DEFINED BENEFIT PENSION PLAN FUNDING LEVELS AND INVESTMENT ADVICE RULES

HEARING

BEFORE THE

COMMITTEE ON WAYS AND MEANS
U.S. HOUSE OF REPRESENTATIVES

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COMMITTEE ON WAYS AND MEANS

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CONTENTS

HEARING ON DEFINED BENEFIT PENSION PLAN FUNDING LEVELS AND INVESTMENT ADVICE RULES

THURSDAY, OCTOBER 1, 2009

U.S. HOUSE OF REPRESENTATIVES,
COMMITTEE ON WAYS AND MEANS,
Washington, DC.

The committee met, pursuant to call, at 10:12 a.m., in Room 1100, Longworth The Capitol, the Honorable Charles B. Rangel [Chairman of the Committee] presiding.

[The advisory of the hearing follows:]

HEARING ADVISORY

FROM THE COMMITTEE ON WAYS AND MEANS

Chairman Rangel Announces Hearing on Defined Benefit Pension Plan Funding Levels and Investment Advice Rules

September 24, 2009

By (202) 225–1721

House Ways and Means Committee Chairman Charles B. Rangel today announced that the Committee on Ways and Means will hold a hearing on the funding levels of defined benefit pension plans and the rules that apply to investment advice that is provided to participants in defined contribution plans. **This hearing will take place on Thursday, October 1, 2009, in 1100 Longworth House Office Building, beginning at 10:00 AM.**

In view of the limited time available to hear witnesses, oral testimony at this hearing will be from invited witnesses only. However, any individual or organization not scheduled for an oral appearance may submit a written statement for consideration by the Committee and for inclusion in the printed record of the hearing. A list of invited witnesses will follow.

BACKGROUND:

Congress enacted the Pension Protection Act, Public Law 109–280 ("PPA"), in 2006. Among the provisions of the Act were significant revisions to the minimum funding rules for defined benefit pension plans. The minimum funding rules specify the minimum amount that a sponsoring employer must contribute each year to the trust that funds the pension plan. Benefits promised under a defined benefit pension plan are funded through contributions and earnings on those contributions. For many plans, the changes made by PPA first became effective in 2008, just prior to the world-wide economic meltdown. As a result, employers who sponsor defined benefit pension plans may find themselves simultaneously struggling to navigate an economy during a severe downturn with decreased cash flow and less access to credit while having to make up for significant investment losses incurred in the pension trusts that fund their workers' pension benefits. While some relief modifications were made to the minimum funding rules in the Worker, Retiree, and Employer Recovery Act of 2008, Public Law 110–458, many employers believe that additional relief is necessary.

For many Americans, a defined contribution retirement plan (such as a 401(k) plan) may be the only retirement savings plan that their employer offers. The benefits provided under such a plan are equal to the participant's account balance, which is increased by contributions made on behalf of the employee and earnings on those contributions. Under many plans, employees direct the investment of their account balance. This prevalence of employee-directed investments in defined contribution plans has underscored the need for investment advice for plan participants. PPA provided rules under which entities that were previously prohibited from providing investment advice on account of the prohibited transaction rules in the Internal Revenue Code and the Employee Retirement Income Security Act of 1974, Public Law 93–406 ("ERISA"), could provide advice, subject to a number of conditions. The Bush Administration issued final regulations implementing the PPA investment advice provisions and provided a new class exemption related to investment advice from the prohibited transaction rules of the Internal Revenue Code and ERISA. The Obama Administration has delayed the effective date of both the final regulations and the class exemption to allow for evaluation of the legal and policy questions reflected in the rules.

In announcing the hearing, Chairman Rangel said, **"Defined benefit funding and the regulation of investment advice are important issues for American workers and employers. Defined benefit pension plans have been the bedrock of retirement security for millions of Americans and we must ensure that workers continue to have access to stable pension benefits. The pension funding rules are a crucial component of that goal. The millions of other American workers in defined contribution plans who are responsible for investing their retirement savings accounts need advice when making that decision and such advice must be unbiased."**

FOCUS OF THE HEARING:

This hearing will focus on two issues currently facing employer sponsored retirement plans. First, with respect to defined benefit pension plans, the hearing will focus on the impact of the financial crisis on the funding levels of such plans and whether additional funding relief is necessary. Second, with respect to defined contribution plans, the hearing will focus on plan participant access to investment advice and whether such advice is unbiased.

DETAILS FOR SUBMISSION OF WRITTEN COMMENTS:

Please Note: Any person(s) and/or organization(s) wishing to submit for the hearing record must follow the appropriate link on the hearing page of the Committee website and complete the informational forms. From the Committee homepage, http://democrats.waysandmeans.house.gov, select "*Committee Hearings*". Select the hearing for which you would like to submit, and click on the link entitled, "*Click here to provide a submission for the record*." Once you have followed the online instructions, complete all informational forms and click "submit" on the final page. ***ATTACH*** your submission as a Word or WordPerfect document, in compliance with the formatting requirements listed below, by close of business **Thursday, October 15, 2009**. Finally, please note that due to the change in House mail policy, the U.S. Capitol Police will refuse sealed-package deliveries to all House Office Buildings. For questions, or if you encounter technical problems, please call (202) 225–1721.

FORMATTING REQUIREMENTS:

The Committee relies on electronic submissions for printing the official hearing record. As always, submissions will be included in the record according to the discretion of the Committee. The Committee will not alter the content of your submission, but we reserve the right to format it according to our guidelines. Any submission provided to the Committee by a witness, any supplementary materials submitted for the printed record, and any written comments in response to a request for written comments must conform to the guidelines listed below. Any submission or supplementary item not in compliance with these guidelines will not be printed, but will be maintained in the Committee files for review and use by the Committee.

1. All submissions and supplementary materials must be provided in Word or WordPerfect format and MUST NOT exceed a total of 10 pages, including attachments. Witnesses and submitters are advised that the Committee relies on electronic submissions for printing the official hearing record.

2. Copies of whole documents submitted as exhibit material will not be accepted for printing. Instead, exhibit material should be referenced and quoted or paraphrased. All exhibit material not meeting these specifications will be maintained in the Committee files for review and use by the Committee.

3. All submissions must include a list of all clients, persons, and/or organizations on whose behalf the witness appears. A supplemental sheet must accompany each submission listing the name, company, address, telephone, and fax numbers of each witness.

Note: All Committee advisories and news releases are available on the World Wide Web at http://democrats.waysandmeans.house.gov.

The Committee seeks to make its facilities accessible to persons with disabilities. If you are in need of special accommodations, please call 202–225–1721 or 202–226–3411 TTD/TTY in advance of the event (four business days notice is requested). Questions with regard to special accommodation needs in general (including availability of Committee materials in alternative formats) may be directed to the Committee as noted above.

Chairman RANGEL. The hearing will come to order. It has been too long since our committee has gotten together, but we will try to make up for it.

The purpose of the hearing today is to hear private sector recommendations on two critical topics confronting our Nation's retirement plan.

The administration is not here today; they are developing proposals on these two critical topics, and we will hear from them in the future. Meanwhile, we will hear from the private sector on these critical issues.

The first topic is the impact of the financial crisis on the funding rules that apply to private sector defined benefit pension plans.

Today, over 30,000 private sector pension plans provide benefits to almost 40 million Americans. The Tax Code contains rules that require employers to periodically contribute money to pension funds to make sure that promised funds and benefits are paid.

The impact of the global financial crisis on the level of pension funding has been very severe. By some accounts, private sector U.S. pension plan assets fell by $734 million in 2008, or about 27 percent. Employers are faced with the struggle of making up significant pension plan losses while operating their businesses in a challenging economy, with reduced cash flow and with reduced access to credit. Unions and employees are worried about the security of their retirement benefits and cuts to benefits.

Today we will hear from private sector stakeholders on the impact of the global financial crisis on pension funding. These witnesses will present data on the impact of the financial crisis on pension funding, and these witnesses will also provide recommendations on how to provide relief to employers from the perspective of individuals who participate in plans, unions who negotiate retirement pensions for their workers, and sponsoring employers.

The second topic of today's hearings involve defined contribution plans, such as 401(k) plans, where participants get to choose how to invest their account balances. Today, approximately 460,000 plans permit investment direction by participants. These plans cover an estimated 70 million participants and hold an estimated $2 trillion in assets.

Most participants are not experts on financial investment and could use help in selecting their retirement investments. However, some industry surveys indicate only 50 percent of the retirement plans provide investment advice and assistance to participants.

The retirement plan rules should encourage employers to offer investment advice to plan participants. However, the rules must also ensure that the advice is not biased by the financial interests of those who provide the advice.

Today's hearing will focus on whether the present law rules provide for unbiased advice. We will hear testimony from the perspective of plan participants, employers, and plan service providers that want to provide investment advice.

Chairman RANGEL. I look forward to hearing from our witnesses and yield to my friend, Ranking Member Dave Camp, for any remarks he may wish to make.

Mr. CAMP.

Mr. CAMP. Well, thank you, Mr. Chairman. Thank you for yielding, and thank you for holding this important hearing.

As many know, we enacted many improvements to our Nation's pension laws in 2006. The Pension Protection Act was a bipartisan piece of legislation that garnered the support of many current and former Democrats on this committee, including that of now White House Chief of Staff Rahm Emanuel. I think it is important that we continue that bipartisanship as we move forward on an issue that is so critical to the retirement security of working Americans.

Earlier this year, I and several of my Republican colleagues on this committee introduced the Savings Recovery Act to help Americans rebuild their retirement, college and savings accounts. Among the provisions we offered was an effort to stabilize worker pensions and help employers invest in the future by temporarily providing a softer glide path for recognizing losses in defined benefit plans and provide 2 additional years to resolve pension funding shortfalls.

The issues surrounding the funding of future retirement benefits are complex for employers, for Congress, and certainly for workers. Given the severity of the economic downturn, Congress should proceed carefully in order to find the right balance between the concerns of workers, retirees, employers, and taxpayers.

While giving companies additional breathing room to meet their pension obligations may make sense on the surface, we must also recognize that too much latitude could erode the likelihood of workers receiving the full benefits they were promised and could further expose taxpayers to the cost of bailing out the PBGC.

On the other hand, a failure to provide temporary relief to these plans from the chokehold the global economic downturn and credit crisis have placed on American employers could result in more bankruptcies and the dumping of pension plans on the Pension Benefit Guaranty Corporation, which is already on a precarious financial footing and could easily be pushed over the edge.

Clearly, we have our work cut out for us. I am sure the excellent witnesses today will help us better understand the narrow tightrope we need to walk.

Before I yield back, I want to take just a moment to discuss the issue of investment advice. Access to high-quality professional investment advice is crucial, especially given the recent upheaval in the stock market. And while proper safeguards should be maintained to protect against potential conflicts involving the compensation of participants' financial advisors, Congress should not impose unwarranted restrictions that limit the availability of that investment advice.

According to some estimates, the proposed restrictions on investment advice contained in the Education and Labor Committee's bill, H.R. 2989, could cause as many as 20 million 401(k) participants to lose access to investment advice these working families rely on to help them save for the future in this very unsettled economy.

So Americans don't need less help getting through these turbulent times, they need more help; and it is our job to ensure Americans have access to the quality financial advice that they need.

With that, I yield back the balance of my time.

Chairman RANGEL. Thank you for your statement.

Chairman RANGEL. At this time, I ask my friend, Richard Neal, who has had hearings and has covered this subject matter for several months, to start the hearing off by introducing our first panel.

Mr. NEAL. [Presiding.] Thank you very much, Mr. Chairman. And thank you for the timeliness of this hearing as well.

I would like to acknowledge Mr. Craig Rosenthal, Mr. Norman Stein, Mr. Bill Nuti, Judith Mazo, Damon Silvers and Mark Warshawsky. These individuals will all, I hope, offer a perspective to us that will help us in the deliberations for the months and years to come.

You have heard me say many times that given what happened here with the Social Security debate a couple of years ago, we need to be mindful of what the American people see down the road in terms of retirement security.

So with that, I would like to recognize Mr. Craig Rosenthal to be the first witness.

STATEMENT OF CRAIG P. ROSENTHAL, PRINCIPAL, MERCER CORPORATION, NEW YORK, NEW YORK

Mr. ROSENTHAL. Mr. Chairman and Members of the Committee, thank you for the opportunity to discuss the findings of Mercer's recently completed report on the funded status of defined benefit pension plans.

I am a principal at Mercer, who has advised clients on funding issues for more than 20 years. Our report is based on survey data from 874 of our clients' calendar-year plans, and we hope that it will be a useful resource to the committee as it considers pension plan funding levels.

We conducted this survey with an eye towards addressing two important questions. First, to what extent are required contributions for 2009 higher than they were for 2008? And second, to what extent are credit balances available to help meet those 2009 required contributions?

We have drawn four basic conclusions from the survey analysis.

First, many calendar-year pension plans are in good position to meet their 2009 required contributions after taking into account the funding relief already provided by Congress and the IRS, as well as available credit balances.

Second, some calendar-year plans are still facing significantly higher required contributions.

Third, the IRS-provided interest rate relief will not help most noncalendar-year plans for 2009. So many of these plans will be facing higher required contributions than calendar-year plans.

Finally, looking forward to 2010, sponsors of both calendar-year and noncalendar-year plans are likely to face significant increases in their required contributions.

Regarding the funded status of plans, there were major declines in the latter half of 2008 due to both investment market performance and falling interest rates. Looking back to 2008, only about

3 percent of surveyed plans had funded ratios below 80 percent, which, as you know, is the funding level necessary to avoid benefit restrictions under the Pension Protection Act. Without any funding relief for 2009, that 3 percent of plans funded below 80 percent would have instead stood at 39 percent. However, factoring in both the IRS-provided relief and the relief provided by the committee and Congress in the Worker, Retiree, and Employer Recovery Act of 2008, our survey indicates that only 7 percent, instead of 39 percent, of plans would have funded ratios below 80 percent.

Despite these improved 2009 funding ratios, however, sponsors of many calendar-year plans are still facing significantly higher required contributions. This is the case even if sponsors take advantage of both relief provisions. For example, our survey shows that approximately 21 percent of calendar-year plans still face required contributions that are substantially—and in many cases more than 50 percent—higher than the corresponding 2008 amounts. So while the relief has been very helpful for many plans, some calendar-year plans still face both significant and unanticipated contribution increases for 2009. In addition, most plans that operate on a noncalendar-year basis will not benefit as much from the relief in 2009.

While we excluded these plans from our survey because full data were not available at the time we conducted the survey, most of these plans will not be able to use the October 2008 yield curve, as October 2008 is beyond the 4-month lookback period for most noncalendar-year plans.

Interest rates during 2009 have been well below their October levels, and until just recently, asset values have been below their year-end 2008 levels. This suggests that many of these noncalendar-year plans could face both benefit restrictions and sharply higher required contributions for 2009.

Looking at credit balances. As you know, contributions in excess of the minimum required amounts can give rise to so-called credit balances which can be used to satisfy required contributions in later years. These available credit balances have declined significantly since year-end 2007.

The plans in our survey had approximately $52 billion in credit balances at year-end 2007. The amount available for use in 2009 will be reduced to slightly over $20 billion as a result of the treatment of credit balances under PPA. It is also important to note that roughly 25 percent of surveyed plans have no credit balances remaining for use towards their 2009 required contribution amounts.

Looking ahead to 2010, we expect that many plan sponsors will face substantial increases in their required contributions. While the investment returns this year for most plans should be positive, they haven't come close to reversing the dramatic investment losses suffered by most plans in 2008. In addition, interest rates are much lower than they were in October 2008, which will drive up plan liabilities. Plan sponsors are, therefore, likely to face major increases in required contribution amounts for 2010, and, at the same time, we expect that plans will have little or no credit balance amounts available to help pay for these contributions.

Thank you again for the opportunity to discuss these findings with the committee. I will be pleased to answer your questions.

Mr. NEAL. Thank you very much, Mr. Rosenthal.
[The prepared statement of Mr. Rosenthal follows:]

Prepared Statement of Craig P. Rosenthal, Principal, Mercer

Mr. Chairman and Members of the Committee, thank you for the opportunity to discuss with you one of the most important domestic policy issues confronting American workers and employers—the funded status of employer-sponsored defined benefit pension plans.

My name is Craig P. Rosenthal. I am a Principal in Mercer's retirement, risk and finance business. I am a credentialed actuary who has been practicing in the pension field for more than 20 years, advising a number of Fortune 500 companies on a wide variety of funding issues and serving as an internal technical resource for other pension consultants.

Mercer is a leading global provider of consulting, outsourcing and investment services. Mercer works with clients to solve the most complex benefit and human capital issues. We design and help to manage health, retirement and other benefit programs and we are a leader in benefit outsourcing. Mercer investment services include investment consulting and multi-manager investment management. Mercer's 18,000 employees are based in more than 40 countries. The company is a wholly owned subsidiary of Marsh & McLennan Companies, Inc. which lists its stock (ticker symbol: MMC) on the New York, Chicago and London stock exchanges. For more information, visit www.mercer.com.

I am pleased to share with the Committee the findings of Mercer's recently completed report ("Estimated 2009 Required Contributions and Credit Balances") on the funded status of employer-sponsored pension plans, which we trust and hope will be a helpful resource to the Committee as it considers pension plan funding levels and whether additional funding relief is necessary. The report is based on an internal Mercer survey that yielded data from 874 of our clients' calendar-year plans. I ask that the report be inserted in to the hearing record as a part of my statement.

We conducted this survey with an eye to addressing two important questions: first, to what extent are required contributions for 2009 higher than the corresponding required contribution amounts for 2008, and second, to what extent are credit balances available to help meet those 2009 required contributions.

Based on the survey data we collected and our analysis, we have reached the following conclusions:

- After taking into account the recent economic experience in investment returns, movements in interest rates, and the important funding relief that Congress and the Internal Revenue Service (IRS) have already provided, many calendar-year defined benefit plans are in a good position (taking into account their credit balances) to meet their required contributions for 2009.
- Nevertheless, some calendar-year plans face significantly higher required contributions for 2009 even after taking into account their credit balances.
- Because the interest rate relief will not help non-calendar plans for 2009, many of these plans will face significantly higher required contributions for 2009 even after taking into account their credit balances.
- Based on the data and analysis we've already undertaken, many calendar-year and non-calendar-year defined benefit plans will face significantly higher required contributions for 2010 even after taking into account whatever credit balances remain for next year.

Funded status. With regard to the surveyed plans' aggregate funded status, we found significant declines in the latter half of 2008 due to lower investment returns and falling interest rates. The surveyed plans had an aggregate funded ratio (the ratio of total assets to the total funding target of surveyed plans) of about 110% as of January 1, 2008 and relatively few had funded ratios under 80%. Our estimates suggest that as of January 1, 2009, the aggregate funded ratio will have been 93% based on plan sponsor elections in place when we conducted the survey in April of 2009. Further, about 39% of plans will have 2009 adjusted funding target attainment percentages—or AFTAPs—of less than 80%.

The funding relief provided to date by Congress and the IRS is substantial for most calendar-year plans.

Many plan sponsors very much appreciate the relief provided by the Committee and Congress in the Worker, Retiree and Employer Recovery Act of 2008, which made a number of helpful corrections to Pension Protection Act (PPA), including the ability to determine the value of pension assets by using asset smoothing that takes into account anticipated investment returns. If all sponsors of surveyed calendar-year plans elect to adopt (for 2009) asset smoothing with anticipated returns, but maintain their 2008 interest rate elections, the aggregate funded ratio for the surveyed plans would be 95%. Still, more than 33% of the plans would have 2009 AFTAPs under 80%.

The IRS provided a second piece of relief on March 31st of this year when it clarified that plan sponsors may elect to determine their 2009 PPA funding targets using the full PPA yield curve with a look-back period of up to four months. This latter relief is especially helpful for calendar-year plans for 2009, as bond yields peaked in October 2008, and high interest rates translate into lower pension liabilities and, in turn, lower required contribution amounts by plan sponsors.

Assuming all of these plan sponsors adopt both asset smoothing with anticipated returns and the yield curve look-back for 2009, the aggregate funding ratio for surveyed calendar-year plans for 2009 would further increase from 95% to 111%, and only 7% of plans (instead of 33% of plans) would have AFTAPs below 80%.

Required contributions. In spite of these improved 2009 funding ratios, sponsors of some calendar-year plans are still facing significantly higher contributions in 2009. This is the case even if the sponsors take advantage of both of the relief provisions noted above.

For example, approximately 21% of surveyed calendar-year plans still face 2009 required contributions that are substantially (in many cases more than 50%) higher than the corresponding 2008 contributions.

The main drivers of higher 2009 required contributions despite the available relief are:

- the investment losses during 2008 were too significant to be offset by the 10% margin in assets (due to permissible asset smoothing) and the approximately 20% drop in liabilities from using the full yield curve for October 2008, and
- the funding rules were changed to require the inclusion of expenses in the 2009 required contribution calculation.

So, while the aggregate numbers for calendar-year plans indicate that the relief has been very helpful for most of these plans, certain individual calendar-year plans still face significant unanticipated contribution increases for 2009.

Most plans that operate on other than a calendar year basis will not benefit as much from the relief in 2009. We excluded these plans from our survey because full data were not available when we conducted the survey. These plans won't be able to use the October 2008 yield curve (October 2008 is beyond the four-month look-back period for most non-calendar-year plans) and, since October, interest rates have remained well below their October levels. Also, asset values have been below their year-end 2008 values for a good portion of 2009, meaning that many of these non-calendar-year plans could face benefit restrictions and sharply higher required contributions for 2009.

Credit balances. Whether plan sponsors have enough credit balances to substantially offset their higher required contributions for 2009 has of course been a key topic in the debate. As you know, contributions in excess of the minimum required amounts in earlier years can give rise to credit balances which can be used to satisfy the required contribution amounts in later years.

The aggregate year-end 2007 credit balance amount for the surveyed calendar-year plans was $52 billion. This amount was reduced to approximately $42 billion due to mandatory and voluntary waivers as of January 1, 2008. In addition, an additional $3 billion was utilized to satisfy 2008 required contribution amounts, leaving $39 billion to be carried forward to 2009.

PPA changed the way credit balances are carried from one year to the next by applying the actual asset returns. As such, we estimate that approximately one-third of the remaining 2008 credit balance will be lost to 2008 asset returns, leaving only $26 billion to be available at January 1, 2009. After factoring in mandatory and anticipated voluntary waivers as of January 1, 2009, we anticipate that depending on the plan sponsor elections, only $20–23 billion would be available to use towards 2009 funding requirements. It is important to note that even if *all* plans make use of the available relief, approximately 25% of surveyed plans will have no credit balances remaining for use towards their 2009 required contribution amounts. The chart below shows how the aggregate credit balance for surveyed plans is developed.

Current relief will have little effect in 2010. Looking ahead to 2010—barring an enormous market recovery or another spike in interest rates comparable to those in October 2008—we expect that many defined benefit plans will face significantly increased required contributions. While investment returns through August 31, 2009 for most plans should be positive, they are far from being sufficient enough to reverse the dramatic investment losses suffered by most plans during 2008. In addition, current interest rates are substantially lower than they were in October

2008, which means that regardless of the interest rate elections made for 2010, it is anticipated that most plans will be faced with substantially lower interest rates.

As such, plan sponsors will likely face significantly higher liabilities and required contribution amounts for 2010. At the same time, we expect that plans will have little or no credit balance available for use in satisfying these higher 2010 contributions due to mandatory and voluntary waivers that will be made.

Chairman RANGEL. The Chair would recognize Mr. Norman Stein, Senior Legislative Counsel at the Pension Rights Center. You are welcome to begin your testimony.

STATEMENT OF NORMAN STEIN, SENIOR LEGISLATIVE COUNSEL, PENSION RIGHTS CENTER

Mr. STEIN. Good morning, Mr. Chairman, and Members of the Committee. My name is Norman Stein, and I teach law at the University of Alabama. Thank you for inviting me here to speak with you today on the important subject of defined benefit plan funding.

I am testifying today on behalf of the Pension Rights Center, a nonprofit consumer organization that has been working since 1976 to promote and protect the retirement security of American workers and their families.

There is currently an ongoing discussion in the pension community, and today here on Capitol Hill, on whether to grant emergency defined benefit funding relief to some companies, which companies should qualify for any such relief, and what conditions should be imposed on such relief. My testimony today presents our views on these issues.

My written testimony also touches on other topics, including the PPA provisions that result in automatic cessation of new benefit accruals in certain defined benefit plans, the inadequate PPGC guarantees to participants in multiemployer plans, and the need to prohibit so-called Q–SERP arrangements. Although I will not be further addressing these questions in my oral statement, they are important issues and deserve consideration from your committee.

