, the interest crediting requirement contained in the Senate bill does not make sense for pension equity plans, which index benefits based on pay increases. This requirement should not apply to pension equity plans.
- **Interest Crediting Requirements of Senate Bill Have Anti-Employee Effect.** Finally, we wish to note that the interest crediting requirement contained in the Senate bill also poses widespread problems for cash balance plan sponsors. It would unduly restrict the interest rates employers could pay on employees' cash balance accounts and would prevent the payment of many market-related rates of return. The unfortunate result of these requirements is that employers will often have to pay employees lower rates of interest. We hope this can be corrected in the conference agreement so employers can maintain the flexibility to pay market rates of return -- and to offer employees guarantees that their cash balance accounts will never decline.

Hybrid defined benefit plans play an invaluable role in providing retirement security to millions of Americans and their families. To ensure Americans have the option of hybrid plans provided by employers, we hope the conference report will provide legislative certainty and clarity for existing cash balance and other hybrid pension plans such as pension equity plans. Waiting for the *Cooper* case to be resolved on appeal is not the answer; as time goes by, more companies are reacting to the current legal uncertainty and potential liability by freezing or terminating their plans. At the same time, more and more companies are being dragged into copycat litigation. The losers in this scenario are workers across America who will lose the opportunity to be covered by an employer-provided pension plan. Failure to resolve the status of hybrid defined benefit plans comprehensively leaves workers and their retirement security at risk.

Thank you for your attention to our views.

Sincerely,

RICHARD BURR