Testimony of Kyle Brown
Retirement Counsel
Watson Wyatt Worldwide
on behalf of the American Benefits Council

Hearing on Participant Benefit Statements

Working Group on Participant Benefit Statements
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My name is Kyle Brown and I am Retirement Counsel at Watson Wyatt Worldwide. I serve as primary technical resource for Watson Wyatt's U.S. retirement practice, focusing on compliance issues for defined benefit plans. Watson Wyatt Worldwide is a global human capital and financial management consulting firm specializing in employee benefits, human capital strategies and technology solutions. Watson Wyatt has more than 6,000 associates in 88 offices in 30 countries and corporate offices in Arlington, Virginia and Reigate, England.

I also serve as a member of the Board of Directors of the American Benefits Council (the "Council") on whose behalf I am testifying today regarding participant benefit statements for defined benefit pension plans. Thank you very much for the opportunity to testify on this important issue.

The Council is a public policy organization representing principally Fortune 500 companies and other organizations that assist employers of all sizes in providing benefits to employees. Collectively, the Council's members either sponsor directly or provide services to retirement and health plans that cover more than 100 million Americans.

I will focus my comments today on section 508 of the Pension Protection Act of 2006 (the "PPA"), which imposes new periodic reporting requirements on retirement plans, including defined benefit plans. Under the prior-law rules, in general, a plan administrator of a retirement plan was required to provide a benefit statement to any participant or beneficiary who makes a written request for such a statement. If a plan administrator failed or otherwise refused to furnish a benefit statement within 30 days of a written request, the participant or beneficiary could bring a civil action to recover from the plan administrator up to $100 a day, within the court's discretion, or other relief that the court deemed proper.

Section 508 of the PPA replaces these prior-law rules with a new set of requirements. With respect to defined benefit plans, section 508 requires, in part, that a plan administrator furnish a participant benefit statement (i) at least once every three years to each participant with a nonforfeitable accrued benefit and who is employed by the employer at the time the statement is furnished, and (ii) to a participant or beneficiary of the plan upon written request. Alternatively, a plan administrator can satisfy its obligations under PPA section 508 by providing notice at least once a year to defined benefit plan participants of the availability of the pension benefit statement and the way in which such statement may be obtained by the participant. Pursuant to section 105(a)(3)(A) of the Employees Retirement Income Security Act of 1974 ("ERISA"), as amended by the PPA, this alternate notice may be delivered in written, electronic or other appropriate form to the extent the form used is reasonably accessible to plan participants.

The Council applauds the Department of Labor's (the "Department" or "DOL") attention to the important issues surrounding the implementation of the new pension benefit statement requirements. We also applaud the Department's issuance of transitional guidance in the form of Field Assistance Bulletin No. 2006-3 (the "FAB").

The Council and its members were pleased to see included in the FAB a provision allowing for good faith compliance by plans subject to the requirements of section 508 of the PPA. Specifically, the FAB provides that "[u]ntil such regulations or guidance is issued, the Department will, as an enforcement matter, treat a plan administrator as satisfying the requirements… if the administrator has acted in good faith with a reasonable interpretation of those requirements." Plan administrators want to comply, but are faced with a number of uncertainties as to how to comply; a good faith standard permits them to move forward in a reasonable manner without concern that rules will later be promulgated that are inconsistent with their own good faith interpretation of the statute. Given the ongoing uncertainty surrounding the nature and scope of a plan's participant benefit statement obligations pursuant to section 508 of the PPA, the

Council believes that the good faith standard should be preserved unless and until future clarifying guidance is issued. Moreover, to help ensure that plan administrators have sufficient time to adjust to any future guidance once issued and made effective, the Council believes that the good faith standard should be preserved for benefit statements or notices with respect to plan years ending on or before six months following the issuance of final regulations.

The Council was also pleased to see included in the FAB an express acknowledgment by the Department that a participant benefit statement generally may be delivered pursuant to the current DOL electronic delivery rules or, alternatively, pursuant to the electronic delivery rules under Treasury Department ("Treasury") regulations. Specifically, the FAB states "[w]hile the furnishing of the required pension benefit statement information in accordance with the safe harbor prescribed [by DOL] would constitute good faith compliance with section 105 [of ERISA], the Department notes that such manner of furnishing is not the exclusive means by which plan administrators could, in the absence of guidance to the contrary, satisfy their obligation to furnish pension benefit statement information." Noting that Treasury recently issued its own electronic delivery rules, the FAB goes on to state that for purposes of complying with PPA section 508 and ERISA section 105, pending further guidance and a review of the existing DOL electronic delivery rules, the Department will view the furnishing of pension benefit statements in accordance with the Treasury rule "as good faith compliance with the requirement to furnish pension benefit statements to participants and beneficiaries."