To summarize our position at the outset, we support funding relief for companies that maintain defined benefit plans where workers continue to earn new benefits. While we are sympathetic to the financial stresses that other companies are currently facing, we do not believe that blanket relief for every company with a frozen defined benefit plan is appropriate.

As I just noted, we support funding relief for companies that sponsor defined benefit plans where employees continue to earn benefits. We do so for two related reasons. First, as the economic recession has reminded us, defined benefit plans are the best retirement vehicles for assuring a secure source of income in retirement. Such plans provide retirees with a guaranteed stream of income for life and are not subject to the kind of catastrophic failures that have decimated the retirement prospects of so many Americans who rely primarily on their section 401(k) plans. It is appropriate and necessary for Congress to take action to ensure the continued existence of these plans. Without funding relief, some companies may freeze or terminate their plans.

Second, the companies who stood by their defined benefit programs, while others abandoned them, deserve Congress to stand by them now. The type of relief we favor is an extended amortization period for losses attributable to the recession. The risk of employer default, though, falls on employees and the PPGC. Thus, we support limiting funding relief to companies that, first, agree that participants will continue to receive benefit accruals during the extended amortization period; second, agree to amend their plan to prohibit reversion of excess assets if the plan becomes overfunded in the future; and third, secure the consent of any unions whose members participate in the plan.

In addition, funding relief should be conditioned on the company not contributing new assets to quasi-funded executive deferred compensation plans, such as rabbi trusts. Contributions to these plans, no less than contributions to qualified plans, result in fewer operating assets to the company. Moreover, payments from executive compensation plans strip the company of assets that could help fund the company's qualified plan. We thus would recommend conditioning funding relief on companies amending executive deferred compensation plans so that they cannot receive new funding, or quasi-deferred compensation plans, so they cannot receive new funding, and amending all executive deferred compensation plans so that they delay payment of benefits until the company has fully funded its qualified plan.

Funding relief is not free. It is essentially an unsecured debt forced upon participants and the PBGC. If the plan is not eventually brought up to fully funded status, it is the participants and PBGC who will bear the financial burden of funding relief. Thus, we do not believe that emergency funding relief should be made available to plans in which employees are no longer earning new benefits.

We know that some have argued that extending relief to such plans will save jobs, but there is nothing in any of the proposals we have seen that would ensure that the assets freed up by new funding relief would be used for preserving jobs. The assets could be used for any purpose, including moving jobs overseas, automation, or even executive compensation.

Also, the argument that funding relief is necessary to preserve jobs ignores the fact that pension plans invest company contributions in the capital markets, creating long-term investment capital that ultimately is the most effective way to expand the economy, preserve jobs, and create new jobs.

We also note that there are provisions in law that allow employers to request a funding waiver by showing temporary substantial business hardship, and a failure to grant a waiver would be adverse to the interest of the plan participants. We would support providing the IRS with the resources to streamline the waiver process perhaps by setting up a temporary funding review board and requiring that the IRS rule on waiver requests within 60 days.

Thank you.

Mr. NEAL. Thank you, Mr. Stein.

[The prepared statement of Mr. Stein follows:]

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STATEMENT OF NORMAN P. STEIN

ON BEHALF OF THE PENSION RIGHTS CENTER

ON DEFINED BENEFIT PENSION PLAN FUNDING

BEFORE THE

COMMITTEE ON WAYS AND MEANS

UNITED STATES HOUSE OF REPRESENTATIVES

OCTOBER 1, 2009

STATEMENT OF NORMAN P. STEIN
ON BEHALF OF THE PENSION RIGHTS CENTER
ON DEFINED BENEFIT PENSION PLAN FUNDING
BEFORE THE
COMMITTEE ON WAYS AND MEANS
UNITED STATES HOUSE OF REPRESENTATIVES
OCTOBER 1, 2009

Thank you, Mr. Chairman and members of the committee, for inviting me here to speak to you on the important subject of defined benefit plan funding. My name is Norman Stein, and I teach at the University of Alabama School of Law, where I am privileged to be the Douglas Arant Professor of Law. I am testifying today on behalf of the Pension Rights Center. The Center is a nonprofit consumer organization that has been working since 1976 to promote and protect the retirement security of American workers and their families.

The economic crisis has hit American workers and American companies hard. We are here this morning to discuss funding standards for defined benefit pension plans both in the context of this crisis and for the longer haul.

But it is also important to note at the outset that the same economic crisis that has presented new challenges for defined benefit plans has also vividly demonstrated their enormous value to their participants. While millions of Americans have seen their 401(k) retirement savings plans plummet in value, workers and retirees covered by defined benefit plans have been able to continue their lives secure in the knowledge that they have a guaranteed source of stable retirement income to supplement Social Security.

These retirees and workers are living illustrations of what retirement experts have always known: that defined benefit plans, by shifting unacceptable risks away from individual workers and retirees, are the gold standard of retirement plans. We need to support those companies that stood against the tide and maintained active defined benefit plans for their employees. Our support for them will allow those plans to continue.

Overview of the Issues

There is currently discussion in the pension community and on Capitol Hill on the subject of whether and when to grant emergency short-term funding relief to some companies, whether temporarily to ease some of the harsh Pension Protection Act (PPA) restrictions automatically reducing participant benefit accruals if a single-employer plan's funding falls below a specified trigger point, and whether some of the more unreasonable portions of the PPA should be permanently modified or repealed. My testimony today provides our views on these questions. In addition, my testimony also touches on some issues relating to multiemployer plans and on the use of qualified defined benefit plans to unfairly provide special benefits to selected top executives through so-called Q-SERPs, or qualified supplemental executive retirement plans.

To summarize our positions:

1. We believe that Congress should make short-term emergency funding relief available for companies that continue to sponsor defined benefit plans that allow employees to continue

accruing new benefits. Such relief will allow these valuable plans to weather the economic crisis, benefiting employees and employers alike. Such relief, however, should be reserved for employers who agree to conditions to protect employees and the Pension Benefit Guaranty Corporation (PBGC). Funding relief should not be a free lunch.

2. Short-term funding relief should not be extended to companies that are sponsoring "frozen" plans – meaning those that have plans that have ceased benefit accruals for current employees. The substance of such relief would be to force the PBGC and employees to accept risky IOUs from employers. The argument that a broad grant of relief to frozen plans will preserve jobs is unsupported by facts and does not stand up to even modest scrutiny. Moreover, such plans are currently eligible for funding waivers. We would support streamlining the process for applying for funding waivers for companies that have frozen plans which we discuss below.

3. The Pension Protection Act (PPA) includes several ill-advised provisions, which should be revised or repealed. We support a permanent repeal of the mandatory freeze on benefit accruals for plans that fall below a 60% funding level. We also support a more traditional actuarial approach to pension funding, with somewhat lengthier amortization periods than mandated by the PPA for ongoing plans. And we believe that the PPA provision that treats plan termination as the date that an employer enters bankruptcy is ill-advised, upsetting reasonable expectations of plan participants (particularly in collectively bargained plans) and decreasing the likelihood that the plan will be preserved as the employer emerges from bankruptcy.

4. We support certain proposed changes to the funding and PBGC rules related to multiemployer plans, especially an increase in the PBGC guarantee levels.

5. We believe that Congress should end the ability of plan sponsors to amend qualified plans to create enhanced benefits for executives only.

Short-Term Funding Relief for Active Defined Benefit Plans

We support funding relief for companies that sponsor defined benefit pension plans under which employees continue to earn benefit accruals. We do so for two related reasons.

First, as the economic recession has reminded us, defined benefit plans are the best retirement vehicles for assuring a secure source of income in retirement. Such plans provide retirees with a guaranteed stream of income for life and are not subject to the kind of catastrophic failure that has decimated the retirement prospects of so many Americans who rely primarily on their section 401(k) plans. It is appropriate, and necessary, for Congress to take action to ensure the continued existence of these plans. We fear that without funding relief, some companies will terminate or freeze their plans.

Second, the companies who stood by their defined benefit programs while other abandoned them deserve support from Congress.

The type of relief we favor is to permit an extended amortization period for losses attributable to the recession. The risk of employer default would be borne by employees, so it is appropriate that relief be conditioned on certain commitments to employees. Thus, we support conditioning funding relief to companies with ongoing plans that:

(i) agree that plan participants will continue to receive benefit accruals until the end of the amortization of the recessionary investment losses;

(ii) agree to amend their plan to prohibit reversions of "excess" assets if the plan becomes overfunded in the future; and

(iii) have secured the consent of any unions whose members are participants in the plan.

We also support a tiered approach to funding relief for employers who have frozen the plan for new entrants or who have engaged in a soft freeze.[1] These plans should be allowed to amortize only a portion of the recessionary losses or be permitted to amortize them over a shorter period of time than would otherwise be available.

In addition, funding relief should be conditioned on the company amending executive deferred compensation plans that involve segregation of company assets in such vehicles as a rabbi trust. Contributions to these plans, no less than contributions to qualified plans, result in fewer operating assets to the company. Moreover, payments from executive compensation plans strip the company of assets that could help fund the company's qualified plan. We thus would recommend conditioning funding relief on companies amending "funded" executive deferred compensation plans so that they cannot receive new funding, and amending all executive deferred compensation plans so that they cannot pay benefits until the company has fully funded its qualified plan.

Companies With Frozen Plans Should Receive No Additional Funding Relief

Funding relief is not free: it is essentially an unsecured debt forced upon participants and the PBGC. If the plan is not eventually brought up to fully funded status, it is the participants and PBGC (and perhaps taxpayers) who will bear the financial burden of funding "relief." Thus, we do not believe that emergency funding relief should be made available to plans in which employees are no longer earning new benefits.

Some have argued that extending relief to such plans will save jobs, but the factual predicate for this argument is weak. There is nothing in any of the many proposals we have seen that would ensure that the funding relief – the money saved by not being used for pensions – would be used for creating and preserving jobs. The money could be used for any purpose, including moving jobs overseas, automation, or executive compensation.

We believe that the best argument for granting funding relief is not to save jobs – which is a rhetorical argument not supported by the weight of evidence – but instead (as we argued above) because targeted funding relief would serve a constructive societal purpose in preserving pension plans which provide secure and adequate retirement income to working men and women. Also, pension plans invest company contributions (and interest) in the capital markets, creating long-term investment capital that ultimately is an effective way to expand the economy and ensure the preservation and creation of jobs.

[1] A soft freeze occurs when a benefit formula that is amended to deny credit for future years of service continues to reflect future increases in compensation.

It should also be noted that there are provisions in current law that allow employers to request a funding waiver if they can show temporary substantial business hardship and that failure to grant a waiver would be adverse to the interests of plan participants. Moreover, frozen plans have already benefited from generous funding relief provided by the Internal Revenue Service and Congress.

We would support providing the IRS with resources to streamline the process to review waiver requests, perhaps by setting up a special temporary funding review board and requiring that a waiver be ruled upon within 60 days of request. A company with a frozen plan that wants further funding relief could qualify for that relief by unfreezing the plan and accepting the conditions we described above.

Repeal Certain Pension Protection Act Provisions

- Repeal the PPA provision mandating the automatic freeze of benefit accruals in single-employer plans that are less than 60 percent funded. Plan participants should not be penalized because employers have not funded the plan. Alternatively, the PPA provision should be a temporary suspension of benefit accruals rather than a freeze, with the accruals resuming once a plan has attained a specified funding level. (There should be relief from the freeze provision during the current recession if Congress does not want to consider permanently amending the Pension Protection Act at this time.)
- Repeal the PPA provision that allows the PBGC to set the date of a distress termination as the date the plan sponsor filed bankruptcy rather than the date the plan is officially terminated by the bankruptcy court. When the PBGC uses the earlier date, the agency effectively cuts workers benefits by not counting additional accruals under the plan.
- Modify the PPA to allow ongoing plans at least ten years to amortize unfunded liabilities.

- ***Protections for Employees in Multiemployer Plans***

    - Raise the benefit amount guaranteed by the PBGC to at least $20,000 for a full career worker.
    - If multiemployer plans in the future find their way out of the current crisis and become overfunded by a significant amount, Congress should explore ways to reinstate subsidized early retirement benefits (and subsidized survivors benefits) that may have been eliminated under the "Red Zone" (critical status) provisions of the PPA.

Eliminate Q-SERPs

Two years ago, the *Wall Street Journal* revealed a practice in which benefits in qualified plans were amended to provide increased benefits for a few executives. The enhanced benefit formulas for a privileged few were known as Qualified Supplemental Executive Retirement Plans, Q-SERPs. These provisions were an inequitable use of plan assets and may have contributed, at least at the margins, to the current funding problems of some plans. Congress should eliminate Q-SERPs and should also adjust the plan asset allocations in Title IV of ERISA to ensure that Q-SERP benefits receive the lowest priority if the plan terminates.

Conclusion

The economic meltdown of the last year has shown the tremendous value of defined benefit plans to employees and retirees. Congressional response to the economic crisis should be to help ensure the survival of existing defined benefit plans and to stand by those companies that stood by their defined benefit plans in an era when too many companies abandoned them.

Mr. NEAL. We recognize Mr. Bill Nuti, who is the Chairman and Chief Executive Officer of NCR, on behalf of the American Benefits Council.

Mr. Nuti.

STATEMENT OF WILLIAM NUTI, CHAIRMAN AND CHIEF EXECUTIVE OFFICER OF NCR CORPORATION, ON BEHALF OF NCR AND THE AMERICAN BENEFITS COUNCIL

Mr. NUTI. Good morning. My name is Bill Nuti. I am the Chairman and CEO of NCR Corporation. Chairman Rangel and Ranking Member Camp, thank you for allowing me to testify today about the urgent need for pension relief.

I am here today on behalf of the American Benefits Council. The Council has over 300 member companies, representing a variety of sectors, including technology, retailers, manufacturers, energy and media, and represents plans that cover or service more than 100 million Americans.

NCR is a 125-year old technology company with 22,000 employees worldwide, operating in more than 100 countries. We are the worldwide leader in self-service solutions. In the last few days, you have probably withdrawn cash from one of our ATMs, checked in for a flight at one of our kiosks, checked out of a supermarket at one of our self-service checkout systems, scheduled a medical appointment at one of our medical kiosks, or rented a DVD from one of our entertainment kiosks.

I want to state something at the outset; we are fully committed to funding our pension plan and meeting our pension obligations. The American Benefits Council and NCR are categorically not requesting a bailout; we are requesting a timeout. We need more time to deal with an unprecedented market downturn that nobody foresaw when the Pension Protection Act was approved, a downturn that has affected pension plan sponsors in every industry.

Congressman Pomeroy has put forth a legislative proposal that would allow more time to amortize losses from the financial crisis. This is a reasonable solution to a difficult and rapidly approaching problem, and we strongly support it. It would give reasonable and responsible companies the tools that they need to support their pension funds, without sacrificing current operations.

I want to make two important points about this legislation. First, this isn't just about pensions, it is about jobs and investing in America. Second, we need the legislation now.

Why is this about jobs? Many companies are going to have to make catch-up contributions to their pension funds, in excess of $100 million a year, for several years. That is a major drain on any company's resources. In the current economy where growth is more difficult to achieve, companies don't have a lot of financial flexibility. Some companies are going to have to lay off employees or cancel investments that would create jobs and help our economy recover.

These decisions have a snowball effect. If a retailer has to close stores, it orders fewer goods from suppliers, it orders less equipment from companies like mine, and there are fewer shipping orders for trucking companies and railroads. If we want the economy to grow, we need a solution that allows the employers to bring their plans back to full funding, without sacrificing current investments. The Pomeroy bill strikes the right balance.

Why is it urgent? The recent IRS regulations have helped a great deal this year; however, this is still very time-sensitive. Our next round of funding obligations, which are going to be very large, will be locked in on January 1, 2010. That is just 3 months away. Even though these payments won't come due until 2011, most plan sponsors are still going to be in a difficult position.

For instance, NCR's own pension was 110 percent funded at the beginning of 2008, but only 75 percent funded at the beginning of this year, purely as a result of the financial downturn.

Other companies in our coalition are in the same boat. For example, another company's projected contributions for the next 7 years have jumped from $200 million to $1.5 billion due to the economic downturn, an astounding increase of 650 percent.

With unplanned obligations of this magnitude, companies have to begin preparing now. Just to give you an idea of the scale we are talking about, a $100 million pension obligation is equivalent to 2,000 workers earning $50,000 a year.

These are choices nobody wants to make, and the Pomeroy bill would allow us to bring our funds back to 100 percent and make critical investments to support our businesses and our employees.

I would like to close by saying a few words about something we are doing that I am excited about. NCR is creating a new manufacturing facility in the United States. We are creating approximately 900 new jobs in Columbus, Georgia, to manufacture our next innovative generation of ATMs.

This was a huge investment for us, but it is going to help us to bring new technologies to market faster and be more responsive to our customers. If we had to make a $100 million payment to our pension fund this year, we probably wouldn't have been able to do this. That is the kind of tradeoff we are talking about, the kind of tradeoffs other companies across the country are going to have to make.

The Pomeroy bill is good and balanced legislation. It will allow us to bring our pension funds back to full funding, while ensuring all of us stay focused on our pension obligations. That is something we are all committed to doing. At the same time, it will give us breathing room so we can continue to invest, create jobs, and generate economic growth.

Although I am sure few CEOs come before you to recommend proposals that raise revenue, I was also glad to hear that the CBO estimates that Chairman Miller's bill, which is quite similar to Congressman Pomeroy's proposal, raises $10 billion over the next 10 years. On behalf of the American Benefits Council and all of our member companies, I urge you to act on this this year. Thank you.

Mr. NEAL. Thank you, Mr. Nuti.

[The prepared statement of Mr. Nuti follows:]

AMERICAN BENEFITS COUNCIL

TESTIMONY OF MR. WILLIAM NUTI

ON BEHALF OF

AMERICAN BENEFITS COUNCIL

BEFORE THE

COMMITTEE ON WAYS AND MEANS

OF THE

U.S. HOUSE OF REPRESENTATIVES

FOR THE HEARING ON

DEFINED BENEFIT PLAN FUNDING LEVELS AND INVESTMENT ADVICE RULES

OCTOBER 1, 2009

TESTIMONY OF MR. WILLIAM NUTI
CHAIRMAN AND CHIEF EXECUTIVE OFFICER
NCR CORPORATION
BEFORE THE COMMITTEE ON WAYS AND MEANS
OCTOBER 1, 2009

Good Morning. My name is Bill Nuti. I am the Chairman and Chief Executive Officer for NCR. I am here today on behalf of NCR and the American Benefits Council. NCR is a member of the Board of Directors of the Council.

I appreciate the opportunity to testify before the Committee today. Chairman Rangel and Ranking Member Camp, I commend you and the Committee for holding a hearing on the need for defined benefit funding relief. This issue is critically important not only to NCR and its employees, but also to every company, every employee, and every community across the United States. This is far more than a pension issue. Fundamentally, it is a jobs issue and a critical economic recovery issue. This Committee and this Congress have the opportunity to save thousands of jobs without spending one penny of government money. In fact, the Education and Labor Committee funding relief bill would actually raise $10 billion. It is not often we can simultaneously save jobs and raise money. I urge you to move quickly and help to save American jobs.

Before I explain further why this is a jobs issue, I want to share some information about NCR and why the defined benefit pension plan issue is important to us. NCR is a 125-year-old global technology company, with approximately 22,000 employees worldwide. We are the leading self-service company focusing on how the world connects, interacts, and transacts with business. We serve the retail, financial, travel, healthcare, hospitality, entertainment, and gaming sectors of the economy, operating in more than 100 countries. Every day, you or someone in your family most likely touches our technology in some way, whether it is checking out at the grocery store, getting cash from an ATM, checking in for a flight, or registering for a medical appointment.

I want you to know that we are committed to fully funding our pension plan. I do not want there to be any confusion about that. Our defined benefit plan has 6,000 active participants, 23,000 retirees and 21,000 deferred vested participants. We made the difficult decision to freeze our plan in 2007. It was a decision we made in the context of the competitive environment in which we do business. Very few companies in our industry maintain defined benefit pension plans. I also want to point out that, at that same time, we froze accruals in our nonqualified executive retirement plans.

We are not here today to ask for a bailout. We are not seeking taxpayer assistance. Nor are we asking to be relieved of our pension funding obligations. NCR will meet its obligations to the participants in the defined benefit pension plan. Rather we and other plan sponsors need more time to amortize the extraordinary market losses of 2008.

Given such time, we can manage the losses our plan sustained in the market downturn, and at the same time make the necessary investments to grow our business and create jobs.

Why is funding relief so critical for NCR and so many other employers? The passage of the Pension Protection Act ("PPA") accelerated our funding requirements, and those of other defined benefit pension plan sponsors, just before the market turmoil and the world-wide economic crisis struck. The new funding rules were effective in 2008, the year the financial crisis began. We continue to support the goals of the Pension Protection Act to increase, over time, the funding levels of defined benefit pension plans. However, the rules were enacted in a more robust economy and did not account for the impact of a scenario where we faced the combined effects of tightened credit and precipitous market losses. The recession has been deep and the recovery challenging. Interest rates are low and funding obligations for NCR's pension plan will increase dramatically. As of January 1, 2008, we were 110% funded. By January 1, 2009, our plan was 75% funded purely as a result of the unprecedented market downturn. Many other plan sponsors find themselves in the same predicament. For example, another company's projected contributions for the next seven years have jumped from $200 million to $1.5 billion due to the economic downturn, an astounding increase of 650%.

Late last year Congress enacted the Worker, Retiree and Employer Recovery Act that provided relief to some, but not all, companies. In fact, the 2008 Act will, under a possible regulatory interpretation of the law that is currently pending before Treasury, actually increase the obligations of some companies. In addition, the Treasury Department has provided some additional relief through regulatory guidance that has helped many companies for 2009, including important guidance issued last week. Unfortunately, the market has not recovered and interest rates remain low. Companies across the country are facing staggering funding obligations for 2010 as a result.

This issue is time sensitive. Under the PPA, the vast majority of plan sponsors' funding obligations will be locked in on January 1, 2010, regardless of what happens in the economy for the remainder of the year. That is a short 3 months away. As a business, we must undertake steps NOW to reserve cash for this very large liability. Our creditors, investors, and business partners want to know NOW how we will pay for this liability. We, and the many other companies in a similar position, will have to make decisions before the end of this year in order to be ready to satisfy the dramatically increased funding obligation we expect to owe. Because this obligation is required by law, we will be forced to divert resources from our business and from job retention and creation. At a time when we can least afford to do so, we will need to divert capital away from critical investments in business growth and toward funding for a long-term obligation. As an example, if a company has to set aside $100 million for its pension plan in one year, that's equal to 2,000 employees earning $50,000 a year. In order for that company to pay that amount in 2011, it might have to lay off those employees near the beginning of 2010. This is why it is critical we take action now.

This would be extremely important, not just for NCR, but for many of this country's oldest and largest employers - and some of its most respected charitable organizations. In working with some of our colleagues under the umbrella of the American Benefits Council, we have learned that these businesses – from energy and transportation companies, to companies in the manufacturing, retail, and technology sectors - are experiencing similar situations. We are also acutely aware of the important interrelationship in our economy that may not be readily apparent, but which has a very dramatic impact on the American people.

Though each of our stories is somewhat unique, all of us are intertwined. When we divert resources away from meeting the demands of the new economy and maintaining and creating jobs, we suffer competitively, which impacts our customers and suppliers as well. For example, when a retailer is forced to shut stores and lay off employees, it reduces its orders for merchandise, advertising, and shipping. That retailer also does not need as many scanners, cash registers, and other products to transact business. In turn, a trucking company that provides services to that retailer now has fewer shipping orders and may, consequently, reduce its orders for new trucks and parts to replace or update its fleet. The company that manufactures the trucks in turn is affected.

In this economic downturn, companies do not have much financial flexibility. Many companies are facing a very difficult choice - fund their long-term obligations under their pension plans or make investments that create jobs. Some companies may have to lay off workers to meet their funding obligations. The need to fund the extremely large, unprecedented 2008 market losses too quickly undermines the creation and retention of jobs. Workers will be displaced or remain unemployed too long. This hurts workers, their families, communities, and the overall economy. Providing funding relief will help to keep Americans working, which in turn allows companies the ability to invest in jobs down the road.

We are very pleased that Representative Pomeroy has issued a discussion draft of legislation that provides relief to plan sponsors and workers. It is focused on providing employers the ability to manage the losses from the recent market turmoil by providing more time to make up those losses. This makes tremendous sense given the sharp downturn in the economy, uncertainty ahead, the number of displaced workers, and the continued tightened credit markets.

