March X, 2006

Dear Conferee:

The undersigned organizations write to share our views regarding how the provisions addressing hybrid pension plans should be resolved in a final pension conference agreement.

At the outset, we wish to express our appreciation that both the House and Senate bills seek to address these critically important issues. We believe strongly that hybrid pension plans (cash balance and pension equity) are a valuable retirement plan vehicle for both employers and employees and must remain a viable defined benefit plan design. The outcome of the pension conference will determine whether hybrid designs do, in fact, remain viable for the thousands of employer plan sponsors and millions of employees who currently benefit from these plans. Indeed, given the many pressures already prompting employers to consider freezing or terminating their defined benefit plans, a failure to resolve comprehensively the age discrimination issue regarding hybrid pension designs or the imposition of onerous new hybrid plan mandates will undoubtedly drive more hybrid plan sponsors out of the defined benefit system.

With respect to the specific hybrid plan issues under consideration in the pension conference, we recommend the following:

- **Extend the Age Discrimination Clarification for Hybrid Pension Designs to Existing Plans.** Both the House and Senate bills contain important provisions that make it clear that hybrid pension designs satisfy age discrimination standards. Yet these provisions apply only on a prospective basis. We strongly urge you to apply the final conference agreement provision on this design issue to existing hybrid plans under current law as well. A failure to do so will leave the more than 1,800 existing hybrid plans vulnerable to continuing and crippling class action litigation. Plaintiffs' counsel in these suits are asserting that compound interest is illegal and are making the incredible claim that employees are entitled to as much as 40 years worth of interest payments in a single year to "correct" for compound interest. The result is claims for hundreds of millions of dollars for benefits well beyond what plan provisions provided to employees. If such suits are allowed to persist, an increasing number of hybrid plan sponsors will depart the pension system. It is critical that the final provision clarifying the validity of hybrid plan designs be truly comprehensive in nature and not contain any sort of litigation carve-out. Such a carve-out would unfairly penalize employers that happen to have been sued -- employers with plan designs no different from those of companies that have not been sued. Finally, the clarification of the age discrimination standard must be carried out in each of the parallel provisions of ERISA, the Internal Revenue Code and the Age Discrimination in Employment Act.

- **Clarify the Age Discrimination Standard for Defined Benefit Plans Generally Rather Than Only for Cash Balance Plans.** We recommend that you adopt the approach taken in the House bill of clarifying the general age discrimination standard for all defined benefit plans (including hybrid plans) rather than creating a new age discrimination standard specifically for cash balance plans, as the Senate bill does. Clarification that compound interest and time value of money concepts do not run afoul of the age discrimination rules is important for many defined benefit plan designs (e.g., pension equity plans and several traditional pension designs, such as contributory defined benefit plans and plans integrated with Social Security), not

merely cash balance plans. An unduly narrow approach will suggest that compound interest and time value of money features are indeed suspect, leaving many plan designs vulnerable to continued legal uncertainty.

- **Avoid Imposing Costly Mandates on Employers That Choose Hybrid Designs.** The Senate bill imposes a number of new mandates on the ongoing operation of hybrid plans and on the process of converting to a hybrid plan. These hybrid-specific mandates will encourage employers to depart the defined benefit system altogether in favor of a purely defined contribution approach. Of particular concern to us are the conversion mandates in the Senate bill that would turn employee expectations and hopes regarding future benefit levels into outright legal entitlements. Such mandates are a fundamental departure from current benefit and employment law norms and will deny employers the flexibility to adapt their benefit offerings to meet evolving workforce demands while remaining competitive in an increasingly global economy. Business leaders in today's competitive environment simply will not maintain pension plans under such a regime. Furthermore, each hybrid plan conversion is designed differently to address the unique needs of the employer's workforce. Mandatory rules for conversions would remove flexibility and discourage employers from remaining in the defined benefit system. It is important to keep in mind that we are not asking for a legislative blessing of past hybrid plan conversion practices. Rather, we are only asking for a comprehensive clarification of the legality of the underlying hybrid plan designs. Thus, we recommend that the final conference agreement not address conversion methods and focus instead on the design and compliance issues addressed herein.

- **Remedy the "Whipsaw" Problem Comprehensively.** Both the House and Senate bills address the so-called "whipsaw" issue that has forced many employers to lower the interest rate they credit on employee cash balance accounts in order to pay departing employees their account balances (as intended under the plans). We recommend adoption of the House provision on whipsaw, which will allow the account balance to be paid to employees as long as the plan does not credit interest in excess of a market rate of return. We also recommend an explicit statement in the conference agreement that the provision of a minimum guaranteed interest rate will not run afoul of the market rate requirement. Without that statement, many employers will actually be forced to reduce further the interest rates they pay to reflect the presence of the non-market guarantee. Finally, we strongly urge that the final provision addressing whipsaw explicitly apply to *distributions* after the effective date of the legislation. (The precise operation of the whipsaw effective date in the House and Senate bills is not clear.) Application only to *benefits accrued* after the effective date will fail to correct the existing whipsaw issue and will create an entirely new whipsaw problem for cash balance plans (due to interplay with use of yield curve rates for measuring lump sums).

- **Refrain from Mandating Interest Crediting Rates.** We do not believe there is a need to prescribe a specific range of interest rates that must be credited in a cash balance plan, as the Senate bill does. Moreover, this interest crediting mechanism, while apparently applicable to pension equity plans, is inconsistent with the pay-indexed nature of the benefits in these plans. We recommend that the final conference agreement not contain a required interest crediting range and certainly not apply any such requirement to benefits accrued in pension equity plans prior to termination of employment.

We sincerely appreciate your consideration of our perspective on what we believe are some of the most critical issues to be resolved in the pension conference.

American Benefits Council
Business Roundtable
Coalition to Preserve the Defined Benefit System
Edison Electric Institute
The ERISA Industry Committee
The Financial Services Roundtable
HR Policy Association
National Association of Manufacturers
Society for Human Resource Management
U.S. Chamber of Commerce

Aetna, Inc.
Alliant Techsystems Inc.
American Electric Power
Amerisure Mutual Insurance Co.
Assurant
AT&T
Bank of the West
Belden CDT, Inc.
BlueCross BlueShield of Michigan
BlueCross BlueShield of Minnesota
BP America
Canadian Imperial Bank of Commerce (CIBC)
Caterpillar Inc.
CIGNA Corporation
Cooper Industries, Inc.
Cooper Tire & Rubber Company
Corning Incorporated
Cummins Inc.
Degussa Corporation
Detroit Diesel Corporation
Dial Corporation
The Dow Chemical Company
Eastman Kodak
Eaton Corporation
EDS
El Paso Corporation
Fortis, Inc.
Fortune Brands, Inc.
Holcim (US) Inc.
Hormel Foods Corporation
Honeywell
Hughes Electronics
IBM Corporation
Illinois Tool Works Inc.
John Hancock Financial Services, Inc.
John Muir/Mt. Diablo Health System
MedStar Health
Lourdes Health System
Memorial Hermann Health System
Mercer Human Resource Consulting
MidAmerican Energy Holdings Co.
Motorola, Inc.
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Pitney Bowes, Inc.
Public Service Enterprise Group
Puget Sound Energy
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Reynolds American Inc.
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Xerox Corporation