The electronic delivery rule promulgated in Treasury Department regulation § 1.401(a)-21 provides more flexibility for plan administrators in satisfying their delivery obligations than the current DOL rule and better accounts for the increasing and central role that electronic communication plays in the life of the American worker. Specifically, pursuant to regulation § 1.401(a)-21, a plan administrator can satisfy its delivery requirements by providing participants access to required plan notifications

and disclosures electronically so long as the participant is "effectively able to access the electronic medium." Treas. Reg. § 1.401(a)-21(d)(2). Actual delivery is not required under the Treasury rule. Thus, for example, a plan administrator could satisfy its obligations by sending via company or individual email a notification or benefit statement to the extent the intended recipients are "effectively able to access" the email notice/statement. It is the Council's view that employers, plan administrators and participants collectively are best served by electronic communications, which are more effective, less expensive, and consistent with the increasing technological skills and usage rates of American workers. Accordingly, the Council is pleased to see that the FAB permits plans to rely not only on the Department's existing electronic delivery rule but also on the delivery rule as promulgated in regulations by Treasury and the IRS.

On a related note, it is our understanding that the Department may be considering a guidance project to explore revising its current electronic delivery rule. The Council is pleased that the Department may be considering a revision of the rule. The Council believes that a revised rule would be consistent with the electronic world in which we live and the increasing role of technology in the daily life of the American worker. The Council suggests that the current rule promulgated by Treasury and the IRS could serve as a model for any such revised rule.

We also ask that any revised electronic delivery rule be made applicable to participant benefit statements. Specifically, we ask that future guidance make clear that a plan administrator may use electronic medium, *e.g.*, internet-based email, to deliver benefit statements to those participants and/or beneficiaries with effective access to such medium. Such a rule would help reduce the costs associated with the delivery of participant benefit statements, thereby benefiting participants and the plan as a whole. With respect to the alternate annual notice to participants regarding the availability of a benefit statement, the Council believes that plans should be permitted to (i) satisfy the notice requirement through the use of similar electronic media, and (ii) make benefit

statements available to participants through a company or third party provider internet or intranet website.

As you know, section 508 of the PPA also requires that a pension benefit statement contain certain information with respect to a participant or beneficiary's accrued benefit. It is important to note that the required information for defined benefit plan pension benefit statements is a short list of three items: (1) the total benefit accrued; (2) the nonforfeitable pension benefits, if any, which have accrued, or the earliest date on which benefits will become nonforfeitable, and (3) an explanation of any permitted disparity under section 401(l) of the Internal Revenue Code of 1986 or any floor-offset arrangement that may be applied in determining any accrued benefits. The simplicity of this list should not be overlooked. Defined benefit plans are complex financial arrangements that can be difficult to fully understand. Keeping the focus of benefit statements on the core information of the benefits provided by the plan, and not over-complicating the statements (1) would go a long way towards the goal of improving participants' understanding of their benefits in these plans, and (2) would simplify administrative requirements in producing such statements. Such simplifications would increase the likelihood that sponsors will provide benefit statements to participants under ERISA §105(a)(1)(B)(i) every three years rather than use the alternative notice approach in ERISA §105(a)(3)(A).

A pension benefit statement must also include an explanation of any permitted disparity or any floor offset arrangement. The Council believes that an explanation of the use of such permitted disparity or floor offset arrangement can be meaningfully provided through a cross-reference to the plan's Summary Plan Description (the "SPD"), which, pursuant to DOL regulations, must include the plan's benefit formula. Requiring a plan to restate the full benefit formula in the benefit statement in addition to the SPD serves no apparent purpose. Moreover, for the vast majority of plan participants or beneficiaries, explaining the intricacies of imputed permitted disparity, etc., would not be meaningful. In fact, requiring the inclusion of several additional

pages of material explaining the plan's permitted disparity or floor offset arrangement is likely to serve only to obscure or otherwise dilute important information contained within the benefit statement.

Information concerning floor offset arrangements, which provide benefits coordinated through the operation of two different plans, a defined contribution and a defined benefit plan, of necessity will have to be provided through multiple documents. The defined contribution plan will provide a separate benefit statement for benefits under that plan and satisfying the benefit statement requirements for defined contribution plans. It is extremely likely that information for the defined contribution plan will be provided by a different service provider than the information for the defined benefit plan, making provision of a single, coordinated benefit statement a practical impossibility. For the same reasons that FAB 2006-3 permits use of multiple documents or sources for benefit statement information, multiple documents or sources for benefit statement information should be permitted for floor offset arrangements.