The proposal includes a rule whereby employers could pay interest only for two years followed by use of the existing law's amortization period for amortizing losses (the so-called "two and seven" approach). Alternatively, companies can elect an extended amortization period for repaying the extraordinary 2008 losses; this alternative is more costly initially but avoids the sudden increase in funding that can arise in the third year of the two and seven rule. Each company's situation is different and the two approaches provide reasonable choices for companies based on their own circumstances. Both alternatives are based on the principle that we need to remain committed to the goals and intent of the PPA, while providing businesses some relief to deal with an extraordinary set of economic circumstances. The two and seven approach has also been included in legislation reported out of the Education and Labor Committee as well as in savings legislation introduced by Republican Leader John Boehner.

While there have been some suggestions that legislation should be written in a way so as to screen out any companies that might not meet specified criteria, none of the bills have yet to accomplish this goal. We strongly urge this Committee not to include any such "targeting" provisions. The targeting concept ignores the critical fact I discussed earlier -- that businesses are necessarily interrelated. If targeting denies relief to a company, that company may not be able to advertise in media outlets, hire new workers, place orders for new parts and new inventory, or build a new facility. Helping one business helps others. Denying relief to one company can profoundly affect all those businesses that interact with that company.

The Pomeroy legislation includes a provision that would allow companies fuller use of the so-called "smoothing" provision. For many companies, this provision would provide enormous relief because it would allow companies to effectively spread out recognition of the unforeseeable losses over a 24-month period.

It is important to note that the Pomeroy discussion draft includes a number of other provisions that will help provide greater stability to defined benefit pension plans -- including multiemployer plans -- and will correct some critical problems that exist in the implementation of the PPA. Every one of the relief proposals either is essential to the economic recovery of at least one of the Council's members or corrects a clear glitch in the rules.

For example:

- The draft prevents plans from being forced to freeze benefits by reason of the market downturn.

- Without relief, many companies that prepaid their funding obligations would lose the ability to use those prepayments ("credit balances") to satisfy their funding obligations. The draft would solve that problem.

- The draft eliminates an unfortunate glitch in the law that would prevent many companies from providing additional benefits to bridge their early retirees until the retirees are old enough to qualify for Social Security benefits.

- The draft would prevent an outdated reporting rule from artificially triggering a loan default, which could be ruinous for a company.

- The draft would clarify a technical correction contained in the 2008 relief bill, so that companies are not forced to contribute $50 million or more in additional amounts never intended by Congress.

- Some companies were provided delayed effective dates with respect to the PPA funding rules. Since the pre-PPA rules can be even tougher than the PPA rules in some situations, the draft very appropriately applies the same relief to those companies.

We are also very pleased that the Education and Labor Committee has passed funding relief and that Republican Leader Boehner has introduced funding relief legislation. And we look forward to continued constructive discussions of this critical topic with the Senate.

I want to close by talking about something I am very proud of. NCR is opening a new manufacturing facility in the United States. We are creating approximately 900 new jobs in Columbus, Georgia to manufacture our next generation of innovative ATMs.

We believe this will be a big win for our company and our customers. It will help us bring new products to market faster by moving manufacturing closer to our global innovation center. And as a result, we will be more responsive to customer needs.

This is a significant investment for NCR. If we had to make a considerable catch-up contribution to our pension fund this year, we would not be able to meet our investment goals, open up a plant and create new jobs. That is why the Pomeroy bill is so important for NCR and for the many great companies in the same predicament. We are absolutely committed to bringing our pension fund back to 100% funded; what we are asking for is more time to do exactly that.

Over the next three to four years, responsible companies are going to have to choose between making very large payments to their pension funds or making investments that create jobs. Or worse yet, many will find themselves forced to lay off employees as a result of the funding requirements. Passage of the Pomeroy bill helps what is important to us all: the future of American jobs and innovation.

Thank you very much for the opportunity to testify today. I look forward to answering your questions.

Mr. NEAL. The Chair would recognize Judith Mazo, Senior Vice President, Director of Research, Segal Company.

STATEMENT OF JUDITH MAZO, SENIOR VICE PRESIDENT, DIRECTOR OF RESEARCH, SEGAL COMPANY, ON BEHALF OF THE NATIONAL COORDINATING COMMITTEE FOR MULTIEMPLOYER PLANS

Ms. MAZO. Mr. Chairman, Ranking Member Camp, Members of the Committee, I am very happy to be here today. I am a representative of the Segal Company, which is the largest actuarial firm in this country specializing to a great extent with multiemployer plans. I am here on behalf of the National Coordinating Committee for Multiemployer Plans—you have to take a breath between the words, so we tend to say NCCMP. But beyond that organization, a multiemployer coalition of employers, employer associations, unions, employee benefit funds, and others in the benefit community. That really covers the spectrum to all of whom are united, as we were in 2006 and in the years leading up to 2006, in looking for some continued solutions for our plans.

I will give you a little bit of a preview. I think we could use some of that $10 billion, so we appreciate that.

My written statement goes in some detail into what a multiemployer plan is. Many people are not familiar with them although, again, you probably run into the results of them, just like NCR's products, on a daily basis. They are union-negotiated plans covering, by definition, people working for at least two employers, often could be 20 employers, could be 100, could be 1,000 employers. They range very dramatically in size. They represent, often, people in very mobile employment, working for companies that are very small. And without banding together to provide these benefits as a group, as a pool, they couldn't provide them at all, particularly in the construction trades, in trucking, in retail trades, in entertainment. The actors you see on television, Harry and Louise, are covered by multiemployer plans, as well as others.

There are, I think, probably three very important key principles about multiemployer plans to keep in mind. One is they are not single-employer plans, they are stand-alone plans covering a lot of employers. They are not directly hooked into any employer's database to help keep track of who the participants are. And every nickel spent on running the plans comes from the money that is contributed by all of the employers and earned when we earn it in the market otherwise to pay benefits.

The second really important thing is it is collectively bargained. And we say this over and over again. That means it is not discriminatory. There is no concern about a lot of the money being targeted primarily to highly paid people within the group? These are egalitarian groups. There is no tax manipulation going on. No employer is trying to put extra money into a trust fund that the employer will have no control over and can't get any of it back. They are not trying to manipulate or increase tax deductions by giving money to cover their union-represented people. They are really benefit trusts and funds designed to take care of working people.

They are jointly trusteed. They are often called union plans, but in fact they are employer-union plans because the law requires that they be run by boards that are jointly employer and union. So there is a lot of counterweight and counterpoise and check and balance going on in the design and operation of the plan. They kind of have, to a great extent, built-in oversight going on.

I want to give you just a few facts about where multiemployer plans as a group stand as a result of the investment catastrophe that we encountered last year. They are the same investors in the same market as the single-employer plans. But over time—in 1980, there were about 2,200 multiemployer defined benefit plans. In 2008, there were about 1,500 of them. Where did they go; did they all terminate? No. In fact, in 1980, there were about 8 million participants in these plans, and now there are 10 million of them. What they did was merged. The multiemployer plans kind of take care of one another, and if a small plan falters it has, at least in the past, been able to be taken care of by the bigger ones.

One other important number, the median actual investment return for multiemployer plans, based on a survey of 400-some plans covering 6 million people, for 2007 the median investment return was about 8 percent. For 2008, the median was about minus-21 percent. That is really what we are here to talk about today or to answer your questions about today.

We can live with PPA, we just need some help in two ways; getting over some of the hard places, just as the single-employer plans do, and for some plans, there may not be any recovery without more dramatic help, and we need to focus on those as well as the majority that will continually help thrive. Thank you.

Mr. NEAL. Thank you, Ms. Mazo.

[The prepared statement of Ms. Mazo follows:]

Prepared Statement of Judith F. Mazo, Senior Vice President, Director of Research, The Segal Company, on behalf of the National Coordinating Committee for Multiemployer Plans and the Multiemployer Pension Plan Consortium

Mr. Chairman and Members of the Committee, it is an honor to speak with you today. I am Judith F. Mazo, Senior Vice President of The Segal Company, an actuarial and benefits consulting firm with the country's largest concentration of multiemployer plan clients. I am here on behalf of the National Coordinating Committee for Multiemployer Plans (the "NCCMP")[1] and the Multiemployer Pension Coalition, a broad group that comprises employers, employer associations, multiemployer pension funds, and unions from across the spectrum of the multiemployer community.

The Multiemployer Pension Coalition, which is coordinated by the NCCMP, came together early in this decade to harness the efforts of all multiemployer-plan stakeholders toward the common goal of benefit security for the working people who rely on these plans. We pressed for the multiemployer funding rules that were adopted in the Pension Protection Act of 2006, because we know that benefit security rests on rules that demand responsible funding and discipline in promising benefits. And now we are here again to talk with you about the multiemployer funding challenge, as the plans work to reconstruct their reserves after last year's universal investment catastrophe.

Sophisticated funding requirements, by themselves, will not pay workers' pensions. For that, the industries that sponsor the plans must survive and be strong enough to provide the support needed to meet those obligations. What we are seeking now is the temporary infusion of a little more flexibility in the multiemployer funding rules, to enable the employers and unions to muster the resources that the plans need to recover and flourish once again.

To understand what we need and why it is not the same as what single employer pension plan sponsors are seeking, it may help to go back to basics.

[1] The NCCMP is the premier advocacy organization for multiemployer plans, representing their interests and explaining their issues to policy makers in Washington since enactment of ERISA. Its more than 200 affiliates include pension and health plans as well as employers and labor unions whose workers and members participate in multiemployer plans.

I. What Are Multiemployer Plans and Why Do They Need Special Rules?

The core definition is straightforward: a multiemployer plan is one to which two or more employers are required to contribute, under one or more collective bargaining agreements.

Beyond that simple statement lies a world of variations. The funds may range, for instance, from 50–100 workers and 2–4 contributing employers in a locality to hundreds of thousands of participants and thousands of employers covering large geographic regions. Similarly, assets may range from, say, $25 million to $20 billion. The typical size is probably in the range of 1,000–5,000 participants, with assets of about roughly $100 to $250 million.

Ordinarily the covered workers are all represented by the same Local Union, or by Locals affiliated with the same International Union. Multiemployer plans are found throughout the economy, notably in the construction industry, entertainment, trucking and transportation, longshore, retail, mining and manufacturing, food service, hospitality, health care, building service, communications and the garment trades. More than half of the funds are in the construction trades, which, according to PBGC data, cover roughly 35% of the participants.

Understanding that there are exceptions at each general point, here are some general characteristics of multiemployer funds that have led to the development of special rules to accommodate their special circumstances:

- Virtually all multiemployer plans are set up as trusts structured under the Taft-Hartley Act, operated by a joint management-labor Board of Trustees as stand-alone entities that are independent of the contributing employers and the unions that represent their participants. The Trustees, as plan sponsor, have full responsibility for managing the assets and administering the benefits, including the duty to make sure the plan meets all applicable legal requirements.
- Typically, the employers contribute the amounts negotiated under their bargaining agreements, say $2 for each hour that participants work in covered service. The trustees, working with their professional advisors, determine and set the benefits, while the unions and employers independently negotiate over the flow of contributions.
- While the employers' most salient obligation is to contribute as defined in their labor contracts, because the plans promise a fixed benefit these are classified as defined benefit plans under ERISA and the Internal Revenue Code.
- The contributing employers are often small businesses that could not provide pension or health coverage on their own, whose employees often work for short periods before moving on to similar jobs with different contributing employers. They compete with each other and with non-contributing companies for contracts and customers.
- Regardless of which or how many employers a participant worked for, his or her pension is owed by the plan, backed by the industry. Contributing employers may come and go, but whoever is obliged to contribute in a given year is funding a portion of the plan's accumulated liabilities to all of its participants over time, not just the benefits being earned by its own workers.
- Benefits are rarely based on employees' pay. The pension is a specified dollar amount per year of covered service, or a specified percentage of the contributions required on the participant's work, say $80/month times year of service, or a monthly benefit equal to 2% of total contributions. Few multiemployer plans pay benefits before early retirement age or offer a lump sum as an alternative to a life annuity.
- Most multiemployer groups have defined benefit plans, many also have defined contribution plans (called "annuity funds") and a fairly small subset of those are 401(k) plans. Many multiemployer pension plans facing financial problems have reduced future benefit accruals, but so far very few have frozen accruals.

Several pertinent points emerge from this overview:

1. Because multiemployer plans are creatures of collective bargaining, the funding and other regulatory requirements must accommodate bargaining realities, where stability in pension costs is paramount. Thus:
    a. Since employers cannot be compelled to contribute beyond what they have agreed to in collective bargaining, the required funding cannot change during the term of a collective bargaining agreement;
    b. As many plans have a multitude of bargaining agreements that expire and renew at varying times, and as the bargaining process cannot accommodate sharp or unanticipated expense shocks, predictability in pen-

sion funding demands over time is essential beyond the standard 3-year duration of a single bargaining agreement, and

c. When the parties negotiate pension contributions, the amounts are explicit alternatives to increases in wages, health contributions or other elements of compensation, so the employees often view the contributions as "their money." If they do not believe the trade-off is worth it, they might reject the agreement, which could throw the plan's funding arrangements into disarray.

2. The fact that the plans are run for union-represented groups also means that:

   a. There is little or no opportunity for tax manipulation by contributing employers—they have no opportunity to benefit from the plan's assets (except, of course, by having the plan meet their employees' needs);
   b. The plans are egalitarian, providing essentially the same benefits for all employees with the same patterns of service under the plan, so there is no question of discrimination in favor of the highly paid, and
   c. Due to the Taft-Hartley structure, with an independent operation run by a Board on which the employers and the employees have equal representation, the entire cost of plan administration must be paid out of the plan's assets, with funds that would otherwise be dedicated to paying benefits.

3. Multiemployer plans are typically far more stable than single employer plans because of their broader contribution bases: they do not depend on the fortunes of one company. Often when a local multiemployer plan does begin to falter it is merged into a larger, stronger plan covering people represented by the same International Union. On the other hand, if a multiemployer plan fails that tends to be because of the failure of the industry that has supported it, and the losses to participants and to the pension guarantee system can be very large.

II. How Do the Pension Funding Rules Address This Now?

Distinctions for multiemployer plans have been part of the ERISA minimum funding rules and termination insurance program since the start. As experience under ERISA has developed, the differences between the regimes governing single employer and multiemployer plans have broadened. That history can be instructive.

1974–1980: ERISA. From the start, the Internal Revenue Code has included special rules to allow multiemployer plans to function as pools rather than a cluster of individual employers, and to rely on negotiated contribution rates for funding and deduction purposes, see, e.g., IRC s. 413(b).

Although pension plan termination insurance was at the core of ERISA's retirement income security promise, Congress was initially uncertain whether it was needed by or appropriate for multiemployer plans. When ERISA was passed, no multiemployer plan had ever terminated, and, because of their broad contribution bases, they were expected to be able to cover all of the benefits they promised. Accordingly, the initial multiemployer guarantee program was an experiment: from 1974–77, the PBGC had discretion to insure benefits under terminated multiemployer plans, and very little financing for it ($0.50/participant annual premiums, vs. $1.00/participant for single employer plans).

Early Experience. Then three multiemployer plans sought PBGC protection (compared with several hundred terminated single employer plans). They were from three failed industries, covering milkmen in New York, milkmen in New Jersey, and cap makers in St. Louis. This made clear that there was a role for a government guarantee of multiemployer pensions, and although it was rarely likely to be invoked the pension claims would be large. Experience during that discretionary period also disclosed one of most serious threats to the plans' survival and to the guarantee program: like the employers sponsoring single employer plans, employers contributing to multiemployer plans could be liable to the PBGC for the underfunding of a terminated plan that PBGC took over, so it was in an employer's interest to leave a multiemployer plan when its funding first showed signs of weakening. This, of course, would aggravate the plan's problems as fewer and fewer employers were left to carry the funding load. It would also stress established labor relations, as employers had only three ways to get out of a multiemployer plan: with the union's agreement (which was likely to mean an agreement to close out the pension plan and substitute a defined contribution plan), by ousting the union, or by going out of business.

Multiemployer Funding Reform, Version 1.0. Congress extended the discretionary-coverage period to allow for the in-depth study of multiemployer pension plans that had not been done in the lead-up to enactment of ERISA. It concluded that adapting the PBGC guarantee program to fit multiemployer plans would be futile unless the law also addressed the "last-man's-club" psychology that was propelling employers to exit multiemployer plans or press for their termination.

Accordingly, the Multiemployer Pension Plan Amendments Act of 1980 ("MPPAA") introduced the concept of withdrawal liability. Highly complex and highly controversial—for obvious reasons—in general this imposes liability on an employer that withdraws from a multiemployer plan for a pro rata share of the plan's underfunding. The more underfunded the plan is when the employer leaves, the higher its withdrawal liability is likely to be.

Withdrawal liability created a major incentive for the employers to push to get their multiemployer plans well funded and to keep them there. MPPAA also revamped the pension guarantee program for those plans, to make PBGC the financier of very last resort. Instead of guaranteeing unfunded benefits when a multiemployer plan terminates, the PBGC does not step in with financial support until the plan becomes insolvent and does not have enough cash to pay benefits at the guaranteed level.

The multiemployer benefit guarantees themselves were redefined and re-set at a low level. Initially this was a maximum of $234/year for each year of service, or an annual pension of $7020 for a retiree who had worked under the plan for 30 years. This is not indexed for inflation. Congress has increased the guarantee level once, and now the maximum is $429/year for each year of service, or $12,870 a year for someone with a 30-year career under the plan.

The other especially notable MPPAA change was the introduction of special funding rules for multiemployer plans nearing or at bankruptcy (IRC ss. 418–418E), which authorized benefit reductions and required that benefit payments be cut down to guaranteed levels. As it turned out, this plan reorganization concept hardly ever came into play. When multiemployer plans started running short of funds, it was for reasons other than those identified in MPPAA.

1980–2006: MPPAA. While the single employer funding and guarantee programs were changed repeatedly over the next quarter century, the multiemployer rules stayed essentially the same. The 1976 ERISA rules still governed multiemployer plans' minimum funding requirements. After a flurry of protest and litigation, including several trips to the U.S. Supreme Court, employers adapted to withdrawal liability and learned to take it into account in business planning. Only a few small plans applied for PBGC assistance and the multiemployer guarantee fund consistently ran a surplus. During the 1990s, most plans faced the challenge of overfunding, and looked for ways to be sure the employers could take a tax deduction for their pension contribution.

MPPAA helped establish this period of repose. After the intensity of the 1979–1980 legislative battles, neither Congress nor the Administration had much appetite for re-igniting the withdrawal liability controversy, so multiemployer plans were routinely exempted from whatever funding changes were enacted. But the real reason why the MPPAA reforms seemed to work so well was that multiemployer plans were prominent among those benefiting from the general prosperity of the 1990s. In the main, plans' investments were doing well, there was plenty of work for participants and profits for their employers, so neither withdrawal liability nor statutory minimum funding requirements drew much attention.

This era of general contentment came to an abrupt stop when the investment markets crashed in 2000 and 2001. Mature multiemployer plans with many retirees and declining numbers of active participants, had been living off the earnings from the very considerable reserves they had built up. When those investment gains turned into losses, funding levels declined and withdrawal liability flared back up, reawakening employer suspicions. Some plans saw funding deficiencies looming and turned to IRS for help, but it was swamped with pleas from troubled single employer plans and relatively unfamiliar with the intricacies of multiemployer funding.

The Pension Funding Equity Act of 2004 provided a little breathing room for single employer plans but not for multiemployer plans. Because they seemed to be treading water well enough to avoid the catastrophic terminations that workers and the PBGC had faced in the airline and steel industries, they could not command the policy makers' immediate attention.

And so the multiemployer community pulled together, establishing the Multiemployer Pension Coalition to work in concert with the NCCMP for a substantive update to the multiemployer funding rules. The need to would protect the employers from ruinous contribution obligations and tax penalties was becoming urgent, as was the community's conviction that multiemployer plans could not survive under the kinds of rules that were being considered for single employer plans. The Coalition's work with Congress led to the development of the multiemployer provisions of the PPA.

2006–Present: PPA'06. As in 1980, the PPA made few changes in the mechanics of the ERISA funding standard account and related rules, which continue to apply to multiemployer plans. New benefits and benefit increases must now be amortized over 15 rather than 30 years, and short-term benefit increases must be funded as quickly as they will be paid. Unlike single employer plans, multiemployer pension plans can continue to use long-term interest assumptions chosen by their actuaries and actuarial methods of smoothing changes in asset values to temper the impact of investment market fluctuations. PPA also increased the limits on deductible contributions, to help pension plans can build reserves without penalizing contributing employers.

Longer-Term Perspective: The Zones. For multiemployer plans, the PPA's principal innovation was to impose a clear requirement that the trustees and bargaining parties look past the plan's financial status as of a given valuation date, to take the measure of where it is headed. If the funding is projected to deteriorate to specified levels, they are required to adopt a formal corrective plan, with annual monitoring and adjustments required if needed to stay on course. The law provides new tools to help bring plan liabilities and assets into balance. Additional reporting to participants and employers, as well as to the government, provides extra accountability.

Specifically, the law characterizes a multiemployer plan as "endangered" if its funding percentage is below 80%, or if it is projected to have a funding deficiency within 7 years. If both are true, the plan is "seriously endangered." "Critical status" indicates more serious problems: a projected funding deficiency within four or five years or pending cash-flow difficulties. Colloquially, endangered status is called the "yellow zone" and critical status is the "red zone." Following this Homeland-Security theme, a plan that is neither endangered nor critical is said to be in the "green zone," although there is no official classification for a plan that looks healthy.

When a plan goes into the *yellow zone*, contribution reductions and benefit increases are restricted. The trustees must come up with a Funding Improvement Plan ("FIP") designed to improve the plan's underfunding by at least 30% over a ten-year period (for most seriously endangered plans, the goal is a 20% improvement over 15 years). This has to include schedules of benefit cuts and, if necessary, contribution increases, to be presented to the employers and unions so that they can choose a solution for their group through collective bargaining. The FIP must be reevaluated each year, and adjusted if needed to stay on schedule.

The *red zone* indicates a more serious problem, and may be addressed with more serious solutions. When a plan goes into the red zone, in addition to enforcing restrictions on reducing contributions and increasing benefit, the plan must stop paying lump sums and similar front-loaded benefits to new retirees. The trustees must adopt a Rehab Plan that, like the FIP, aims at getting the fund out of critical status over a 10-year period. This includes offering the bargaining parties schedules of benefit cuts and contribution increases that are calibrated to achieve this improvement, for them to select through bargaining.

Benefit reductions under a Rehab Plan can include the reduction or elimination of recent benefit increases, early retirement subsidies and other benefit features—other than the accrued benefit payable at normal retirement age—that are ordinarily protected from cutbacks. These benefit reductions are ignored when computing withdrawal liability. For active workers, future accrual rates cannot be cut below 1% of contributions unless the union and employers negotiate a deeper reduction as part of a package that is acceptable to the trustees.

The employers that contribute to a red-zone plan are subject to a 5% contribution surcharge (going up to 10% after the first year) until they agree to an acceptable schedule of contributions and related benefit adjustments under the Rehabilitation Plan. However, there are no penalties on employers if a red zone plan actually has a funding deficiency, as long as the parties are living up to their red-zone obligations and the fund makes progress as expected under the Rehab Plan. The Rehab Plan benchmarks can be revised if it turns out that the original program was too ambitious, but the ultimate goal remains the same: financial recovery by the end of the rehabilitation period.

If the trustees determine that, after exhausting all reasonable measures, the plan will not be able to recover within the statutory time frame, they must adopt recovery program that may take longer but is likely to work. If they believe that nothing will turn the situation around, they must design a plan to forestall insolvency.

III. How Is PPA Working? Why Do Multiemployer Plans Want More Relief?

Early Results. PPA became law late in August of 2006. Its funding changes took effect at the start of the 2008 plan year, which was January 1 for most plans. For the most part, trustees and bargaining parties whose plans had been struggling were alerted by their actuaries that they should expect to be in endangered or critical status, and many had already come up with a way to deal with by the time it became official. The resulting additional sacrifices imposed on the participants and employers were not pleasant, and the many ambiguities in the law left many important questions open for interpretation and dispute, but through the first half of 2008 the process was working fairly smoothly.

Among Segal Company multiemployer pension clients, the actual zone determinations were a little better than had been predicted. Through July 2008, about 80% were green, 12% were yellow and 8% were in the red zone. Then the September market crash hit. For all of 2008, the breakdown for about 400 multiemployer plans whose zone status was determined by The Segal Company was **78% green, 12% yellow** and **10% red**.

The severity of the impact of the asset losses really began to show up when calendar-year plans' zone status was re-certified for 2009. The pattern has completely reversed. By late March 2008, The Segal Company had determined that 83% of its multiemployer clients that operated on a calendar-year basis were in the green zone, 10% were yellow and 7% were red. By the same point in 2009, after a number of those plans that were in a zone had begun carrying out their correction programs and others that were on the brink had cut benefits or requested contribution increases in an effort to avoid troubled status, the breakdown was **39% green, 29% yellow** and **32% red**.

This covers about 230 plans; determinations made later in 2009 have shown consistent results.[2]

From January 1, 2008 to January 1, 2009, multiemployer plan assets dropped an average of more than 20%, most of it in the last 3 months of 2008. Suddenly, problem plans that were on their way to recovery were knocked back farther than before; traditionally strong plans that had been fully funded for decades were faced projected funding deficiencies, critical status and, for the first time ever, benefit reductions. None were prepared for such an abrupt and dramatic reversal.

WRERA. Like other financial institutions, pension plans called for help. In its second special session after the Presidential election, Congress threw them a rope—the Worker, Retiree, and Employer Recovery Act of 2008 ("WRERA")—to stay afloat while more substantial solutions could be developed. WRERA offered multiemployer plans two options for short-term relief: for the 2009 plan year, they could either keep the zone status they had had for 2008 (a "freeze") or, if their status was already endangered or critical, add three more years to their recovery period.

Both approaches give the plans' stakeholders some extra time to sift through the components of their dilemmas and look for ways to resolve them. Ironically, the challenge is often hardest for those plans that have been the strongest, whose trustees and bargaining parties have little experience in working through financial adversity. On the other hand, the severe asset losses may have closed off the avenue to recovery for some plans in shrinking industries with high proportions of retirees.

PPA gives multiemployer plan stakeholders a clear mission: to monitor their plans' financial outlook and take action to counter emerging problems. But after the 2008 market meltdown, even PPA is not flexible enough to enable them to devise and implement approaches that could work for their specific problems.

IV. What Is Needed Now?

At this point what worries multiemployer stakeholders most is that the yellow and red zone mandates could force them to cut benefits or raise contributions—or both—beyond what their industries can tolerate. Once a contribution increase or benefit reduction is put in place for an endangered or critical plan, it cannot be undone until the plan recovers, so acting too quickly could cause years of unnecessary loss for employers and participants.

The Goldilocks recommendation—do not do too much or too little, make sure it is just right—is not practical. What the multiemployer community is looking for now is some tweaking of the funding rules to make them more forgiving, on the one hand, and, for plans with little chance of growing their way out, financial assistance to contain and minimize the damage. The Coalition has proposed a two-pronged approach to help multiemployer plans facing these two quite different sets of difficulties, plus some general program clarifications and improvements.[3]

[2] The published results of these surveys are attached to this statement.

[3] The proposal is described in an attachment to this statement.

In brief, *for plans that are basically solvent* but need some help to get through this especially rough patch, we are asking for some temporary tweaks to the funding rules to give them more time to absorb the 2008–2009 losses. The proposal includes a list of options, to deal with the variety of technical issues that different plans face. These include:

- starting new 30-year amortization periods, either for all of the outstanding charges and credits to the funding standard account, or just for the 2008–2009 market value losses;
- further buffering the impact in any single year by allowing the asset losses incurred in those two years to be smoothed over 10 years (instead of than the current 5) before amortization, as long as the asset values taken into account are no more than 30% above or below current market value;
- lengthening to 10 years (from the current 5) the automatic amortization extensions introduced in PPA and clearing away bureaucratic barriers so they can be used efficiently, and preserving pre-PPA IRS-granted relief notwithstanding the recent investment losses, and
- For all plans that are or become endangered or critical, extending the recovery periods by 5 years, or 2 years on top of the 3-year extensions that some plans elected in 2009.

More direct financial help is proposed for *severely troubled plans*:

- To promote the rescue of troubled plans through mergers as long as participants' benefits are not put at risk, clarify the applicable fiduciary standards; create a new type of multiemployer plan merger called an "alliance" that would insulate the stronger plan from the weaker plan's funding problems, and direct the PBGC to facilitate productive mergers, including by contributing seed money;
- Turn the existing concept of plan partition into an active vehicle for saving multiemployer plans that are in sharp decline because of employer bankruptcies and uncompensated withdrawals, by giving those plans the right to transfer the liabilities that those departed employers left behind to the PBGC,[4] and
- Provide a short-term federal tax credit to help employers cover the incremental contributions required under the Funding Improvement or Rehabilitation Plan for a seriously endangered or critical-status multiemployer plan.

Generally applicable improvements for multiemployer plans endorsed by the Coalition's proposal are:

- An increase in the maximum PBGC guarantee for multiemployer plan benefits, from the current $429 a year times years of service to $669 a year for each year of service (raising the guarantee for someone with 30 years of service from less than $13,000/year to slightly more than $20,000);
- Federal guarantees for pension compliance bonds issued by employers, the proceeds of which would be earmarked for contribution to a multiemployer plan to retire its outstanding unfunded liabilities, and
- Several technical adjustments to the endangered plan rules, to resolve inconsistencies and ambiguities.

* * * * *

We know that this is an ambitious agenda and that the subject matter looks both complex and arcane. But underlying the algorithms, actuarial notations and tax jargon is the retirement security of real rank-and-file workers. With them in mind, we hope that you will consider these proposals seriously. The Multiemployer Coalition will be happy to answer any questions or provide any additional information available to it that might help you with this task.

Mr. NEAL. The Chair would recognize Damon Silvers, who is associate general counsel, AFL–CIO.

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[4] Because plan partitions could assign vary large liability amounts to the PBGC's multiemployer guarantee fund, the proposal calls for this to be financed with funds outside of the premiums paid by multiemployer plans.

STATEMENT OF DAMON A. SILVERS, ASSOCIATE GENERAL COUNSEL, AFL–CIO

Mr. SILVERS. Good morning, Chairman Rangel, Ranking Member Camp, Congressman Neal. My name is Damon Silvers, and I am an associate general counsel of the AFL–CIO. Our 55 member unions and 12 million members participate in both single and multiemployer plans. I obviously appreciate the opportunity to appear before the committee.

Defined benefit pension plans have a number of features that make them particularly effective structures for providing retirement income security. The first of them is significant sustained employer funding of these plans. Features additionally include insurance against longevity—outliving your benefits, insurance against investment risk, professional investment management, and economies of scale.

You are going to be taking up the problems that are associated with plans that don't have these features in the second half of this hearing.

The Pension Protection Act, however, has at its heart a fundamental misunderstanding about the nature of defined benefit pension plans. That act is built on the assumption that a pension plan is like a deposit-taking institution where all funds can be withdrawn at any time, and thus the plan must be in the position to meet most or all of its benefit obligations at any moment. The PPA undid a funding regime that was based on averaging assets over time and spreading funding obligations and replaced it with one based on arbitrary snapshots.

Now, the PPA's approach adds volatility to pension funding requirements, even in relatively favorable market conditions, as do recent changes to the pension accounting rules by FASB. In conditions such as we have seen in the last 24 months that the other witnesses have referred to, this volatility is so extreme that it threatens the very survival of what remains of the private sector pension system.

During market downturns, PPA requires employers to radically increase their funding to make up for large, unrealized market losses. Employers must make these payments just at the moment when employers themselves are likely to be weakest. While some tightened funding requirements may be necessary to prevent a downward spiral in weaker plans during a market crisis—Judy alluded to this a moment ago—funding obligations should not be based on one-time asset valuations or one-time discount rates.

In this environment, employers that are providing retirement for their employees' retirement security—responsible employers—are under great pressure to cease doing so from multiemployer plans. Each employer that does so creates greater pressures on the next employer to follow suit.

The long-term implications for the provision of retirement security across our economy and the ability of retired Americans to contribute to our consumer economy are very serious.

Consequently, the AFL–CIO urges Congress to address the retirement security crisis in two steps. First, pension funds need immediate relief from the provisions of the PPA that force funds to behave as if they had to pay out all benefits at any one time. This relief should generally take the form of a return to a smoothing approach to pension valuation. This return should be understood as a return to the proper approach to pension valuation, not as a deviation from that approach.

We should also recognize the extent to which interest rates, which are driving the liability side in a negative direction against funds, interest rates since 2008 are in fact a product of public policy, of Federal Reserve interventions, for good reasons, to protect our banking system and our housing markets; but they have the consequence of inflating the liability side, just as the asset side is collapsing.

At the same time, Congress should consider a number of more temporary measures to ease the procyclicality of the current pension regulatory system, to preserve active plans, and prevent pension fund weakness from contributing to downward pressure on the economy as a whole.

Here, as has been indicated by a prior witness, Congress should provide relief only to those plans where participants are accruing benefits, and should require continued benefit accrual during the period the relief is in effect.

However, undoing the destructive aspects of the PPA will not be sufficient to stabilize America's private pension system. For that, Congress should look in the long term to the principle of universal shared responsibility for retirement security; government, through Social Security; individuals through savings; and employers through minimum retirement benefit funding obligations for all employers.

Congress should act and act fast, as a prior witness has stated, to ensure that the system of pension regulation does not act as one more headwind retarding economic recovery.

I hope I have given in this testimony broader context for understanding this action as part of an approach to regulating pension funds for what they are: financial intermediaries with long-term time horizons.

Thank you very much for the opportunity to appear before you today and I welcome your questions.

Mr. NEAL. Thank you, Mr. Silvers.

[The prepared statement of Mr. Silvers follows:]

Prepared Statement of Damon Silvers, Associate General Counsel, AFL–CIO

Good morning Chairman Rangel and Ranking Member Camp. My name is Damon Silvers, and I am an Associate General Counsel of the American Federation of Labor and Congress of Industrial Organizations (AFL–CIO). On behalf of the AFL–CIO, our 55 member unions and 12 million members, I appreciate the opportunity to appear before this Committee to discuss the critical issue of pension funding in the context of the current economic and financial crisis and the long term crisis of declining retirement security for American workers.

In this testimony, I hope to give the Committee a framework for taking up the issue of pension funding in the midst of the economic crisis. I want to make two basic points. First, the last thing we should be doing now is shutting down viable retirement vehicles. Absent funding relief, plan sponsors may have no alternative but to freeze viable pension plans, cutting retirement incomes just when our economy is most vulnerable to demand side shocks. Second, and more profoundly, putting pressure on what remains of the defined benefit pension system will worsen the long-term retirement security crisis by removing plan structures without proposing any viable replacement. The short term approach the Pension Protection Act takes to the valuation of pension assets is both mistaken as an analytical matter and is a powerful accelerant to these fundamentally destructive trends.

I'd like to begin with a brief survey of the recent history of retirement in the United States. Prior to World War II, pensions were unusual, and generally only managers, relatively privileged white-collar employees, and public sector workers received them. Following World War II and the growth of the labor movement, pension coverage increased dramatically. By 1980, 50% of the private sector workforce was covered by a defined benefit pension plan. In the public sector, pension coverage was close to universal, as it remains today.

This growth in pension coverage, combined with the creation of Social Security and Medicare, created retirement as a time of life the typical American could look forward to, rather than fear.

Defined benefit pension plans have a number of features that make them particularly effective structures for providing retirement income security.

1) Funding levels: In the United States, defined benefit pension plans have typically been funded at levels averaging around 8% of payroll. Funding at this level provides a retirement benefit that, when combined with Social Security, is enough to maintain a pre-retirement standard of living.

2) Insurance against longevity: Defined benefit pensions typically pay a lifetime benefit. They are structured with an insurance feature that protects retirees from outliving their income.

3) Insurance against investment risk: Defined benefit pension plans function as financial intermediaries for the participants. While the plans are exposed to investment risk, they provide a guaranteed benefit, sheltering individuals from the timing risk associated with volatile assets, regardless of investment performance.

4) Professional investment management and economies of scale: Defined benefit plan assets are professionally invested as a pool under a prudent expert standard. As a result, participants benefit from greater expertise and economies of scale not associated with individual accounts. Not surprisingly, defined benefit plans have generally been found to outperform self-directed individual account plans by significant margins.

Despite these benefits, private sector employers have retreated from providing defined benefit pension plans since Congress created the 401(k) plan in the late 1970s. While employers often cite the regulatory burdens associated with defined benefit plans as a reason for their interest in other plan types, I believe the real issue is simply the substantial cost savings employers may realize by moving from defined benefit plans, where employer contributions average 8% of payroll, to defined contribution plans where employer contributions are in the range of 0–3% of payroll. This employer retreat from responsibility coincides with the decline of trade union bargaining strength in the private sector.

In this environment, it is hardly surprising that those employers maintaining defined benefit plans have looked for ways to minimize contributions to them. In particular, the period of explosive 401(k) growth in the 1990s coincided with a prolonged bull market during which plan sponsors generally did not make cash contributions. Here, public policy played a destructive role. In a misguided effort at preventing employers from sheltering profits from taxes through pension contributions, Congress prevented employers from making tax deductible contributions to funds that appeared to be overfunded.

Alarmingly, the growth in 401(k) and other defined contribution plans and the decline in defined benefit coverage in the private sector have not increased overall retirement plan coverage. Nor have the retirement assets of American workers increased. Even before the 2008 stock market crash, median 401(k) account balances for families with income earners in their fifties were less than $60,000. Consequently, the private sector workforce today is significantly less well prepared for retirement than it was in 1980. Of course, this decline in secure retirement income has happened as the baby boomers approach retirement age. With the passage of time, if no action is taken, we will almost certainly be living in an aging society where retirement security is out of reach for more and more of our fellow citizens, with serious consequences for the strength of our consumer economy.

It was against this backdrop that Congress sought in 2006 to strengthen pension funding by passing the Pension Protection Act (PPA). While well intentioned, the Act, at its heart, reflects a fundamental misunderstanding about defined benefit pension plans. The Act assumes that a pension plan is like a deposit-taking institution, where all funds can be withdrawn at any time, and thus the plan must be in a position to meet all of its benefit obligations at any one time. The PPA undid a funding regime based on averaging assets over time and replaced it with one based on arbitrary snapshots.

The result is a regulatory structure fundamentally at odds with the institutions being regulated. Modern pension funds, as financial intermediaries, invest in a mix of assets—some of these assets, such as high grade corporate bonds, are relatively stable, income producing assets. But, a pension fund's real value to participants from the perspective of managing investment risk, is its ability to invest in more volatile, and thus higher yield investments, most importantly public equities or stocks. While returns on stocks, historically, have been significantly higher than returns on bonds, stocks go through periods, even long period, of low returns—such as the period that began in 2000 and continues today.

During these periods, pension fund assets must be sufficient to pay benefits and to avoid a downward asset spiral. However, it is simply inconsistent with the nature of defined benefit pension funds to require full funding at all times for pension plans with a healthy demographic profile. Such a requirement amounts either to a requirement to invest exclusively in short term fixed income obligations or to be so over-funded that the real rate of return on funds set aside for retirement in terms of benefits paid will be uncompetitively low. Such an approach forfeits one of the core strengths of defined benefit plans. It is also at odds with the federal courts' interpretation of trustees' fiduciary duties under ERISA in relation to investment management.

The PPA adds volatility to pension funding even in relatively favorable market conditions (as do recent changes to the pension accounting rules by FASB). In conditions such as we have seen in the last twenty-four months, this volatility threatens the very survival of what remains of the private sector pension system. Under PPA, during market downturns, employers are required to radically increase their funding to make up for large unrealized market losses. Employers must make these payments just at the moment when employers themselves are likely to be weakest. While some tightened funding requirements may be necessary to prevent a downward spiral in weaker plans during a market crisis, funding obligations should not be based on one-time asset valuations.

The effect of the PPA is to shorten the investment time horizons of pension funds. This fundamentally is not in the national interest. A wide range of commentators have noted that the short term orientation of our capital markets and our financial institutions was a major contributor to our current economic crisis. Recently, the newly elected President of the AFL–CIO, Richard Trumka, joined with Warren Buffett, Pete Peterson, and a number of business leaders in calling for public policy measures that would lengthen the time horizons of America's capital markets.

There is no question that even with a more rational approach to regulating funding levels, defined benefit pension plans are under serious economic pressure. Such pressure is inevitable when there are no effective minimum requirements for employers, generally, to contribute to their employees' retirement security.

In this environment, employers that are providing for their employees' retirement security are under great pressure to cease doing so—to freeze single employer plans or to withdraw from multiemployer plans. Each employer that does so creates greater pressures on the next employer to follow suit.

The AFL–CIO urges Congress to address the retirement security crisis in two steps. First, pension funds need immediate relief from the provisions of the Pension Protection Act that force funds to behave as if they had to pay out all benefits at any one time. This relief should take the form of a return to a smoothing approach to pension asset valuation. This return to a smoothing approach should not be understood as a temporary adoption of a less appropriate approach, but rather a return to a more appropriate approach to pension asset valuation that should be made permanent.

At the same time, Congress should consider a number of more temporary measures to ease the procyclicality of the current pension regulatory system to preserve active plans and prevent pension fund weakness from contributing to downward pressure on the economy as a whole. Here, Congress should provide relief to those plans where participants are accruing benefits. To protect participants, Congress should condition such relief on participants' continued accrual of benefits during the period of relief.

However, the undoing of the destructive aspects of the Pension Protection Act will not be sufficient to stabilize America's private pension system. For that Congress needs to look to the principle of universal shared responsibility for retirement security—government through Social Security, individuals through savings, and employers through minimum retirement benefit funding obligations. Such an approach would not require that employers all participate in any particular plan, just that they set aside enough for funds for all their employees to accumulate sufficient retirement assets to be able to achieve modest financial security in retirement. Variants of this type of approach to broad based retirement security are currently in place in Australia, the Netherlands and Switzerland. A recent GAO study that looked in particular at the Dutch and Swiss experiences found their programs for universal private pension coverage should be of interest to policy makers seeking to address the lack of meaningful private retirement plan coverage for American workers.[1]

I have attached to this testimony a more lengthy paper submitted to the University of Pennsylvania's Wharton School addressing in more detail the challenges of risk management in the context of retirement security provision. This paper contains detailed sources for this testimony.

Other witnesses before you today will address in more detail specific forms of relief needed to protect what remains of the private pension system, and to ensure the system of pension regulation does not act as one more headwind retarding economic recovery. I hope on behalf of the AFL–CIO through this testimony to give a broader context for why it makes sense conceptually to regulate pension funds for what they are—financial intermediaries with long term time horizons. Thank you for the opportunity to appear before you today and I welcome your questions.

Mr. NEAL. I would like to recognize now Mr. Mark Warshawsky, Director of Retirement Research at Watson Wyatt Worldwide.

STATEMENT OF MARK J. WARSHAWSKY, PH.D., DIRECTOR OF RETIREMENT RESEARCH, WATSON WYATT WORLDWIDE

Mr. WARSHAWSKY. Chairman Rangel, Ranking Member Camp, and Members of the Committee, I appreciate the opportunity to present testimony on funding relief for single-employer defined benefit pension plans.

Although single-employer pension plans have declined in importance over recent years, they still represent an important source of retirement benefits to millions of workers and retirees. They are also a significant financial responsibility for major employers.

If there is to be a good chance of a renewal of interest in defined benefit plans, which I know is supported by many committee members—and here, in particular, I commend Representative Pomeroy for his leadership—it is important that there be a supportive public policy environment for their continuation and creation.

Perhaps of more immediate impact at this sensitive time in the economic cycle when weakness is still widespread, particularly in the job market, and the recovery apparently is just coming forth, we must be sensitive to the broad economic implications of the timing and amount of pension funding requirements.

From 2004 through 2006, I was Assistant Secretary for Economic Policy at the Treasury Department, and I participated actively in the Bush administration's formulations of policies in this area, ultimately leading to the passage of the Pension Protection Act. Although not perfect and somewhat incomplete, we believe that PPA is an important improvement over old law in many ways; in particular, to lead to fuller plan funding and more accurate measurement.

PPA provided plan sponsors with some of the tools and incentives to ultimately better manage their funding risks, either to go with a liability-directed investment approach and smaller exposer to equities, or to build an asset cushion to reduce the need to make sudden large contributions and pay increased PBGC premiums. These are good ideas, and in more normal times will improve ben-

[1] Government Accountability Office, *Alternative Approaches Could Address Retirement Risks Faced by Workers but Pose Trade-offs,* July, 2009, revised September, 2009. Found at http://www.gao.gov/new.items/d09642.pdf.

efit security for workers and retirees, and also reduce risk exposure at the PBGC.

Yet, at the exact time that the somewhat stricter funding regime of PPA was coming online, we experienced an almost unprecedented financial meltdown and deep recession. If the financial troubles had come later, I believe that corporate plans would have been in a better position, with new investment policies, or perhaps larger asset cushions; but the timing could hardly have been worse, and huge funding contributions would have been required when corporate cash flows were low and capital markets closed.

So it was appropriate and timely that Congress passed last year, on a bipartisan basis, the Worker, Retiree and Employer Recovery Act, and that the IRS and Treasury provided this year some pieces of guidance that reduced the funding burden for the 2009 plan year.

Our estimate is that for the 2008 plan year, the average regulatory funded status was about 96 percent, and required funding payments for all single-employer defined benefit plans was just under $40 billion. With no changes, the average funding status would have declined to 75 percent, and required funding payments would have increased to $110 billion for the 2009 plan year. But because of the combined impact of legislative and regulatory relief through September 25, we now estimate that the funding status will be nearly 94 percent and required funding payments of about $32 billion for the 2009 plan year. That required funding will decline in 2009 from 2008 is a good result for the economy, giving plan sponsors some breathing room.

But the 2010 plan year is upon us, and corporate plan sponsors are considering its implications. Our estimate, even considering some recovery in the stock market thus far this year, is that the funding status will decline to 84 percent, and required funding payments will increase to almost $90 billion in 2010 under current law.

And the 2011 plan year looks worse, even assuming some positive returns, as the funding status is projected to decline to 77 percent and the required funding payments will increase to $146 billion, a heavy burden by any measure and consideration. So it is, again, appropriate and important that Congress is considering further relief.

In my written testimony, I have some details about our estimates of modeling the three legislative proposals which are before Congress: Representative Miller's bill, approved by the Education and Labor Committee; key aspects of Representative Pomeroy's bill, circulated in draft discussion form; and House Minority Leader Representative Boehner's bill. Although they employ different technical mechanisms, each of the bills would reduce required funding payments somewhat in both 2010 and 2011. Over the 3 years, Representative Boehner's bill gives the most relief, but the overall approach in all three bills of increasing requirements over time is reasonable.

As a simple suggestion, in the spirit of all three bills but with the intent to give more relief, a cap could be imposed on current law required funding payments for the 2010 and 2011 plan years of progressively increasing percentages based on the 2009 required contributions.

In closing, we believe that further legislative relief for single-employer defined benefit plans is both good economic and retirement plan policy. In particular, we want to emphasize that funding relief is not just a pension issue, but with cash flows still tight and borrowing difficult, for many plan sponsors it is a matter of jobs and even survival.

I would be happy to answer your questions. And also, on behalf of Watson Wyatt Worldwide, I offer our technical assistance to the committee if you decide to pursue funding relief.

In that regard, the committee acting quickly and positively on this important issue, on a bipartisan basis, would send the most positive signal to the plan sponsor community.

Mr. NEAL. Thank you, Mr. Warshawsky.

[The prepared statement of Mr. Warshawsky follows:]

Prepared Statement of Mark Warshawsky, Director of Retirement Research, Watson Wyatt Worldwide, Arlington, Virginia

Gaobo Pang and Brendan McFarland of the Research and Innovation Center at Watson Wyatt Worldwide provided valuable input in helping to prepare the analyses upon which most of this testimony is based.

Chairman Rangel, Ranking Member Camp and Members of the Committee on Ways and Means, I appreciate the opportunity to present testimony on funding relief for single-employer defined benefit pension plans. The testimony represents the views of Watson Wyatt Worldwide, a global firm focused on providing human capital and financial management consulting services, doing business in the United States and in 32 other countries.

Although they have declined in importance over recent years as the primary retirement vehicle for active workers in the private sector in the United States, single-employer defined benefit pension plans still represent an important source of retirement benefits to millions of workers and retirees. They also are a significant financial responsibility for major employers. Moreover, as experienced in the recent financial meltdowns and market volatility, the main alternate retirement plan type—defined contribution such as 401(k) plans—did not perform so well in providing retirement security and peace-of-mind to retirees and workers, or, by preliminary indications, a smooth and orderly flow of retirements for employers.