The Council requests that any future guidance also make clear that a plan's vesting schedule can be explained by cross-reference to the schedule contained in the plan's SPD. The information contained in the SPD is sufficient to enable a participant or beneficiary to determine their nonforfeitable vested benefits under the plan, as required by section 508 of the PPA. Moreover, the express statutory language of section 508(a)(1) of the PPA, which includes ERISA section 105(a), clearly supports the use of a cross-reference with respecting to the plan's vesting schedule. Specifically, section 508(a)(1) states that "the requirements of subparagraph (A)(i)(II) [related to vesting notice] are met if, at least annually and in accordance with requirements of the Secretary, the plan— (i) updates the information described in such paragraph which is provided in the pension benefit statement, or (ii) <u>provides in a separate statement such information as is necessary to enable a participant or beneficiary to determine their nonforfeitable vested benefits</u>" (emphasis added).

With respect to the timing of required participant benefit statements, the Council notes that many plan administrators will not have the complete and accurate information needed to fully complete the requisite benefit statement until the completion of the Form 5500 for the plan to which the benefit statement relates. In fact, in many instances, compiling the necessary information to calculate individual participant benefit statements requires that employers aggregate payroll and service data from across business lines, controlled group entities, divergent or incompatible payroll systems, etc. For a great many plans, this process can involve several months of intensive work. In light of the foregoing, the Council requests that the Department issue final guidance which provides that a plan administrator is not obligated to deliver to participants and beneficiaries a benefit statement for the applicable plan year until the due date, including extensions, for the filing of the plan's Form 5500. Such a rule would help ensure that plan administrators have available to them all of the information necessary to generate and deliver an accurate and complete benefit statement.

There will also be many instances where it is not cost effective to develop precise statements for every participant every three years. For example, there may be groups of participants formerly employed by an acquired company for whom precise data is not readily available. Or it may be more efficient to provide reasonably accurate estimates for a broad group of participants (and not do a precise calculation until benefit distribution). Thus, it is critical that the Department's regulations permit reasonable estimates, as provided for in the statute. Without this ability to estimate, far fewer plans will provide statements every three years (and will instead provide annual notices). However, even these estimates would require significant work in order to make them reasonably accurate, so the deadline should not be accelerated where estimates are used.

Congress directed the Secretary of Labor, by no later than August 17, 2007, to develop one or more model benefit statements for use by defined benefit plan administrators in complying with the requirement to provide pension benefit statements to participants

and beneficiaries, as mandated by section 508 of the PPA. On behalf of the Council's members and all defined benefit plan sponsors, the Council urges the Department to issue such model statements for use by plan sponsors. Moreover, to the extent practicable, we request that the model benefit statements include a list of required content in addition to specific model language. The inclusion of a required content list in addition to model language will help plan administrators in their efforts to ensure compliance with requirements of section 508 of the PPA.

Lastly, on behalf of the Council, I would also like to request that future guidance, including any model benefit statements or lists of required content, address hybrid plans. Specifically, we ask that future guidance clarify that a participant benefit statement with respect to an accrued hybrid plan benefit need only include the participant's notional account balance (or current value in the case of a pension equity plan). This is the form of benefit determined under the terms of the plan, and should be the form of benefit communicated to participants. Communication of the notional account balance (or current value in the case of a pension equity plan) would reflect the nature of the plan, a design specifically endorsed by Congress as part of the Pension Protection Act.

If, however, the ERISA Advisory Council and the Department determine that the benefit statement must also include a participant's annual benefit at normal retirement age, we believe that such annual benefit should be in the form of the participant's projected normal retirement benefit based on his or her notional account balance or current value. Communication of the participant's annual benefit at normal retirement age would need to include disclosure that such benefit is determined using variable interest rates and can fluctuate in future years prior to retirement based on changes in those interest rates.

The Council's position that only the notional account balance or current value need be set forth in the benefit statement is supported by the PPA's anti-whipsaw provision.

Specifically, PPA section 701 overrides the IRS' prior position that, in computing a participant's single sum accrued benefit under a hybrid plan, a plan is required to project the participant's account balance to normal retirement age using the plan's interest rate assumptions, and then discount back using the statutorily prescribed discount rate. Moreover, the Council's position is consistent with the core objectives of benefit statements, which is to communicate useful information to participants with respect to their accrued benefit so that they can plan accordingly. To require that plans include both the participant's single sum benefit (*i.e.*, their notional account balance or current value) and an annual projected benefit is likely to confuse participants as to the value of their accrued benefit. Additionally, many hybrid plan designs themselves were developed, in part, based on participants' desire to understand the single sum value of their benefit. Requiring plans to include an annual projected benefit is not only likely to lead to participant confusion, but also fails to fully reflect one of the key participant desires that led to the development of hybrid plans.

On behalf of the Council and Watson Wyatt, I would like to thank the ERISA Advisory Council for holding today's hearing and for inviting the Council to testify.