If there is to be a good chance of a renewal of interest in defined benefit plans, for the mutual advantages of employers, workers, retirees, and society, it is important, at a minimum, that there be a supportive public policy environment for their continuation and creation. Perhaps of more immediate impact, at this sensitive time in the economic cycle, when weakness is still widespread, particularly in the job market, and the recovery, apparently, is just coming forth, we must be sensitive to the broad economic implications of the timing and amount of pension funding requirements.

From 2004 through 2006, I was Assistant Secretary for Economic Policy at the Treasury Department. Because of my long and extensive research background in retirement plans in prior positions, at the Federal Reserve Board, the IRS, and TIAA–CREF, I participated actively in the Bush Administration's formulation of policies in this area, ultimately leading to the passage of the Pension Protection Act of 2006 ("PPA"). Although not perfect and somewhat incomplete, we believe that PPA is an important improvement over old law in many ways, in particular, to lead to fuller plan funding and more accurate measurement.

In the funding area, my modeling results indicate that, across many different economic circumstances, PPA would produce less volatile outcomes than old law.[1] Old law was based on a knife-edge funding approach and Treasury bond yields which tended to go quite low in recessions, increasing pension liabilities somewhat artificially. Also, PPA provided plan sponsors with some of the tools and incentives to ultimately better manage their funding risks—either to go with a liability-directed investment approach, and smaller exposure to equities, or to build an asset cushion,

[1] See Mark J. Warshawsky, "The New Pension Law and Defined Benefit Plans: A Surprisingly Good Match," *Journal of Pension Benefits,* Spring 2007, 14(3), pp. 14–27.

to reduce the need to make sudden large contributions and pay increased PBGC premiums. These are good ideas and in more normal times *will* improve benefit security for workers and retirees, and also reduce risk exposure at the federal guaranty agency, the PBGC.

Yet, at the exact time that the somewhat stricter funding regime of PPA was coming on line, we experienced an almost unprecedented financial meltdown and deep recession. If the financial troubles had come later, I believe that corporate plans would likely have been in a better position—with new investment policies or perhaps larger asset cushions. But the timing could hardly have been worse, and huge funding contributions would have been required when corporate cash flows were low and capital markets closed.

So it was appropriate and timely, that Congress passed, last year, on a bipartisan basis, the Worker, Retiree and Employer Recovery Act of 2008, and that the IRS and Treasury provided this year some pieces of guidance that reduced the funding burden for the 2009 plan year. Our estimate (see the attached article and sources indicated in the footnotes there for more details) is that for the 2008 plan year, the average regulatory funded status was about 96 percent and required funding payments for all single-employer defined benefit plans just under $40 billion. With no changes, the average funded status would have declined to 75 percent and required funding payments increased to around $110 billion for the 2009 plan year. Because of the combined legislative and regulatory relief through September 25, 2009, we now estimate that the average funded status will be nearly 94 percent and required funding payments about $32 billion for the 2009 plan year. That required contributions will decline in 2009 from 2008 is a good result for the economy, giving plan sponsors some breathing room.

But the 2010 plan year is upon us, and corporate plan sponsors, with their long planning and budgeting horizons, are considering its implications. Our estimate, even with some recovery in the stock market thus far this year, is that the average funding status will decline to 84 percent and required funding payments increase to almost $90 billion in 2010, under current law and regulations. And the 2011 plan year looks worse, even assuming positive returns in the stock and bond markets, as funding status is projected to decline to 77 percent and required funding payments to increase to $146 billion, a heavy burden by any measure and consideration.

So it is again appropriate and important that Congress is considering further relief. We have modeled three legislative proposals—Representative Miller's bill approved by the Education and Labor Committee, keys aspects of Representative Pomeroy's bill circulated in draft discussion form, and House Minority Leader Representative Boehner's bill. Although they employ different technical mechanisms, each of the bills would reduce required funding payments somewhat in both 2010 and 2011 plan years. Representative Boehner's bill would also reduce 2009 funding payments significantly, while Representative Pomeroy's approach would increase them somewhat. The funding status of plans would improve significantly in 2009 under Representatives Pomeroy's and Boehner's bills, but would not change much thereafter in any of the bills.

More specifically, our estimate is that under the Education and Labor Committee bill, funding payments would be $30 billion for the 2009 plan year, $71 billion for 2010, and $130 billion for 2011. Under Representative Pomeroy's approach, funding payments would be $41 billion in 2009, $79 billion in 2010, and $121 billion in 2011. Under Representative Boehner's bill, funding payments would be $10 billion in 2009, $71 billion in 2010, and $125 billion in 2011. Over the three years, Representative Boehner's bill gives the most relief, but the overall approach in all three bills of increasing the requirements over time is reasonable. I should note that these estimates are based on a particular assumed set of future asset returns and interest rates; with more time, we could produce estimates for a few other sets to determine sensitivity to different economic conditions.

As a simple suggestion, in the spirit of all three bills, but with the intent to give more relief, a cap could be imposed on current law required funding payments of increasing percentages of the 2009 required contributions for the 2010 and 2011 plan years, respectively.

Because of its many features, we did not model all of the provisions of Representative Pomeroy's draft discussion bill. For example, his bill would offer employers an alternative amortization approach of funding recent shortfalls over 15 years, a good idea. But the maintenance of effort provisions contained in the bill represent a tricky challenge to modelers because we do not know whether they would cause plan sponsors to pass on the funding relief to avoid the burdens and intrusions of the retirement plan benefit requirements. More fundamentally, it is an open question whether the twin purposes of temporary economic relief for plan sponsors and governmental support of defined benefit plans are well-served by the maintenance of effort provisions.

If other than temporary narrowly drawn provisions are to be considered now, a supportive stance to consider to encourage full and ample funding for defined benefit plans in the long run and to discourage freezes and closes would be to reform the punitive asset reversion tax, with due protections for plan participants and the PBGC, as I have proposed and modeled elsewhere.[2] In a more administrative vein, it would help policymakers and budget experts if the PBGC's financial statements and projections used the law's corporate bond market yield curve in valuing pension liabilities rather than a survey of group annuity prices that cannot be audited.

In closing, we believe that further legislative relief for single-employer defined benefit pension plans is good economic and retirement plan policy. In particular, we want to emphasize that funding relief is not just a pension issue, but with cash flows still tight and borrowing difficult, for many plan sponsors it is a matter of jobs and even survival.

I would be happy to answer your questions. On behalf of Watson Wyatt Worldwide, I also offer our technical assistance to the Committee if you decide to pursue funding relief. In that regard, the Committee acting quickly and positively to this important issue on a bipartisan basis would send the most positive signal to the plan sponsor community.

Attachment: An article forthcoming in the Watson Wyatt Worldwide *Insider newsletter.*

Funding for DB Pension Plans in 2010 and 2011 Under Relief Proposals

While recent legislative and regulatory measures have given defined benefit (DB) plan sponsors some funding relief for 2009, required contributions for 2010 and 2011 have loomed large.[3] In this analysis, Watson Wyatt projects funded status and required contributions for single-employer DB plans using an updated version of its comprehensive and realistic model of plan funding.[4] It considers five scenarios: (1) the law prior to Sept. 24, 2009, including the Pension Protection Act of 2006 (PPA), the Worker, Retiree and Employer Recovery Act of 2008 (WRERA) and the March 2009 IRS guidance; (2) current law, including the IRS guidance released on Sept. 25, 2009; (3) House Education and Labor Committee bill (H.R. 2989) introduced in June 2009; (4) the main provisions of Representative Earl Pomeroy's (D–N.D.) discussion draft released in August 2009; and (5) House Minority Leader John Boehner's (R–Ohio) bill (H.R. 2021) introduced in April 2009.

Our results indicate that the most recent IRS guidance eases the DB funding schedule through 2010. The legislative relief proposals further lighten the DB funding schedule and extend it into 2011, freeing up financial resources—currently in short supply generally—for other corporate purposes, including jobs and investment in plant and equipment.

Relief proposals

Figure 1 summarizes the major provisions in current law and the relief proposals. The Sept. 25 IRS Employee Plans News confirms that "the final regulations will provide automatic approval for a new choice of interest rates for the first plan year beginning in 2010.[5] Two of the relief proposals also provide this relief. Sponsors that have the option of electing a liability valuation method will likely switch from mark-to-market methods to smoothed-value methods for 2010—the latter approaches are more advantageous for 2010 and 2011 plan years under the normal economic and financial conditions assumed.[6]

All three legislative proposals include a "2+7" rule, which allows sponsors to make up any 2009 and 2010 shortfalls with interest-only payments in the first two years, followed by normal seven-year amortization of the shortfall amount. Representative Pomeroy's discussion draft additionally mandates that contributions for 2009, 2010 and 2011 must exceed 2008 minimum contributions by specified percentages increasing over time. A wider asset smoothing corridor in the proposals from Representatives Pomeroy and Boehner would make the smoothing method more attractive for asset valuation and cushion market losses.

[2] See Gaobo Pang and Mark Warshawsky, "Reform of the tax on reversions of excess pension assets," *Journal of Pension Economics and Finance,* 2009, 8(1), pp. 107–30.

[3] See "New Relief From IRS Reduces Required DB Plan Contributions for 2009, but Large Increase Looms for 2010," *Watson Wyatt Insider,* 19(4), 1–3, April 2009.

[4] For details of the original model, see "The Future of DB Plan Funding Under PPA, Recovery Act and Relief Proposals," *Watson Wyatt Insider,* 19(1), 1–6, January 2009.

[5] Employee Plans News, Special Edition, IRS, Sept. 25, 2009.

[6] See the Appendix.

Figure 1: Summary of funding relief proposals

	Law prior to Sept. 24, 2009	Current law as of Sept. 25, 2009	Education and Labor Committee bill	Rep. Pomeroy's discussion draft	Rep. Boehner's bill
Amortization relief	Generally 7-year amortization	Generally 7-year amortization	2+7 rule: interest-only for 2 years, then 7-year amortization of the 2009 and 2010 shortfalls	2+7 rule; additionally, the minimum contributions for 2009, 2010 and 2011 must be at least 105%, 110% and 115% of 2008 minimum contributions, respectively	2+7 rule
Asset smoothing corridor	10%	10%	Current law	20% for 2009 and 2010	20% for 2009 and 2010
Interest rate elections	IRS allowed changes in 2009. The rule for 2010 was unknown prior to Sept. 24, and "not allowed" is modeled here	Allow a switch from spot yield curve for 2009 to segment rates for 2010	Proposed to allow a switch from spot yield curve for 2009 to segment rates for 2010; current law in effect	Proposed to allow a switch from spot yield curve for 2009 to segment rates for 2010; current law in effect	Not addressed; current law in effect

Note: Representative Pomeroy's discussion draft allows plan sponsors to choose between applying the 2+7 rule and amortizing the shortfalls over 15 years under various conditions. The latter is not modeled here. The draft also includes various "maintenance of effort" plan requirements, opposed by the employer community.

Source: Watson Wyatt summary and assumptions.

Funding model results

Average regulatory funded status is projected to decline from 96.4 percent in 2008 to 93.8 percent in 2009 (see **Figure 2**).[7] The modest decline, despite horrific investment losses, is attributable to the asset value smoothing provided under WRERA and use of the most favorable spot rate for liability valuation allowed by the March 2009 issue of the IRS's Employee Plans News (the composite corporate bond rate, CCBR, which is used as a proxy for spot yield curve, peaked in October 2008). Without the Sept. 25, 2009, IRS guidance allowing interest rate election, average funded status, however, would have plummeted to about 78 percent in 2010 and to 77 percent in 2011, thereby driving required contributions up to roughly $121 billion in 2010 and to $145 billion in 2011. Moreover, some sponsors would contribute more to avoid benefit restrictions at the 80 percent funded threshold—the model conservatively projects another $7 billion and $12 billion extra contributions for 2010 and 2011, respectively.

The IRS's automatic approval of interest rate elections in 2010 is projected to boost average funded status to nearly 84 percent in 2010 and 77 percent in 2011. This scenario lowers required contributions to $89 billion for the 2010 plan year but requires $147 billion of contributions for 2011.

The Education and Labor Committee bill would increase measured funded status in 2009, reduce required contributions in 2009 and 2010, and postpone a large part of the funding obligations to 2011. Compared with the Sept. 25 IRS guidance, the two-year interest-only rule here provides further funding relief in terms of lower contributions for the 2009–2011 plan years.

Representative Pomeroy's discussion draft would afford the biggest gains in funded status for 2009 and 2010, both because the draft permits a wider asset smoothing corridor and because contributions for new plan years must exceed 2008 minimum contributions by certain margins. Note that contributions in 2009 exceed current law requirements. In this scenario, contributions for 2009–2011 jump from roughly $41 billion to $121 billion, the funded status of nearly 77 percent in 2011 remains

[7] The Appendix gives a brief description of the methodology and assumptions.

close to the level produced by current law, and fewer plans face the 80 percent funding threshold for benefit restrictions.

Representative Boehner's bill provides the greatest funding relief for 2009—total contributions would be only around $10 billion. In later years, the bill results in higher contributions and funded status similar to the other legislative proposals.

Note that the interest rate elections and/or the proposed wider asset corridors reduce the shortfalls recognized for 2009 and 2010 plan years. This in turn would make the amortization payment significantly smaller than otherwise in 2011 when the 2+7 rule reached its seven-year amortization component for these specific shortfalls.

Figure 2: Measured funded status and contributions under current law and proposals

	Plan year	Law prior to Sept. 24, 2009	Current law as of Sept. 25, 2009	Education and Labor Committee bill	Rep. Pomeroy's discussion draft	Rep. Boehner's bill
Average measured	2007	95.9	95.9	95.9	95.9	95.9
funded status (%)	2008	96.4	96.4	96.4	96.4	96.4
	2009	93.8	93.8	93.8	102.3	102.3
	2010	77.7	83.8	83.7	84.5	82.5
	2011	77.4	76.8	75.7	77.1	74.5
Contributions	2007	53.1	53.1	53.1	53.1	53.1
($b)	2008	37.9	37.9	37.9	37.9	37.9
	2009	32.4	32.4	30.4	40.8	10.4
	2010	120.5	89.0	70.9	79.0	71.4
	2011	145.2	146.5	130.0	120.8	124.9
Extra contributions						
($b)	2008	0.5	0.5	0.5	0.5	0.5
	2009	0.9	0.9	0.9	0.2	0.2
	2010	7.0	3.1	3.4	4.0	7.5
	2011	11.7	11.6	4.2	6.7	3.9

Notes: Contributions are the minimum required by law. Extra contributions by certain plans are to avoid benefit restrictions at the 80 percent funded status level.
Source: Watson Wyatt calculations.

These results indicate that the funding relief in the September 2009 IRS guidance enables DB plan sponsors to avoid burdensome contribution obligations for 2010. The 2011 funding obligations, however, remain large. These obligations could divert financial resources that companies would otherwise spend on hiring workers—or continuing to employ them—and on increasing their compensation and paying for other benefits,[8] thus escalating the risk of a jobless economic recovery. The funding relief proposals would further alter the schedule and magnitude of DB contributions, in varying patterns. Like past relief actions, further relief would signify bipartisan congressional and administration support for keeping DB plans viable for American workers and employers.

Appendix: Methodology and assumptions

We use a comprehensive model to simulate the dynamics of DB plans. The model codes in the shortfall amortization schedules of the PPA, the provisions of WRERA and IRS guidance. It uses 2007 initial funded status, 2007 aggregate liabilities of

[8] One criticism of our model has been that, in the absence of data and plan-specific information, credit balances are ignored. Market value declines, past use and forfeitures (both voluntary and required) have likely significantly reduced credit balances outstanding. Moreover, from the perspective of employers making job decisions, credit balances are largely as valuable as cash, so reducing credit balances should have essentially the same economic impact as making cash contributions.

$1.857 trillion, matrices of asset allocations by funded status and plan size for 2007–2009 as data allows, and market conditions as of Sept. 15, 2009. This analysis assumes that by the end of 2011, market interest rates will have reached year-end 2007 levels. The data sources include the IRS, Form 5500 and Global Financial Data. Average returns for equity and bond assets in 2010 and 2011 are based on the forward-looking projections of Watson Wyatt Investment Consulting (WWIC), which incorporates higher market volatilities in the near term and assumes a gradual convergence to equilibrium over a five-year period. **Figure A–1** lists the basic economic and financial assumptions.

Figure A–1: Economic and financial assumptions at end of calendar year (%)

	2007	2008	2009	2010	2011
Equity return	5.5	–37.0	18.7	9.7	9.5
Bond return	5.2	1.8	15.5	4.4	4.3
CCBR	6.28	7.90	6.03	6.16	6.28
2nd segment rate	5.90	6.38	6.73	6.29	6.16
3rd segment rate	6.41	6.68	6.82	6.29	6.16

Notes:

1. The most favorable CCBR (as a proxy for spot yield curve) for the 2009 plan year was 7.90 percent in October 2008, while December 2008 had the highest segment rates.
2. CCBR and segment rates for 2009 are as of August and September 2009, respectively. The end-of-2011 CCBR is set to the year-end 2007 level, the 2nd and 3rd segment rates (assumed to be equal in 2010 and 2011) are correspondingly calculated as 24-month moving averages.
3. Asset returns for 2009 are based on S&P500 and Dow Jones corporate bonds total return indexes as of Sept. 15, 2009. Annual equity and bond returns for 2010 and 2011 are based on WWIC forward-looking (July 2009) projections. Monthly returns are log-linearly interpolated.

Source: Watson Wyatt calculations and assumptions.

Mr. NEAL. I would now like to recognize Chairman Rangel.

Chairman RANGEL. Before I turn the panel back over to you, I would like to ask Mr. Nuti if he would describe the expected size of your company's expected minimum contribution for the 2009 plan year and the 2010 plan year. How do these minimum contributions vary from your company's contribution in 2008 and earlier years?

Mr. NUTI. The best way to think about this, Chairman Rangel, is over the next—NCR is approximately $1 billion underfunded today, based on the market downturn, the third worst market downturn in the last nearly 100 years that we have suffered over the last 12 months. That $1 billion, if you just used straight-line amortization, would be approximately $150 million a year of additional cash we would need to use to fund the plan over that time period. That breaks down for us, using the simple math I used before at $50,000 per employee, to about 3,000 employees that we may need to lay off as a result of that issue alone. So that gives you a sense of the magnitude.

And if you looked at the other companies in the ABC that we are talking about, some are significantly larger and have even larger burdens than our own significant burden I just discussed.

Chairman RANGEL. Thank you.

Mr. Neal.

Mr. NEAL. Thank you very much, Mr. Rangel.

The Chair would now recognize Mr. Camp from Michigan.

Mr. CAMP. Thank you very much. I appreciate that.

Mr. Warshawsky, as we think about relief for defined benefit plans, obviously balancing the competing interests we have heard other people mention today—workers, retirees, employers and taxpayers—we need to make sure pension plans are fully funded so workers can be confident they get the benefits they are entitled to, and we need to protect the financial health of the PBGC; but at the same time, with this lingering recession and the credit crisis, declining stock prices and other items, it is appropriate to provide some temporary relief from the stricter funding rules Congress enacted in 2006.

How can Congress best strike this balance?

Mr. WARSHAWSKY. Mr. Camp, I believe the best way of striking a balance is to give temporary relief in the context of the preservation of PPA. I think that is the right balance in terms of the competing interests which you correctly noted.

Mr. CAMP. So your view is that, given that some relief should be necessary, that it makes more sense to provide temporary relief from those 2006 rules as opposed to permanently changing the rules themselves?

Mr. WARSHAWSKY. Yes. And I would note that we probably will need more relief—some of the bills indicate the relief as applied to the 2009 and 2010 plan years, but unfortunately the depth of the problem indicates that it might be necessary to include the 2011 plan year as well.

Mr. CAMP. Last Friday, the Treasury Department announced that it will be providing guidance regarding interest rates that plans may use going forward. Can you discuss the significance of the Treasury's announcement on plan funding requirements?

Mr. WARSHAWSKY. The Treasury has been very helpful in this area, both earlier in the year in March, and recently. In particular, it relates to the use of interest rates that are used to measure liabilities for plans. And both for 2009 and 2010, they provided flexibility within the context of PPA and within the context of the regulations, which have a major impact in reducing 2009 contributions.

Mr. CAMP. Smoothing allows plans to deal with unusually large declines in asset values by adjusting those values in a particular range. Can you describe for the committee in laymen's terms how each of the major proposals—Boehner, Miller and Pomeroy—deal with that issue of smoothing and the merits of each approach?

Mr. WARSHAWSKY. That is a tall order to describe in laymen's terms. Maybe the one way of approaching it is there are different technical aspects of each of the bills. In both Representative Boehner's bill and Representative Pomeroy's bill, if my memory serves me correct, one way in which they accomplish the temporary relief is by allowing a wider corridor of asset smoothing for the losses in 2009 and 2010. There are a lot of ways of accomplishing that. I would almost characterize those as technical matters. I think the important thing is that there be the relief, and that it be temporary. And there are a lot of ways of accomplishing that.

Mr. CAMP. Are you familiar with the Miller bill on that issue?

Mr. WARSHAWSKY. The Miller bill does not expand the asset smoothing corridor.

Mr. CAMP. All right. Thank you very much.

Mr. NEAL. Thank you, Mr. Camp.

Mr. Warshawsky, let me drill down a bit with you on some of the assumptions that you discuss in your study. If we were sitting here 2 years ago, I presume that your assumptions would have been very different than the assumptions you would offer today for the next 2 years. Do you want to talk a little bit about the assumptions in your study for the next couple of years?

Mr. WARSHAWSKY. We used the assumptions that Watson Wyatt uses for its investment advice. For 2009, basically we assume market advance through September 15, and no further advance through the remainder of the year. And then for 2010 and 2011, we assume about an 8 to 9 percent positive return. So not gangbuster returns, but neither a decline, sort of a middle-of-the-road approach. And on interest rates, we assumed a gradual decline in interest rates that are used to value liabilities as conditions, as the economy settles down.

So those are middle-of-the-road assumptions. I think it would be very valuable, if you have an interest, to do a little bit of sensitivity testing of the model, and we could easily do that.

Mr. NEAL. How does this compare to assumptions that have been made in the past, considering this atmosphere?

Mr. WARSHAWSKY. I think these are very standard assumptions and would have been made in the past as well.

Mr. NEAL. Mr. Rosenthal, you have indicated in your testimony that the IRS relief provided earlier this year has been fairly helpful. I understand that businesses have flexibility in selecting the relevant discount rate which can impact the present value of their liabilities.

Does that mean that the true financial picture of private pension plans in the United States could be worse than your testimony has suggested?

Mr. ROSENTHAL. The IRS relief allowed companies to look back to interest rates that were in effect in October 2008, which are substantially higher and, therefore, derived lower liabilities than interest rates in effect at the beginning of 2009. So that lookback, while very helpful for plans, did reduce plan liabilities by approximately 10 to 20 percent, based on our study.

Mr. NEAL. Let me recognize the gentleman from Michigan, Mr. Levin, to inquire.

Mr. LEVIN. Thank you very much.

You know, as we read the materials, and now hearing your testimony, it did bring back some memories of our debate of a few years ago, and it involved real technical issues. I think the bottom line—and some of us objected to parts of the legislation as being too stringent.

I take it from the testimony of most, if not all of you, it is turning out that in retrospect, what was written then is not working now. And there is a serious problem facing these pension plans.

Mr. Warshawsky, when I read your testimony, I kind of came to that conclusion. You essentially said what was done a few years ago was better than what was replaced, but we face a basic issue today. And I think all of you agree we have to do something; is that right? Does anybody think we should do nothing? I know there is disagreement as to under what conditions, but I think all of you agree we need to act; is that true? When you nod—yes. So in other words, what was done several years ago isn't meeting the requirements of today.

But none of the bills, at least what we have before us, doesn't make a basic change in the structure. Mr. Pomeroy's bill, which is still in the process of being worked out, I think more effectively addresses some of these issues. So the difference of opinion, I think, is under what conditions this relief for these years should be provided; is that correct? And we then get into the important issue as to what should be done with plans that have frozen benefits, reduced benefits, or frozen out people from being covered; is that true?

So to try to boil this down in this important but somewhat technical area, what we are facing is not whether, but how much and under what conditions. I have just a couple minutes.

Mr. Stein, you take the position that there are conditions that should apply here, right, relating to frozen plans?

Mr. STEIN. Yes.

Mr. LEVIN. And that is where your disagreement is.

Mr. Silvers, you talked about some of the basic issues, so spend a couple minutes telling us what you think the disagreements are in terms of what we do right now, not redoing this. And I think the administration is taking some time because it faces this dilemma of a bill that is not adequate for yesterday, today, and near tomorrow, right? So they are trying to wrestle with this.

So, Mr. Silvers, in the minute or two I have, why don't you—because I think you talk about something a little more basic.

Mr. SILVERS. Yes. Congressman, I think there are two longer-term agendas, and then there is the immediate. And you asked what the disagreement was here. I think that the disagreement is whether or not we ought to craft the relief not just to prevent a catastrophe immediately, but to ensure the continued health of the actual provision of benefits to employees. The business community would like the relief to be unconditional to any plan, regardless of whether the plan continues to be a living plan.

I think the position of the advocates here for American workers and for pension participants is that we should not be giving relief to companies who are essentially withdrawing from, retreating from the obligation to provide retirement security to their employees. That is the disagreement.

Now, more longer term, I think there is a disagreement about whether or not there needs to be ongoing change to the Pension Protection Act.

And finally, I am sure there would be a disagreement, if we got into it, as to whether or not employers really ought to be responsible, in part, for the retirement security of their employees.

Mr. LEVIN. I hope there would not be much disagreement about that. We have enough to disagree about.

My time is up, so I think it would be helpful, as we proceed, that we try to flesh out where we are and what the issues are in terms of immediate action so that we can act. Since all of you agree we need to act, we need to act.

The administration, I think, Mr. Chairman, is going to come to forth with some recommendations in the near future. Thank you.

Mr. NEAL. [Presiding.] Thank you, Mr. Levin.

Consistent with that suggestion, this committee has received a letter signed by almost 200 companies and trade organizations representing employers, asking for immediate relief on the pension funding issue.

I would like to enter it into the record at this point—without objection—and ask that the staff continue to distribute a copy to the Members of the Committee.

With that, I would like to recognize the gentleman from California, Mr. Herger, to inquire.

Mr. HERGER. Thank you very much, Mr. Chairman.

[The information follows:]

******** COMMITTEE INSERT ********

Mr. HERGER. Mr. Warshawsky, some have proposed that additional funding relief be conditioned on employers accepting a maintenance of effort obligation or certain limitations on executive compensation. I understand that employer groups view additional funding relief as absolutely imperative, so much so that some of them are willing to accept these kinds of conditions in exchange for this relief.

Is it possible that some employers might be unwilling to accept relief tied to these kinds of conditions, effectively limiting the breadth of relief that Congress is considering?

Are you concerned that linking these kinds of conditions to funding relief for the first time may set a precedent for the future, possibly undermining the voluntary nature of employer-sponsored retirement plans?

Mr. WARSHAWSKY. Mr. Herger, I am concerned on both counts.

First of all, the maintenance of efforts and provisions do undercut the economic relief that funding relief represents because $146 billion for 2011 is a massive number, and would have very bad implications for the broad economy.

When we talk about relief, you know, in general terms—certainly the stimulus package earlier in the year—generally, we do not do a lot of conditioning because we are interested in the economic impact, and if that is the main purpose here, which I believe it should be, there really should not be a lot of conditioning.

The second point relates to more of a pension policy issue, which, of course, takes time to consider, and it therefore, in and of itself, I think, delays the immediacy of what relief is needed. I think the quicker we act on this, the stronger signal it sends, and therefore, doing a lot of conditioning, leads to unnecessary delays, and it also represents a very significant policy change.

Mr. HERGER. Again, Mr. Warshawsky, I believe that, as we consider defined benefit funding relief, we need to carefully balance a number of competing interests—those of workers, retirees, employers, and taxpayers.

On the one hand, it is important for Congress to ensure that pension plans are fully funded so that workers and retirees can be confident that they will receive their promised retirement benefits. It is also important to protect the financial health of the PBGC, which ensures private pension plans, to avoid a situation where American taxpayers are forced to bail out the PBGC.

At the same time, given the lingering recession, the ongoing credit crisis and a decline in stock prices as compared to pre-recession levels, it may be appropriate to provide employers some temporary relief from the stricter funding rules Congress enacted in 2006.

Can you, please, share your thoughts about how Congress should strike this balance?

Mr. WARSHAWSKY. Mr. Herger, as I said in my testimony, I think the problem here is the matter of timing, that the onset of PPA and the somewhat stricter regime that it represented came exactly at the time that the stock market declined in almost an unprecedented manner, not just the level but the rapidity of it, and therefore, the temporary relief is necessary.

Even with as large a decline as what we saw, if we had had more years in the development of response to PPA, either in terms of investment changes or a development of funding cushions by employers, we would have been in a much better position to deal with this event.

Mr. HERGER. I thank you.

Thank you, Mr. Chairman.

Mr. NEAL. Thank you, Mr. Herger.

The gentleman from Georgia, Mr. Lewis, is recognized to inquire.

Mr. LEWIS. Thank you very much, Mr. Chairman.

Mr. Chairman, I want to thank you for holding this hearing today on this very important issue.

I want to thank all of the members of this panel for being present and for your contribution. We all know and understand that one of the main reasons companies offer pension plans is to stay competitive and to attract employees, but for many employers, it is more than just the business reasons.

Can you tell us more about the moral obligation of an employer to offer retirement benefits to their workers?

Any of you may respond.

Ms. MAZO. Mr. Chairman, I would like to talk a little bit from the perspective of the multi-employer community that I am representing and, first of all, take the time to just point out that the issues that we are raising about funding and the temporary assistance that we are asking for is quite different than what the community needs.

In part, that is because PPA was, in some ways, more adaptable for the multi-employer plans than it was for the plans, but the multi-employer plans represent a commitment by the employers and the unions that represent the workers. They are part of a package. Typically, they are part of a package that includes health benefits and retirement benefits and sometimes other benefits where, because these promises are being made by everybody in the industry, they do represent a moral commitment by the entire industry to take care of the people who have been generating the wealth within that industry.

These groups are remaining committed to defined benefit plans, committed to ongoing defined benefit—not to freezing the plans if they can possibly afford not to—and committed to keeping the employers viable to avoid not having plans and their pension and health commitments be so strenuous that they strangle the employers who are the lifeblood of the industry, the jobs and the future of the workers who are covered by the plans.

Mr. LEWIS. Yes, sir.

Mr. SILVERS. Congressman Lewis, first, let me just say that it is an honor to discuss moral issues with you, sir, and that my written testimony goes into this issue in some detail.

We inherited in the postwar world a pension system that provided coverage through defined benefit plans that leveraged an employer's capacity to be able to manage money expertly, and that involved substantial employer contributions. We had defined benefit pension funds covering 50 percent of the American workforce. Since 1980, that number in the private sector has declined to under 20 percent.

The consequence of that decline has been the wholesale deterioration of retirement security for American workers such that the typical defined contribution balance for families in their 50s is around $60,000. It was that before the collapse of 2008. That represents a societal moral failing.

We are here today—and the substance of the disagreement that exists between the employee advocates and the employers here is a disagreement about whether or not there is a moral obligation on the part of the Congress to ensure that, in the course of providing the relief, we bolster pension plans that can actually provide retirement security or whether we essentially provide relief to employers who are running away from that moral obligation. That is the fundamental issue facing the Congress.

Mr. LEWIS. Thank you.

Mr. NUTI. Congressman Lewis, I will be short, but I want to be clear as well with you with regard to how we at NCR and, candidly, the members of the American Benefits Council view pensions. We view them as a moral obligation and very important.

Over the last 10 years, my company has paid benefits of $1.5 billion into our pension plan, and we were fully funded as of the 1st of January 2008. The Pomeroy bill also holds us accountable to fully funding that plan on schedule and on time and maintaining our commitments to our employees—our pensioners—and that moral obligation.

The 2 and 7 method that is being recommended—what it does is recognizes that, over the past year to a year and a half, there has been an incredible event in the marketplace that has occurred and with respect to the global economic crisis and the impact it has had on our return on assets and on our pension portfolios, and it allows us simply to recover but does not allow us to disregard our commitment in that same time period to fully funding the pension plan, which we intend to do and which all of the members of our council intend to do.

Mr. LEWIS. Thank you very much.

Mr. NEAL. Thank you, Mr. Lewis.

Let me advise our members and witnesses that we have three votes on the House floor. The committee will recess until after the last vote, and I think that we can speed this up so that we can resume testimony very quickly.

[Recess.]

Mr. NEAL. With that, the gentleman from Texas, Mr. Johnson, is recognized to inquire.

Mr. JOHNSON. Thank you, Mr. Chairman.

Mr. Rosenthal, are you ready?

Mr. ROSENTHAL. I am, sir. I will even turn the microphone on.

Mr. JOHNSON. In your testimony, you claim many "defined benefit plans are going to face significant higher required contributions in 2010." Absent any legislative relief, would you know what percentage would be able to meet their requirements in 2010?

Mr. ROSENTHAL. That I do not know, sir. I do know that interest rates are well below where they were in October 2008, which will make liability significantly higher for plans come 2010.

Mr. JOHNSON. Okay. In your testimony, you contend ". . . many calendar year defined benefit plans are in a good position to meet their required contributions for 2009."

In terms of investment return and legislative and regulatory relief, what has helped these plans the most in being in a "good position"?

Mr. ROSENTHAL. Mostly the ability to use that October 2008 full yield curve where interest rates, in a sense, peaked in 2008 back in October. So the ability to look back, which came from the IRS guidance provided in March of this year, helped most of those plans.

Mr. JOHNSON. Notwithstanding the extra percentage we gave them?

Mr. ROSENTHAL. Of course.

Mr. JOHNSON. Yes. Thank you, sir.

Mr. Warshawsky, compared to defined benefit plans, you state defined contribution plans, such as 401(k)s, "did not perform so well in providing retirement security and peace of mind to retirees and workers" during the recent downturn.

With that in mind, do you have any suggestions or ideas in terms of what can be done to provide a more secure retirement for workers who have defined contribution plans as their primary retirement vehicle?

Mr. WARSHAWSKY. Mr. Johnson, I think there are a number of elements that can be put together that would make defined contribution plans more effective.

One is the steady stream of contributions over a worker's life. I think that is an important element. Certainly, an important aspect is the investment strategies that workers use, and also, as workers approach retirement, they need to consider that that money that they have accumulated is not just a lump sum, but is something that they will then need to support them in retirement as an income flow.

So, although, you know, a lot of people have talked about annuitization, I think it is a little more sophisticated than that. Basically, they need help in getting strategies for distributing assets in a regular and steady way into their retirement.

So those are elements of a package, which need to be added to defined contribution plans, which a lot of plans do not have right now.

Mr. JOHNSON. Well, that kind of leads into our next deal; but investment advice, in your opinion then, is important?

Mr. WARSHAWSKY. Well, I think there are a lot of elements—both the investment advice and also the products and services that are offered to both the participants and the plan sponsors.

Mr. JOHNSON. Thank you.

Thank you, Mr. Chairman.

Mr. NEAL. Thank you, Mr. Johnson.

The Chair will recognize the gentleman from North Dakota, Mr. Pomeroy, to inquire.

Mr. POMEROY. Mr. Chairman, thank you.

I want to begin by saying how much I am enjoying this hearing. I believe that the issue of pensions is urgently important, and I just think the panel has been terrific relative to bringing important information about the need for funding relief to our Ways and Means Committee.

I want to begin, I think, with Mr. Nuti. Am I pronouncing that correctly? I want to thank you for being here. Often we have the HR department's representative or some other department's representative, but to have the CEO of a global company come to talk about the importance of pension funding issues relative to employment ramifications across your firm or across the marketplace is extremely valuable information, and because it has been a while since your initial testimony, I would like to get you back to essentially what you have already covered so well, but let's emphasize it some more.

This is a jobs issue, Mr. Nuti, is it not?

Mr. NUTI. It is, indeed. It is a very serious jobs issue, and I think it is important that we understand the implications of your decisions relative to jobs.

The reality is—and I said this before—if we do not move forward with pension reform, we and hundreds of other companies are going to have to cut jobs. Let me be very clear on that. There is no other way for us to cover the cost of providing the pension benefits we will need to, which, by the way—I want to be clear on this—will be amortized over, you know, 30 years.

So the money we are putting into a pension today or next year or the year after is to pay benefits over a 30-year period while, now, we sit here today, making a very critical decision on this, knowing full well, with the stimulus ending in 2010, coming to a halt, at a time when jobs will be a much more important issue to our country.

We have a very uncertain economy we are still navigating, and that all of our CEOs are navigating through. This has to be of paramount concern to you because you will see jobs eliminated, and you will see investment eliminated in this country, which impacts our competitiveness, U.S. competitiveness, in the marketplace.

Mr. POMEROY. Importantly, right across the panel, there seems to be agreement that some funding relief is appropriate. We have got different ways of doing it. Some would revise a bit the provisions of the Pension Protection Act. Some would give temporary relief. There seems to be agreement across the panel that some relief is appropriate.

Mr. Warshawsky, you have spoken to that very clearly. I want my friends on the other side of the dais to hear you clearly. Some pension funding relief is appropriate under these extraordinary circumstances; is that correct?

Mr. WARSHAWSKY. Yes, Mr. Pomeroy, because of the extraordinary circumstances in asset markets.

Mr. POMEROY. Thank you. We have to take that agreement and really internalize it. We have got some work to do as a committee. Jobs and retirement security are at stake.

For purposes of argument now—we do not see the world entirely similarly—Mr. Warshawsky would have temporary relief. That is better than nothing; but I believe the prospect is, if you do temporary relief, well, maybe you have to do temporary relief again, and maybe you have to do temporary relief again; and pretty soon you have got companies that face extraordinary funding exposure, and they do not know whether the temporary relief is going to come or not. They really need to know what the rules are on a permanent, going-forward basis.

Mr. Nuti, as a CEO, what is your comment on that?

Mr. NUTI. The predictability is critical to us. We must have it.

If I can just divert your attention to another important matter that is similar in scope, it is the issue of—because I think this is on the table—whether or not you do this for companies who have a defined benefits program in place today, or for one who has been frozen, and I think, to make that choice is a difficult one.

First of all, I do not think that would be prudent in terms of your decision, because the impact it would have on the supply chain on an overall basis would be massive. To penalize those companies who have frozen defined benefit plans penalizes those employees, those companies and those companies' supply chains. Let me give you an example:

If you chose, as an example, to not give pension relief to a company who has frozen their defined benefits plan as a retailer, let's remember that retailer also buys clothing, garments and general merchandise from a supply chain. They also have truckers working for them who truck this supply around the world. They have employees who work for the company who will be greatly impacted, and there are hundreds of companies who have chosen this as a method to control costs, particularly at a time when this economy is so uncertain and has damaged our companies.

Let's not forget that, while profits over the course of the last few quarters have improved, they have improved based on cost-cutting, not based on growth. Further cost-cutting would only damage this economy further, in my view, and that is exactly where we are headed if pension reform is not passed.

Mr. POMEROY. If I hear you correctly, with credit remaining tight, if you take cash out of a business to fund under an extraordinarily conservative funding regimen, the pension plan, there are consequences——

Mr. NUTI. Huge.

Mr. POMEROY [continuing]. The investment in a business, the layoff of the existing workforce, and that occurs relative to whether the plan is still present or whether the plan is frozen. Now, I did notice that, even though you indicated you would have to freeze your plan at NCR, as you took that step, you also froze the accruals for the exempt plan, for the executive suites plan.

Mr. NUTI. That is correct, we did. We froze our senior executive retirement plans at the same time.

Mr. POMEROY. Another area—and I know my time is up, Mr. Chairman. I will just conclude with this statement, and we can ponder this in the future—is whether or not some maintenance of effort provisions would be appropriate.

I would think that NCR, representing best practices, set out in their executive suite: what our employees live with, the executive suite lives with, and I think that is just matter of fundamental fairness.

Thank you, Mr. Chairman. I yield back.

Mr. NEAL. We thank the gentleman for his many years of good work on this issue. As I told him earlier this morning, Congressman Pomeroy is the only Member of Congress I know who can excite a crowd of actuaries.

With that, I would like to recognize the gentlelady from Florida, Ms. Ginny Brown-Waite.

Ms. BROWN–WAITE. Thank you very much.

First of all, Mr. Nuti, I want to thank you. It was very refreshing to hear you start off your statement by saying you are not here for a bailout. That was very, very refreshing. Believe me, having served on the Financial Services Committee prior to Ways and Means, it was like, oh, yes, I have not heard that in the 6 years I served on Financial Services.

I appreciate each and every one of you who came here today to testify. I do have a question, however, for Ms. Mazo.

By the way, Ms. Mazo, I find, when there is a group of males testifying, the female very seldom gets asked any questions, so I am going to ask you a question.

At a May 2007 Education and Labor hearing, you stated that a major achievement of the PPA was the recognition of the special context—and I am going to read this because I do not want to misquote you. Believe me, everyone sitting up here and probably those of you testifying have been misquoted in your lifetimes.

You said: The major achievement of the PPA was the recognition of the special context of multi-employer plans and accommodating the collectively bargained framework in which the plans operate. The distinctive funding rules that were established by PPA will, we think, allow our plans to flourish. That is the end of your quote.

Well, we all know that the economy has changed a whole lot since May of 2007; but could you provide any additional insight as to why multi-employer plans continue to struggle rather than flourish even as compared to single-employer DV plans that are facing the same, very tough economy.

Ms. MAZO. Thank you, ma'am. It is a pleasure, with the committee largely full of men, to have a question from a woman.

The answer is very simple. The money that they thought would be there is not there because it disappeared somewhere in the market. Nobody can flourish when they have lost 20 percent of their assets. Nobody who is made up of just being a big fund full of invested money to be paid out to people in the future can survive—can flourish readily by losing that amount of money.

The one thing that was really insightful, as I said—and I completely believe this, and I think I emphasized it here, too was recognizing the special collectively bargained context for the multi-employer plans was crucial. We are hearing how fundamental it is for single-employer plans, whether the plan year begins or ends in time to take advantage of interest rates in October, a 1-month's difference or a 3-months' difference could make all the difference in terms of what the cost could be for a company.

What PPA did for multi-employer plans was, to a very great extent, allow them to avoid that sort of, if you will pardon the expression, arbitrary and abrupt, sudden and volatile demand for funding so that they could negotiate out, work out the needs for benefits and the needs for assets. One of the things PPA does for multi-employer plans if they are in serious trouble is it allows them to cut benefits more deeply than they would ever be allowed to before or they would under any other circumstances—to take away the vested benefit rights of people. That is something nobody wants to do if they can possibly avoid it, but they have that as a tool, too.

The problem was, in many plans which were working their way towards a, really, kind of hopeful solution, they designed very careful recovery plans based on assuming they would make, maybe, 6 or 7 percent per year, something conservative. All of a sudden, they lost 20 percent, and when you lose 20 percent and you have built a long-term plan assuming you are going to make 7, what you have lost is 27 percent that you have to make up. So it was basically they got knocked back on their heels. It was not PPA's fault.

What we are looking at now are some adaptations to PPA to give the plans the chance under this chain of circumstances to bring themselves back to soundness so that they can continue on that——

Ms. BROWN–WAITE. So is it because you have all of these differing years that you are working with and contracts as opposed to a single-employer type benefit?

Ms. MAZO. Thank you for helping me clarify that.

It is because the employers contribute what they have agreed to contribute in their bargaining agreement. They negotiate an amount. That is their deal.

One of the things PPA did was enable the employers in the union to live up to their deal otherwise, if there were a big crash, we could not live up to that. If employers who had built their business plan around a promise to the union to pay $2 an hour suddenly had somebody call up and say, Oh, it is going to have to be $40 an hour, even if they call up and say it is going to be $2.50, that is not the basis on which the employer made other contracts, built their business plans, made bids on contracts, et cetera. We are talking about small employers here.

I think, you know, in listening to the concern about jobs and to Mr. Nuti's explanation of how this translates in a very large company, something like in the construction trades that these plans cover, 80 percent or more of the employers have less than 15 employees. They would not lose jobs. They would not have to lay people off if the funding had to increase dramatically. They would just go out of business. So workers would lose their jobs. Owners would lose their jobs. Families would lose their businesses if they had to quickly adapt to the kind of dramatic changes that PPA lets us avoid. We are asking for a little bit more room, in light of what happened last year, to work through.

Ms. BROWN–WAITE. So, just as a follow-up question, Mr. Chairman, even if Congress does decide to grant the very substantial and somewhat unprecedented relief that the multis are requesting, does this crisis suggest that maybe the multi rules ought to be thoroughly reviewed as we move forward?

Ms. MAZO. Well, that was another, actually, very good thing that PPA recognized.

The answer is I think that the whole pension system deserves a very careful and thorough reexamination because I share the goals of a number of us here that we can find a way to keep the defined benefit system going. PPA calls on the Internal Revenue Service, PBGC and Labor Department to conduct a thorough study of the multi-employer funding rules, to report back to you all in 2012 and to impose discipline on Congress by making the multi-employer rules sunset in 2014. So I think they will get the thorough study that is worthwhile and that will develop useful information for all of us about what we really need to carry it forward.

Ms. BROWN–WAITE. Thank you.

Mr. NEAL. I thank the gentlelady.

The gentleman from North Carolina, Mr. Etheridge, is recognized to inquire.

Mr. ETHERIDGE. Thank you, Mr. Chairman.

Let me thank you for the hearing and our panelists for being here this morning.

I do not know if anything could be more timely given the current situation we find ourselves in in this economy and the nervousness that people have as it relates to not only their income but to their retirement income. Depending on their age, the intensity goes up, obviously, because they are closest to retirement. So let me follow up on a line of questioning—and I will just have one question—that Mr. Pomeroy touched on because I think it is critical.

We really are talking about a system that we want to keep healthy, but at the same time, we want to make sure that we have health in the business sector, because I bump into people every day. My neighbor is one. I just talked to him over the weekend. He is still working, but his hours have been cut back, which means his income has been cut back. It tells me that business has got the same problem.

If I understood you correctly—and I think I understand the bill Mr. Pomeroy has in—this is a temporary fix to a long-term problem; is that correct?

Mr. NUTI. That is correct. Think about it as a time-out and not a bailout.

Mr. ETHERIDGE. I think that is important for folks to understand, that you are really asking not to be taken out of the game.

Mr. NUTI. Indeed.

Mr. ETHERIDGE. It is like you are playing a basketball game. You need just a little time to take a break——

Mr. NUTI. Indeed.

Mr. ETHERIDGE [continuing]. And then you are going to come back in, and we are going to have a full court press after that because we do need to make sure that these systems are healthy, that they are there for workers over the long run and that the business community is going to continue to do their part but that they need those revenues now to employ people and expand this economy and get it going.

Mr. NUTI. Congressman Etheridge, let me just give you a little more perspective because I think you have hit the nail right squarely on the head on the issue.

None of us want to find ourselves in a position where we are not obligating our pensions. We intend to fully fund our pensions in the same time frame we originally intended to fully fund them. The difference is, over the course of the first few years, given the unprecedented drop in the markets—and one other item we did not discuss, which was interest rates, which have a more material impact on our cash flows—and giving us time to adjust to the realities of what has happened in this unprecedented market downfall, and giving interest rates an opportunity to adjust, it allows us to, in effect, smooth somewhat that cash exposure we all have and to enhance the impact it has on our ability to fund new investments and, most importantly, to fund the creation of new jobs.

Mr. ETHERIDGE. Thank you. I think we all understand what you are doing is trying to take the spike out of it and do it over the long haul.

Thank you. I yield back, Mr. Chairman.

Mr. NEAL. I thank the gentleman.

The gentleman from Nevada, Mr. Heller, is recognized to inquire.

Mr. HELLER. Thank you, Mr. Chairman. I appreciate the opportunity for a few minutes to raise some questions.

I want to also thank all of the panelists for being here and for being patient as we run back and forth from the Capitol building. I want to raise a couple of questions. I will be brief.

Ms. Mazo, I have been just going through some of your testimony and through the comment that you made that, as an organization, you guys pressed for the multi-employer funding rules that were adopted under the PPA in 2006 because we know that benefit security rest on rules that demand responsible funding and discipline and promising benefits. I am sure you are aware of that.

Ms. MAZO. Yes, sir.

Mr. HELLER. Let's talk about green zone plans because you have some multi-employer pension plans like the Western Conference plan that is considered a green zone plan based on their asset to benefit ratios; whereas, there are other groups—and I believe it is the Central States or the Central Conference multi-employer pension plan that does not meet the criteria classification of a green zone plan.

Can you explain to us how one can be so successful while the others are not?

Ms. MAZO. Without going into specific plans, first of all, I appreciate—the changes that were made for multis in PPA were to create flags—a yellow flag, basically, and a red flag. If you are heading towards trouble, you are called endangered, or in the yellow zone, and you have to start doing certain things. If you head further into trouble, you are in the red zone—and this is based on Homeland Security—and you have to do more dramatic things.

I think, from what I understand about those two different plans, they have had different sorts of governance over the years, but the Central States fund had lost a much—again, I do not know as much about the Western Conference, but a large number of their employers have gone out of business. Of the ones that they started with in ERISA, from what I gather of their 70 largest employers in 1980, there is only one such company still left, and it was due, in part, to trucking deregulation, which also, of course, affected the trucking industry in the West as it did in the Midwest. I suspect it was largely due as well to the fact that they were in the Midwest, and they were serving the rust belt markets where the whole economy of the region was declining.

So, as Mr. Nuti said, the things to truck that come from the manufacturers—the auto manufacturers in Michigan and whatever—that the whole economy, I suspect in that area, just declined for their market. Central States built up a very large fund of assets, and during the 1990s—and I believe that certainly by around 2000, the Central States and the Western Conference were kind of alternating—in one year, one was the largest of the pension funds by assets. In another year, the other one was. They both had very large—$20 billion to $24 billion worth of assets.

The Central States investments are run by independent fiduciaries who are appointed by a court and overseen by a court. So, to the extent there is any difference in investment philosophy, I suppose we'd have to blame the Federal courts in Illinois; but as they lost employers and as they lost active workers, they needed—and they were very well-funded until just a few years ago, but like a number of multi-employer funds, not just them, they needed their earnings on their assets in order to pay benefits. They are like a giant retiree. Just as anybody who is no longer earning enough money but has a lot of savings put aside, they need that savings to live on. Then because they were so heavily dependent on their assets and their earnings, the big asset losses knocked them much harder, I gather, than the Western Conference. I do not know as much about Western Conference because, frankly, their fortunes over the past 15 years or so have not been as colorful, and so they haven't gotten quite as much attention.

Mr. HELLER. So was it the loss of participating groups in that region or was it the loss of assets and earning power?

Ms. MAZO. Well, the loss of participating groups in that region led to a severe dependence on investment earnings—we do not have employers to come up with the money if we have a hole, so we had better build up as much in terms of our assets and as much in terms of our earnings as we can because they have a very—I think they have—cannot say this for sure, but they have something like—now they have 70,000 active workers, and they may have 150,000 or 200,000 retirees. There is no way they can increase contributions on the employers left and the employees to make up the hole that they need from their investments.

I gather just—the Western Conference, among other things, services goods that are coming in from over the Pacific, and they just have had, I assume, other opportunities to replenish what is going on. I do not know that life is happy for them, but it is just not as stressful.

Mr. HELLER. Ms. Mazo, thank you.

I yield back.

Mr. NEAL. We thank the gentleman.

With the cooperation of the Members of the Committee and with our witnesses, given the fact that there are three votes coming up on the House floor, we can send this panel on their way after recognizing Mr. Meek and Ms. Sánchez for testimony.

Mr. Meek is recognized to inquire.

Mr. MEEK. Thank you, Mr. Chairman, and I am glad that you are holding this hearing.

Being from Florida, I have a number of constituents who are very concerned and worried about the future of their life-long investments. Hearing Mr. Etheridge from North Carolina in his basketball analogy, we do know that basketball is alive and well in the great State of North Carolina. He kind of really boiled down why we are here and what you are asking for. You know, with my being Baptist, I feel like a singing pastor who is getting ready to deliver the message, and the minister got up and talked about the Scripture before I even hit the podium.

Let me just say very quickly—and, Mr. Rosenthal, I have a question for you. As we start to look at this, do you feel extending the period of time in a single-employer pension plan can make up any shortfalls and that you think that is a solution to what we are dealing with here today?

The second part of that is, since we are crunched for time and I want these other members to ask questions, you are aware of the time period being extended from 7 to 9, which, I believe, Education and Labor is looking at right now. I want to get your feelings on that piece of legislation also.

Mr. ROSENTHAL. Yes, I do think an extension of period of time would be one of appropriate measures to help plans meet their obligations, starting this year or even in 2010. We have not measured the impact on the particular bills and what they would mean to individual plans, so I cannot really say that we have quantified anything with regards to the impact that that would have.

Mr. MEEK. Well, let me just ask you this: As to the extension of time from 7 to 9, talk to me a little bit about it. Will that help? Will that not help?

Mr. ROSENTHAL. It certainly would help, and it would be very helpful in that the first 2 years, as I understand the bills, would be an interest-only amortization. So with the payments, rather than being level over a period of 7 years normally under PPA, there would be 2 years of interest only but no principal, and then the full amortization would be the remaining 7-year period. So, yes, it would be very helpful, most helpful the first 2 years, but the payments would return to their, I will say, pre-relief levels starting in year 3.

Mr. MEEK. Does anyone on the panel have an opposite or opposing view? I just want to kind of get a feel for it because I am paying attention to that legislation.

Mr. Chairman, I also have H.R. 721 that is dealing with public workers and firefighters and their pension plans. I have been looking at all of this, but I am paying very close attention to what Education and Labor is doing, and I want to make sure that what we find as a “solution” or as a response to the present situation that we are talking about here today is actually a solution and is not creating a bigger problem or issue.

With that, Mr. Chairman, I yield back my time.

Mr. NEAL. We thank the gentleman.

The gentlelady from California, Ms. Sánchez, is recognized to inquire.

Ms. SÁNCHEZ. Thank you, Mr. Chairman.

In light of the fact that we have votes that have been called, in the interest of time, I will submit my questions in writing, and will allow the panelists to respond in kind.

I yield back.

Mr. NEAL. Thank you very much, Ms. Sánchez.

Mr. Tiberi is not here. Mr. Camp has asked that he might take Mr. Tiberi’s time for the purpose of inquiry.

Mr. CAMP. Just quickly, Ms. Mazo, in your testimony on page 10, one of the relief proposals you suggest is to turn the existing concept of plan partition into an active vehicle for saving multi-employer plans that are in sharp decline because of the employer bankruptcies and uncompensated withdrawals by giving those plans the right to transfer the liabilities that those departed employers left behind in the PBGC.

If I understand this correctly, it would put liability for the departed plans on the PBGC; but then in footnote number 4 on the bottom of page 10, you state, because partitioning these plans off to the PBGC, in turn, taking the burden off the other companies remaining in the multi-employer plan, would have a large cost, this would need to be financed with funds outside the premiums paid by the multi-employer plans.

Where, in your mind, would these funds come from?

Ms. MAZO. Well, that is something that we are working on looking at. I was encouraged to hear that the changes might save just about enough or more money for the Federal Government, which would then translate into all of this being a package that could help these, actually, maybe, support what we are talking about.

Mr. CAMP. Thank you very much, Mr. Chairman.

Mr. NEAL. Thank you, Mr. Camp.

Before we close on this panel, I want to note for the record that the nonprofit community has filed testimony today with their concerns about pension funding rules. Mr. Lewis and I share those concerns.

With that, I want to thank our panelists for their very thoughtful commentary today. We have three votes scheduled on the House floor, and we will recess until the completion of those votes, and I would hope that Members of the Committee would return quickly so that we can move on to the next panel.

Again, thanks to our panelists.

[Recess.]

Mr. NEAL. Let me welcome our panelists.

First, LeRoy Gilbertson, who is a member of the National Policy Council at AARP; Mark A. Davis, who is the vice president of CAPTRUST Financial Advisers on behalf of the National Association of Independent Retirement Plan Advisers; Robert G. Chambers, a partner of McGuireWoods, on behalf of the American Benefits Council; Christopher Jones, executive vice president of Investment Management, and chief investment officer, Financial Engines; Edmund F. Murphy, managing director, Putnam Investments, Boston, Massachusetts; and Jim McCarthy, managing director of Morgan Stanley, on behalf of the Securities Industry and Financial Markets Association.

To the members of our committee and to our panelists, we are going to have one more vote in about an hour, and I would like as best we can to move the proceeding along.

With that, I would like to recognize Mr. Gilbertson to offer testimony, sir.

STATEMENT OF LEROY GILBERTSON, MEMBER, NATIONAL POLICY COUNCIL, AARP

Mr. GILBERTSON. Mr. Chairman, my name is LeRoy Gilbertson. I am a member of the AARP National Policy Council. I want to thank you for convening this hearing. AARP appreciates the opportunity to discuss the important issues surrounding investment advice.

A majority priority for AARP is to assist Americans in accumulating and effectively managing adequate assets in addition to supplement their Social Security benefits. Because the growth of the 401(k) plans places significant responsibility on individuals to make appropriate investment choices, AARP shares the goal of increasing access to investment advice so that the participants may achieve those goals. To that end, we have consistently asserted that such advice must be subject to the Employee Retirement Income Securities Act, or ERISA, as you know, fiduciary rules based on sound investment principles and protected from conflicts of interest. The recent financial turmoil scandals on Wall Street underscore, once again, the imperative that such investment advice be independent and non-conflicted.

As a result of the shift to individually directed accounts, more to the individuals than before, we are responsible for investment decisions that will ultimately determine whether they have accumulated the savings necessary to ensure an adequate level of retirement benefits. Unfortunately, many individuals are simply not prepared to handle this investment responsibility and risk. Many plans, therefore, provide investment education to plan participants, including asset allocation examples, to inform them of available investment strategies in general and under the particular plan. Too often, however, this information has fallen short for many participants. To address this problem, some plans have begun to make available independent investment advice to the plan participants. In this regard, AARP has consistently believed that two important goals are necessary:

First, the advisers should be qualified to provide the investment advice, and equally as important, the advisers should be independent, that is, free from financial conflict. ERISA has long recognized the financial conflict that investment advice will not be based on the sole interest of the participant. This is particularly relevant in the current uncertain financial environment where financial advisers may feel the greatest pressure to act solely in the best interest of individuals. Indeed, at the very heart of the financial scandals that have now rocked the Nation, scandals which began with Enron and Worldcom and have penetrated through much of Wall Street today are conflicts of interest.

Although ERISA generally prohibits transactions between plans and parties, there are inherent conflicts of interest. The Pension Protection Act, unfortunately, carved an exemption to permit plan fiduciaries to other conflicted investment advice arrangements under certain circumstances. AARP consistently argued that this exemption was unnecessary and undercut ERISA's protections to ensure that all fiduciaries act solely in the interest of plan participants.

Conflicts of interest are particularly disturbing when they impact a participant's retirement account. A review of the recent market upheaval and scandals should make it obvious that conflict-driven advice should be avoided and that common sense compels far more substantial and significant participant protection than PPA provides. The PPA leads us down a road of conflict of interest—the very problems that ERISA has long sought to prevent by ensuring that fiduciaries act solely in investment of plan participants.

In addition, AARP submits that disclosures of conflicts of interest to a plan participant alone is no remedy. As a financial planner's standards of conduct states: Individual consumers possess substantial barriers resulting from behavioral biases to the provision of the informed consent even after full disclosure.

Moreover, not only marketers who are familiar with behavioral research manipulate consumers by taking advantage of weaknesses in human comprehension, and competitive pressures almost guarantee that they will do so. Much of the literature suggests that investment advisers often push investments that may be suitable and risky for investors, and even sophisticated investors purchase investments which they claim not to have fully understood. Consequently, AARP submits that either the provisions of the PPA on investment advice should be repealed or the PPA should be significantly modified to make clear that, under the definition of an "investment adviser," only independent, non-conflicted advice may be provided to the participants.

In conclusion, AARP looks forward to continuing to work with Congress to promote independent investment advice in a way that insurance participants and beneficiaries are adequately protected from conflicts of interest. We prefer an approach that encourages plan sponsors to provide quality investment advice without the potential for conflicts of interest to increase the likelihood that plan participants have adequate income to fund their retirement years.

Mr. Chairman, I want to thank you again for this opportunity for us to testify.

Mr. NEAL. Thank you, Mr. Gilbertson.

[The prepared statement of Mr. Gilbertson follows:]

AARP℠

TESTIMONY BEFORE THE

COMMITTEE ON WAYS AND MEANS

U.S. HOUSE OF REPRESENTATIVES

On

ISSUES RELATING TO INVESTMENT ADVICE

OCTOBER 1, 2009

WASHINGTON, D.C.

Witness: LeRoy Gilbertson
National Policy Council
AARP

Mr. Chairman and members of the Committee, I am LeRoy Gilbertson, a member of AARP's National Policy Council. Thank you for convening this hearing. AARP appreciates the opportunity to discuss the important issues surrounding investment advice.

With 40 million members, AARP is the largest nonprofit, nonpartisan organization representing the interests of Americans age 50 and older and their families. Nearly half of our members are employed full or part-time, with many of them working for employers providing retirement plans.

A major priority for AARP is to assist Americans in accumulating and effectively managing adequate retirement assets to supplement Social Security. Because the growth in 401(k) plans places significant responsibility on individuals to make appropriate investment choices so that they have adequate income to fund their retirement, AARP shares the goal of increasing access to investment advice for individual account plan participants so that participants may achieve their goals. To that end, we have consistently asserted that such advice must be subject to the Employee Retirement Income Security Act's (ERISA) fiduciary rules, based on sound investment principles and protected from conflicts of interest. The recent financial turmoil and scandals on Wall Street underscore once again the imperative that such advice be independent and non-conflicted.

As a result of the shift to individually-directed account plans, more individuals than ever before are responsible for investment decisions that will ultimately determine whether they have accumulated the savings necessary to ensure an adequate level of retirement benefits. Unfortunately, many individuals are simply not prepared to handle this investment responsibility and risk. Many participants have little experience in, or understanding of, investment fundamentals. Compounding the lack of skills and preparation for the task is the fact that too few individuals have the time and/or the knowledge to work through the mountain of financial information available today. Moreover, plan participants often find it difficult to cope with the sophisticated marketing strategies of the financial institutions that offer conflicting and confusing information to unsophisticated investors.

Many plans provide investment education to plan participants, including asset allocation examples, to inform them of available investment strategies in general and under their particular plan. Too often, however, this information has proven to be insufficient and too complex for many participants. To address this problem, some plans began to make available independent investment advice to plan participants.

In connection with plan efforts to give participants access to investment advice, AARP has consistently believed that two important goals are necessary. First, the adviser should be qualified to provide investment advice to the plan participants. Equally as important, the adviser should be independent – that is, free from financial conflict. ERISA has long recognized that financial conflict gives rise to divided loyalties and thus poses the risk that the investment advice will not be based on the sole interest of the participant. *Section 404 of ERISA, 29 U.S.C. § 1104.* Investment advisers that stand to benefit financially from the advice they dispense face such a conflict. Encouraging independent, unbiased investment advice is likely to promote participants' long-term retirement security while minimizing the potential for employee dissatisfaction, plan entanglements in legal conflicts and litigation. Because plan participants are captive to the investment advisers who the employer or other plan fiduciaries chose to provide investment advice to them, participant protections must be stringent.

Unfortunately, research shows that financial illiteracy is widespread among the general population and particularly acute among certain groups. (A. Lusardi, *Household Saving Behavior: The Role of Financial Literacy, Information, and Financial Education Programs* (February 2008), http://www.nber.org/papers/w13824.) Much of the literature suggests that investment advisers often push investments that may be unsuitable and risky for investors, and even sophisticated investors purchase investments which they claim not to have fully understood. Many participants with self-directed accounts are not particularly sophisticated, but these accounts may be the largest pool of assets (besides their homes) that they own.

Advisers generally seek to develop a trust relationship with a client. In the employment context, generally absent a long-standing relationship, trust must be generated in another way. Here, the trust will be generated due to the fact that the employer or plan has chosen the adviser. In effect, the adviser chosen by the employer assumes an air of credibility.

It is exactly in this type of arrangement that ERISA has been designed to protect the participant. And this should be particularly true in the current uncertain financial environment, where financial advisers may feel the greatest pressure to not act solely in the best interests of individuals. Indeed, at the very heart of the financial scandals that have now rocked the nation – scandals that began with Enron and Worldcom and have permeated through Lehman Brothers, AIG, and much of Wall Street – are conflicts of interest. Much of the recent debate has focused on the failure of the regulatory agencies to step in and address the underlying conflicts of interest that drove our financial system off-track. Recent financial scandals clearly illustrate the need for increased, significant and substantive protections for participants.

Moreover, AARP submits that disclosure of conflicts of interest to plan participants alone is no remedy. As the Financial Planner Standards of Conduct states, "individual consumers possess substantial barriers, resulting from behavioral biases, to the provision of informed consent, even after full disclosure. Moreover, 'not only can marketers who are familiar with behavioral research manipulate consumers by taking advantage of weaknesses in human cognition, but . . . . competitive pressures almost guarantee that they will do so.'" FPA FIDUCIARY TASK FORCE – FINAL REPORT, June 1, 2007 at 113.

With the recent turmoil and scandals in the financial markets, trust in the financial markets and the people who provide investment advice is at an all time low. Recent AARP surveys show that employees are reducing their contributions to their 401(k) plans, taking money out of their 401(k) plans and moving their money to lower risk investments. (AARP, *The Economic Slowdown's Impact on Middle-Aged and Older Americans* at pp. 3, 6 (May 2008)). Not surprisingly, a recent AARP poll shows that Americans believe investment advice should be suitable for their needs, objectives and risk tolerance. In addition, they also believe that they should have access to information to check the adviser's record for professional misconduct.[1]

Although ERISA generally prohibits transactions between plans and parties where there are inherent conflicts of interest, the Pension Protection Act (PPA) unfortunately carved an exemption to permit plan fiduciaries to offer conflicted investment advice arrangements under certain circumstances. AARP consistently argued that this exemption was unnecessary and undercut ERISA's protections to ensure that fiduciaries act solely in the interest of plan participants.

Conflicts of interest are particularly disturbing when they impact participants' retirement accounts. A review of the recent market upheaval and scandals should make it obvious that conflict-driven advice should be avoided, and common sense compels far more substantial and significant participant protections than the PPA provides. The PPA leads us down a road of conflict of interest – the very problems that ERISA has long sought to prevent by ensuring that fiduciaries act solely in the interest of plan participants. Indeed, the PPA statutory exemption opens the door to

[1] AARP, Opinion Research on Retirement Security and the Automatic IRA (Aug. 2009).

inappropriate treatment of plan participants by plan fiduciaries that double as investment advisers.

Significantly, under current case law, participants will be further at risk since they will have been deemed to have made the investment decision. Thus, even if there is undue pressure from advisers, participants are left with no remedy for excessive fees or poor advice in connection with the receipt of investment advice and the investment products chosen. Although under traditional trust law, a breach of fiduciary duty would result in "make whole" relief; this is not the case under ERISA. Without adequate remedies under ERISA, it is most imperative that participant protections are in place. Consequently, AARP submits that either the provisions of the PPA on investment advice should be repealed, or the PPA should be significantly modified to make clear that under the definition of an investment adviser only independent, non-conflicted advice may be provided to participants.

In conclusion, AARP looks forward to continuing to work with the Congress to promote independent investment advice in a way that ensures participants and beneficiaries are adequately protected from conflicts of interest. We prefer an approach that encourages plan sponsors to provide quality investment advice without the potential for conflict of interest to increase the likelihood that plan participants have adequate income to fund their retirement years.

Thank you for the opportunity to testify.

Mr. NEAL. Mr. Davis is recognized to offer testimony.

STATEMENT OF MARK DAVIS, VICE PRESIDENT, CAPTRUST FINANCIAL ADVISORS, ON BEHALF OF THE NATIONAL ASSOCIATION OF INDEPENDENT RETIREMENT PLAN ADVISORS

Mr. DAVIS. Thank you, Mr. Chairman and Members of the Committee, for the opportunity to speak with you today.

My name is Mark Davis. I am from Los Angeles, and I am vice president and financial adviser with CAPTRUST Financial Advisers, which is headquartered in Raleigh, North Carolina.

CAPTRUST is an RIA. We are fiduciary to over 450 plans, $22 billion in assets, something over 800,000 participants in our care. We provide fiduciary investment advisory services both to sponsors of qualified plans and to many participants within those plans. We are fully independent, and we fully disclose all fees.

I speak to you today on behalf of the National Association of Independent Retirement Plan Advisers, or NAIRPA, an association of independent registered investment advisers who focus on delivering independent, conflict-free advice both at the plan sponsor and participant levels. It means our fees are the same regardless of the investments that are selected. Our members provide advice to plans covering millions of participants.

I, personally, have practical experience on both sides of the independent investment advice issue, having worked as an education specialist for both a major mutual fund company and a major broker-dealer, and I also have served as an independent adviser for 10 years now.

While most companies are highly ethical and most education specialists are true professionals, it is not wise to rely on a regulatory or legislative framework that presumes that these employees will always separate themselves completely from doing what is in the best interest of their employers. That is contrary to human nature. It is asking for trouble. It is why I am a strong supporter of independent investment advice.

One of the basic problems with the current state of advice is that there really is not a clear set of laws and regulations. What we have are advisory opinions, prohibited transaction exemptions, information bulletins that leave room for practices, I think, that should be of concern to members of this committee. We have advice deliverers who are subject to multiple and very different compliance regimens and oversight. An example of the current confusion is the difference between the services plan sponsors think are being provided to their participants and what the deliverers of those services say they are giving.

Based on the results of the 2007 annual survey of the Profit Sharing Council of America, more than 40 percent of small business retirement plan sponsors think advice services are being delivered to their participants as "one-on-one counseling (in person)." In reality, most of this counseling is provided by brokers who are not permitted to give advice because they are not independent. The brokers are meeting with participants, relying on DOL IB 96–1 which permits education or guidance to be provided without violating the fiduciary rules even though they cannot legally give advice.

Whatever the reason, the outcome is that plan sponsors think participants are being advised; participants think they are being advised, but the vendors responsible for the service deny that advice is being provided.

Many participants who do receive investment advice get it through a computer model based on the SunAmerica opinion. Independent computer model providers, such as Financial Engines, which is here today, provide cost-effective, unconflicted advice to plan participants, and the availability of this kind of service should be encouraged. However, the rules are sometimes stretched to the limit, and that, combined with a lack of clear guidance, leads to some questionable practices in the name of SunAmerica.

We have heard of situations where all of the funds available under a plan are not included in the advice provided by a computer model when it is applied to the plan. The argument is that this limited set of funds in a model is permitted by SunAmerica. To me, it seems obvious that, when the funds that are included are proprietary and the excluded funds are not or when included funds pay for shelf space and omitted funds do not, the advice produced by the model is not independent. There is clearly a conflict in the selection of the funds, and that conflict carries through to the output of the model, and of course, it is the participant who is harmed by the conflict. Simply, that should not be permitted.

The investment advice provisions in PPA did not help bring order to the chaos of rules and regs governing the provision of investment advice. If anything, it may have added to the confusion. The prohibited transaction exemption that was included in the PPA advice regulation would permit conflicts that even the authors of the regulation acknowledge went beyond PPA.

With the new administration and this new Congress, we are hopeful that now is the time for new policy to be made. This Congress has a great opportunity to protect the interests of the American retirement investor. We need a set of clear rules that cannot be bent too far, rules that protect non-ERISA plans, like some 403(b) and 457 plans, as well as ERISA arrangements. NAIRPA urges this committee to act in support of conflict-free investment advice.

Mr. NEAL. Thank you, Mr. Davis.

[The prepared statement of Mr. Davis follows:]

National Association of Independent Retirement Plan Advisors

Statement by Mark Davis, Vice President and Financial Advisor CAPTRUST Financial Advisors on behalf of NAIRPA

Comments Presented to the Committee on Ways and Means United States House of Representatives

Defined Benefit Pension Plan Funding Levels and Investment Advice Rules

October 1, 2009

Thank you to the Chairman and to the members of the Committee for the opportunity to speak with you today. My name is Mark A. Davis and I am a Vice President and Financial Advisor with CAPTRUST Financial Advisors, headquartered in Raleigh, North Carolina. I have practical experience on both sides of the independent investment advice issue, having worked as an education specialist for both a major mutual fund company and a major broker-dealer, and served as an independent advisor for ten years now. I am a strong supporter of independent investment advice.

CAPTRUST Financial Advisors serves as registered investment advisor and fiduciary to over 450 plans representing more than $22,000,000,000 in assets and more than 800,000 participants. We provide fiduciary investment advisory services both to sponsors of qualified retirement plans and to participants within many of those plans. We are independent and fully disclose all fees.

I speak to you today on behalf of the National Association of Independent Retirement Plan Advisors (NAIRPA). NAIRPA is an association of independent registered investment advisors who focus on delivering independent, conflict free advice at both the plan sponsor and participant levels. What that means is our fees are the same regardless of the investments that are selected. Our members provide advice to plans covering millions of participants.

Current Situation

The current situation for investment advice can probably best be described as confusing. The provision of investment advice is not governed by a clear set of law and regulations. Guidance is a mishmash of DOL advisory opinions, information bulletins and prohibited transaction exemptions that allow conflicts to exist that leave a lot of apparent wiggle room for practices that I think are very troubling. Work-arounds that are at least on the surface enabled by the current environment have lead plan sponsors and participants to think they are getting "advice", when advice cannot be given. And the conclusions of an advisory opinion are sometimes stretched to fit circumstances that I find it hard to believe were contemplated by the regulators at DOL/EBSA.

Something needs to be done legislatively to encourage independent advice, and bring clarity to this critical aspect of retirement security. We need a fresh start. I applaud you, Mr. Chairman, and this Committee's leadership in examining this important issue, as well as Chairman Miller and Mr. Andrews for exploring ways to address this matter legislatively.

Current rules and practices are so confusing that plan sponsors and participants do not even know if they are getting advice. According to the 2007 Annual Survey of the Profit Sharing Council of America, more than 59% of sponsors of plans with 200 or fewer participants responded that they offered investment advice services to their participants. More than 70% of those sponsors say that the advice is delivered as "One on One Counseling (In Person)". Most plans of that size are sold and serviced through the brokerage model and most brokerage firms ardently claim that their brokers are not allowed to provide advice so as to avoid potential ERISA fiduciary status. So more than 40% of all small plan sponsors think they are offering advice when in fact the people these plan sponsors think are giving the advice claim that they are not giving advice at all.

It is easy to see how this happens. A recent RFP from a leading broker-dealer clearly states in the middle of a lot of fine print that the broker-dealer is not a fiduciary, and that the selection and monitoring of the plan's investment options are the responsibility of the plan fiduciary (that is, the employer). But the employer should be forgiven for thinking he has received "advice", because the first pages of the proposal, with color highlights, offers the "proposed investment menu". This same broker-dealer relies on the SunAmerica advisory opinion (Advisory Opinion 2001-09A) to provide participant level advice through an independent computer model. That can be a good thing, and should be encouraged if done properly. But this broker implies that the financial advisors will provide off-model advice, which under current rules would not be appropriate.

(Sometimes brokers and others that cannot legally provide advice, because they are not independent, arguably get around the rules by calling it "education" or "guidance", leveraging terms from DOL IB 96-1 in an attempt to be sheltered from the prohibited transaction issues that would arise if conflicted advice were given. So sponsors and participants think participants are getting "advice", but their vendors, who are prohibited from providing advice because it would be conflicted, call it by another name. Another case of a patchwork of rules causing confusion.)

Another concern is that brokers and advisors can view participant education and advice sessions as an opportunity to prospect for other business. This is understandable, but can be abused very easily. Several times in the past year I have heard stories of brokers encouraging participants to take in-service withdrawals from Plans into IRA's managed by the same broker in order to invest differently (and more expensively) than the Plan would allow. This is precisely why conflicted advice should be clearly prohibited.

The SunAmerica opinion has formed the basis for a lot of participant-level advice arrangements, and most of those arrangements, which use an independently developed computer model to generate advice, provide cost-effective, unconflicted advice, to plan participants. That opinion was for a certain set of circumstances, though, and I am concerned that it has sometimes been stretched to "fit" circumstances that were not contemplated. (It is the job of attorneys and other advisors to stretch whatever rules are out there to the limit, so I don't mention this so much as a criticism of the providers as a criticism of the state of current law and regulations.) The opinion says that in the specific situation for which the opinion was requested, it is ok for the model to include only a subset of the investment options available under the plan, provided it is the plan fiduciary that chooses the subset and the options include a variety of risk/return characteristics. Now, it is very easy to envision how this can go wrong if we just apply that at face value, as if this opinion were a broadly applicable regulation. We have heard of situations where not all investment funds available under the plan are included in the computer model when it is applied to the plan. Computer models are generally built, as the SunAmerica opinion anticipates, with certain "asset classes". If plan menus are constructed with only certain funds eligible for use in those asset classes, the independence the opinion perceived is compromised. To me, it seems obvious that when the funds that are included are proprietary and the excluded funds are not, or when included funds pay for shelf space and omitted funds do not, the advice produced by the model is not independent. There clearly is a conflict in the selection of those funds and that conflict carries through to the output of the model. And of course, it is the participant who is harmed by the conflict. This simply should not be permitted.

In my mind it is difficult to separate the fee disclosure and investment advice issues. Without knowing how a vendor, broker or advisor is compensated, and how much and from whom, how can a fiduciary possibly evaluate the recommendations they are being given? Most plan sponsors have no idea how the brokers with whom they work are compensated. Nor do they know or understand the financial relationships that are involved in the creation of the "platforms" of investments offered by many vendors particularly, though not exclusively, in the small plan market. The vendors are conflicted when they create platforms and the brokers are conflicted when they offer certain platforms to their clients. At all levels of the marketplace, it is routine practice for sponsors to only be offered either investments that are proprietary to the vendor or investments that pay for shelf space on the vendor's platform. We regularly see even large market plans being offered only funds that pay some level of "revenue share" to the vendor to be on the recordkeeping platform. While there is nothing inherently wrong with revenue sharing when it is used to properly allocate fees to the appropriate party providing a particular service, it can be abused and become a "pay to play" mechanism where only those funds that revenue share, and thus allow fees to be hidden inside investment costs, get to be seen by sponsors and participants. All these problems can be addressed by the engagement of an independent advisor to assist the plan sponsor with fund selection.

Pre-PPA vs Post-PPA

The Pension Protection Act of 2006 brought sweeping change to our business. I believe Congress did a great thing in incenting Automatic Enrollment protocols and I applaud the efforts of Congress and the new Administration to further press for more. However, Automatic Enrollment also creates an even larger group of workers that need knowledgeable, unconflicted, investment advice. As part of the movement toward "opt-out" savings, PPA also brought new rules on Qualified Default Investment Alternatives (QDIAs) that I think are positive, if properly implemented. However, companies who offer products for the QDIA market don't always take responsibility for their product. There is at least one major firm in the marketplace that has its clients (that is, the plan sponsors) sign off as fiduciary and investment manager for their QDIA solution as a means of getting around the current prohibited transaction rules. Once again, sponsors think the vendor is providing advice but by their signature the plan sponsor is taking responsibility not just for oversight of the vendor, which is what they think their role is, but rather for the construction, management and oversight of the portfolios themselves. I know from experience that not all clients, regardless of size, understand what they are signing in this situation. That clearly is not what PPA intended. What is particularly galling is that these plan sponsors probably think they got good "advice" from the vendor.

We have not seen much, if any, impact on the provision of investment advice from the new PPA investment advice provisions. Providers may be waiting for final regulations. If anything, DOL regulations on the PPA advice provisions, currently on hold under the new administration, muddied the waters on the provision of investment advice. Although PPA did permit some conflicted advice, there were serious protections that attached. The prohibited transaction exemption that was included in the final regulation went well beyond PPA, permitting conflicts that even the authors of the regulation acknowledged were not contemplated by PPA. I think harm will be done if the final regulation is implemented that would permit so-called "fee leveling" at the individual, not the firm, level, and permit "off-model" advice. I am hopeful that the current administration will be making some changes in the near future that alleviate my concerns. The fact that PPA did not preclude DOL putting out an exemption that would allow clear conflicts is proof that PPA did not do what needed to be done.

What Needs to be Done

I am very excited about the future for retirement savings. I believe that the renewed focus on retirement savings brought by President Obama as recently as Labor Day weekend bodes well for the retirement savings futures of American workers. Expanding savings opportunities is a critical part of securing retirement. However, it is critical that conflict-free advice, along with improved disclosure, accompany improved savings opportunities.

Congress should establish that retirement plan sponsors and participants deserve the highest standard of care from those who advise them on the investment of retirement savings. NAIRPA encourages the Committee to consider legislation clarifying the need for independent advice such as the advice provisions in the bill reported out by the Education and Labor Committee (HR 2989). It is especially critical that this Committee act because not all tax-favored plans are subject to ERISA, and unless Internal Revenue Code Section 403(b) and 457(b) plans are covered without regard to their ERISA status, some workers will go unprotected.

I have worked for an investment provider, a broker-dealer, and now I am working as an independent advisor. While most companies are highly ethical and most education specialists are true professionals, it is not wise to rely on a regulatory or legislative framework that presumes that these employees will always separate themselves completely from doing what is in the best interest of their employers. That is contrary to human nature and is asking for trouble.

There is a whole industry of professionals in this country that is ready to help American plans and American workers, including those with minimum balances who may never be good candidates to be clients of the major financial services firms. We will disclose fees, avoid conflicts, educate, console, coach and yes advise American workers in the 21st century. American workers deserve to get advice from someone who has only that worker's best interests in mind. I urge this Committee to take action to make that happen.

Mr. NEAL. Mr. Chambers is recognized to offer testimony.

STATEMENT OF ROBERT CHAMBERS, PARTNER, McGUIREWOODS, ON BEHALF OF THE AMERICAN BENEFITS COUNCIL, AND SOCIETY FOR HUMAN RESOURCE MANAGEMENT

Mr. CHAMBERS. Thank you.

My name is Robert Chambers, and I am a partner in the international law firm of McGuireWoods.

While I have advised sponsors and financial service providers with respect to 401(k) issues since section 401(k) became law in 1978, I am also testifying today as a plan sponsor. McGuireWoods sponsors a defined contribution plan for about 2,600 participants, and it has provided them with access to investment advice since 2005.

Again, I appreciate the opportunity to testify today.

The events of the past year have highlighted the importance of increasing the availability of sound investment advice to the millions of Americans who rely on their defined contribution plans for their retirement security. There has been an active public policy discussion of the investment advice provisions enacted in the Pension Protection Act of 2006. The Department of Labor has issued regulations under those provisions and a correlative class exemption. More recently, the Education and Labor Committee approved a bill that would have a powerful impact on both PPA and pre-PPA unconflicted advice arrangements.

Now, interestingly, the PPA investment advice provision and the Education and Labor Committee's bill seem to share the same goal—the need to broaden the availability of unconflicted investment advice to participants, but the approaches that they took are dramatically different.

Other members of this panel are going to speak on the preservation of the investment advice of those provisions in the PPA, but my focus today is different. I am going to make six pretty simple points regarding the preservation of pre-PPA investment advice alternatives, and here they are:

> Number one, plan participants need investment advice now more than ever.
>
> Two, all investment advice programs must avoid conflicts of interest, and also must adhere to the prohibited transaction rules developed by the Department of Labor and the IRS.
>
> Third, pre-PPA rules that have been approved by the Department of Labor are not conflicted. They provide valuable assistance for millions of Americans.
>
> Fourth, if legislation is enacted with respect to the PPA investment advice provision, it is crucial that the legislation neither change nor eliminate the pre-PPA rules.
>
> Fifth, our plan sponsor members have made things very clear. If the legislation invalidates existing pre-PPA advice programs or adds materially to their cost, plan sponsors will abandon their programs rather than revise them. They currently have neither the resources nor the inclination to engage in the expensive redesigns of these voluntary programs. Millions of Americans will lose access to investment advice at a very inopportune time.
>
> Finally, the bill extends its reach to the provision of investment advice to plans. Now, this was very surprising. It is a significant issue, but it was not addressed by either the PPA or the 2009 class exemption. It has not been the subject of extensive public policy debate, so we believe that additional constraints should not be added under these circumstances. The pre-PPA rules were carefully drafted to avoid conflicts of interest and to ensure that all advice programs operate in the interests of participants, and as I mentioned, they are highly utilized.

We understand that approximately 20 million participants in defined contribution plans are offered advice products based on the SunAmerica advisory opinion alone. Unfortunately, in the context of repealing the PPA investment advice provisions, the Education and Labor Committee approved a bill that goes much further. The bill's broad reach would reduce a sponsor's ability to provide sound, unconflicted advice by invalidating the pre-PPA arrangements, and this, of course, will harm plan participants. The bill would prohibit or make much more expensive several different types of pre-PPA investment advice. It is important to preserve all of them, and we discuss the impact of the bill on each of the individual ones in our written materials; but please remember this: Without them, there will be more expense or less advice with no corresponding benefit to employees.

One way to gauge the soundness of any proposed change is to list the winners and the losers. Here is our assessment of the results of the Education and Labor Committee's bill if it is passed with the current provisions regarding pre-PPA advice.

Mr. CHAMBERS. Here are the winners; investment advisors who currently have a small enough footprint to avoid disqualification as the term plan investment providers under the Advisors Act of 1940. Second, those firms that will provide the newly mandated audits and certifications, and of course—and I speak personally as to this—lawyers who are going to be drafting copious disclosure materials.

But more important, here are the losers under this bill:

> Number one, participants whose employers discontinue access to investment advice under a pre-PPA method, of whom there will be many.
>
> Number two, participants whose employers discontinue access to investment advice under PPA, of whom there are currently rather few.
>
> Third, investment advisors who are displaced under the final interpretation of that term "plan investment provider."
>
> And finally, and maybe most important, plan sponsors, investment advisors, and participants who have relied on 30 years of well-reasoned DOL exemptions and advisory opinions.

So please, consider the winners and the losers. Our assessment causes us to question the soundness of the bill as long as it continues to invalidate pre-PPA investment advice.

[The prepared statement of Mr. Chambers follows:]

AMERICAN BENEFITS COUNCIL PSCA.org SHRM SOCIETY FOR HUMAN RESOURCE MANAGEMENT

TESTIMONY OF ROBERT G. CHAMBERS ON BEHALF OF

AMERICAN BENEFITS COUNCIL

AND

PROFIT SHARING/401k COUNCIL OF AMERICA

AND

SOCIETY FOR HUMAN RESOURCE MANAGEMENT

BEFORE THE

COMMITTEE ON WAYS AND MEANS

OF THE

U.S. HOUSE OF REPRESENTATIVES

FOR THE HEARING ON

DEFINED BENEFIT PLAN FUNDING LEVELS AND INVESTMENT ADVICE RULES

OCTOBER 1, 2009

TESTIMONY OF ROBERT G. CHAMBERS ON BEHALF OF THE AMERICAN BENEFITS COUNCIL, THE PROFIT SHARING/401k COUNCIL OF AMERICA, AND THE SOCIETY FOR HUMAN RESOURCE MANAGEMENT ON INVESTMENT ADVICE RULES

Introduction

My name is Robert G. Chambers, and I am a partner in the international law firm of McGuireWoods LLP. I have advised clients with respect to 401(k) plan issues since 401(k) was added to the Internal Revenue Code in 1978. In that regard, my clients have included both large and small employers that sponsor 401(k) plans as well as many financial institutions that provide services to 401(k) plans. I am testifying today not only as an adviser to my clients but also as a plan sponsor. McGuireWoods sponsors a 401(k) plan for approximately 2,600 participants. Since 2005, our plan has provided participants with much needed investment advice.

I am here today on behalf of the American Benefits Council (the "Council"), the Profit Sharing /401k Council of America ("PSCA"), and the Society for Human Resource Management ("SHRM"). I am also a past chair of the Board of Directors of the Council. The Council is a public policy organization representing plan sponsors, 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.

PSCA is a national non-profit association of 1,200 companies and their six million employees that advocates increased retirement security through profit sharing, 401(k), and related defined contribution programs to federal policymakers. It makes practical assistance available to its members on profit sharing and 401(k) plan design, administration, investment, compliance, and communication issues. Established in 1947, PSCA is based on the principle that defined contribution partnership in the workplace fits today's reality. PSCA's services are tailored to meet the needs of both large and small companies, with members ranging in size from Fortune 100 firms to small entrepreneurial businesses.

SHRM is the world's largest association devoted to human resource management. Representing more than 250,000 members in over 140 countries, the Society serves the needs of HR professionals and advances the interests of the HR profession. Founded in 1948, SHRM has more than 575 affiliated chapters within the United States and subsidiary offices in China and India.

Thank you for the opportunity to testify today regarding the provision of investment advice to defined contribution plans and their participants. The events of the past year have highlighted the importance of increasing the availability and provision of sound investment advice to the millions of Americans who rely on their 401(k) plan and other defined contribution plans for their retirement security.

Summary

In the last several months, there has been an active public policy discussion of the investment advice provision enacted in the Pension Protection Act of 2006 (the "PPA"). As discussed below, the PPA expanded the means by which investment advice can be provided to defined contribution plan participants regarding how to invest amounts allocated to their plan accounts. In addition, in January of this year, the Department of Labor ("DOL") issued regulations under the PPA investment advice provision, as well as a class exemption ("2009 class exemption") that facilitates additional means of providing advice. Neither the regulations nor the class exemption has gone into effect, as the effective date of both has been delayed by the DOL.

While the PPA investment advice provision played a constructive role in seeking to broaden the menu of permissible investment advice approaches, that provision is not my focus today. I am here to make one key point. If legislation is enacted with respect to the PPA investment advice provision, it is critical that the legislation not adversely affect the investment advice rules in effect prior to the enactment of the PPA. Participants need investment advice now more than ever.

A large number of our plan sponsor members provide investment advice to their plan participants under the pre-PPA rules. For example, it is our understanding that approximately 20 million participants in 401(k)-type plans are offered advice products based on the "SunAmerica" Advisory Opinion discussed below. The pre-PPA rules were carefully drafted to avoid conflicts of interest and to ensure that all advice programs operate in the interests of the participants. And our plan sponsors would not offer advice programs that work any other way.

Unfortunately, in the context of repealing the PPA investment advice provisions, the Education and Labor Committee approved a bill that goes much further than that, invalidating many (if not most) pre-PPA non-conflicted advice arrangements as well. The Education and Labor Committee set out to improve the quality of investment advice. However, the bill's broad reach would, in fact, cause a huge reduction in the provision of sound non-conflicted advice by invalidating pre-PPA arrangements. The effect of this reduction in advice arrangements would be very adverse, because, as noted, today, more than ever, participants need advice to get them back on course toward retirement security. In a very large number of cases, the following types of non-conflicted advice would be prohibited or made much more expensive and cumbersome by the Education and Labor Committee bill.

- **<u>"SunAmerica" advice.</u>** As discussed further below, under a SunAmerica advice program, participants receive advice based exclusively on a computer model designed by a third party that (1) has no financial stake in which investment options participants elect and (2) is independent of the financial institutions providing investment products to the plan.

- **<u>Level-fee arrangements.</u>** Again as discussed further below, under a pre-PPA level-fee arrangement, an advisor and all of its affiliates receive the same fee, regardless of which investment options are chosen by the participants. Clearly, such advice is conflict-free.

- **<u>Managed accounts.</u>** Under a managed account, a participant directs the advisor to automatically implement the advisor's investment advice. Many of our members have indicated that generally those arrangements, which are often based on either SunAmerica models or pre-PPA level-fee arrangements, are the most effective advice programs. One important reason for that effectiveness is that once elected, the implementation of advice occurs automatically, rather than relying on participants for implementation.

- **<u>Exemptions.</u>** Since the enactment of ERISA in 1974, the DOL has had the authority to allow advice that is otherwise prohibited if there are sufficient safeguards so that the advice is in the interest of the participants. For over 30 years, Democratic and Republican administrations have carefully used their authority to grant important exemptions with respect to investment advice, most or all of which would be invalidated by the Education and Labor Committee bill.

- **<u>Plan-level advice.</u>** Certain forms of non-conflicted advice to plan fiduciaries would be prohibited by the bill.

Our plan sponsors have made the following very clear to us: if the Education and Labor Committee bill is passed by Congress and invalidates their advice program or adds materially to its costs, they would not re-establish a new program in the near future. Unfortunately, this is not a time when companies have the time or resources to engage in expensive redesigns of <u>voluntary</u> programs. So millions of Amercans would lose access to investment advice. This is not the time to cause Americans to lose access to advice programs.

Set forth below is a more detailed discussion of the evolution of the investment advice issue, which provides more background explaining the points summarized above.

Prior to the Pension Protection Act.

Prior to the PPA, the prohibited transaction rules generally prohibited any provision of investment advice where the advisor could benefit based on the advice given. The only exception to this rule was for class and individual exemptions granted by the DOL, where the DOL had specifically determined that an advice arrangement had enough safeguards in place to remove or substantially diminish any real or potential conflict, so that the use of such arrangement was in the best interests of the participants.

Prior to the PPA, it was clear that certain advice arrangements did not involve any conflict of interest and thus did not violate the prohibited transaction rules. For example, many advice arrangements relied on a DOL Advisory Opinion generally referred to as "SunAmerica". Under SunAmerica, generally a plan advisor, which may be a financial institution, arranges for advice to be given to participants (or implemented automatically, in the case of managed accounts) based solely on a computer model designed and exclusively controlled by an independent third party. The advisory opinion articulates a very specific and objective rule for determining whether the third party is truly independent. Because all advice is provided pursuant to an independently designed computer model, and because that advice cannot be modified by the plan advisor, the advice is not conflicted and there is no prohibited transaction.

Another example of non-conflicted advice is advice given by an advisor that receives the same compensation regardless of which investment option is chosen (the "pre-PPA level fee rule"). This rule was very strictly applied before the PPA. So, for example, if advice is given by an employee of a financial institution, the investment option chosen cannot affect the compensation received by the employee, the financial institution, *or any affiliate of the financial institution.*

Both of these examples—SunAmerica and pre-PPA level-fee arrangements—reflect conscious efforts to design a non-conflicted advisory platform. In addition, both types of arrangements can permit the offering of both traditional advice (whereby a participant decides whether to implement each piece of advice) and managed accounts (whereby the advice is automatically implemented pursuant to prior consent by the participant).

The PPA Level-Fee Rule and the Class Exemption Level-Fee Rule.

The PPA created two exceptions to the prohibited transaction rules described above, solely for use with traditional advice (i.e., they are not available for managed accounts). Under the first exception, the PPA created a new version of the level-fee rule. Under the "PPA level-fee rule", investment advice to a participant is permitted as long as the investment options chosen cannot affect the compensation of (1) the advisor giving the advice or (2) the entity employing the advisor. However, unlike the pre-PPA level-fee rule, the PPA level-fee rule permits variation in the compensation of an affiliate of that entity. So, for example, if an entity provides investment advice to plan participants, it would be permissible for a recordkeeping affiliate of the entity to receive different levels of compensation based on which investment option is chosen. The rationale for the PPA level-fee rule was that if the actual providers of the advice are not operating under a conflict of interest, the advice rendered will not be biased. In addition, as a condition of the PPA level-fee rule, the PPA requires the advisor to acknowledge that it is acting in a fiduciary capacity when providing advice and requires annual audits and extensive disclosures to the participants regarding the relationships among the parties and the fees potentially received by the affiliate.

The DOL took an additional step in the 2009 class exemption (issued in January of 2009), the effective date of which has been delayed. Under the "class exemption level-fee rule", investment advice to a participant is permitted as long as the investment options chosen cannot affect the compensation of the advisor giving the advice. The compensation of the advisor's employer or such employer's affiliate may, however, vary based on the investment option chosen. The rationale for the 2009 class exemption is as follows: if the compensation of the advisor who is actually providing the advice is unaffected by which investment option is chosen, the advice will be impartial. Also, as under the PPA level-fee rule, annual audits and extensive disclosures would be required regarding the extent to which the advisor's employer or its affiliates could potentially benefit from the selection of different investment options.

The PPA Computer Model Rule and the Class Exemption Off-Model Rule.

Under the second rule enacted in the PPA, a financial institution may design its own computer model to provide investment advice to participants even if such financial institution may benefit based on the investment options chosen. This is different from SunAmerica where the computer model must be developed by an independent third party. However, under the PPA computer model, an independent third-party expert must certify that the financial institution's computer model is valid and unbiased. The PPA computer model also includes a number of requirements not applicable to SunAmerica, such as (1) an annual audit by an independent expert (in lieu of control of the application of the model by an independent expert), (2) a requirement that the computer model take into account all investment options under the plan, and (3) a rule limiting its application to non-managed accounts. The PPA computer model is also subject to the extensive disclosure requirements referenced above, so that participants understand the potential benefits derived by the developer of the computer model.

The 2009 class exemption takes the computer model rules a step further. Under the 2009 class exemption, the financial institution that developed the computer model may also provide advice separate from the computer model, as long as the basis for that advice is explained to the participant and the extensive disclosures referenced above are provided. The rationale for the "class exemption off-model rule" is as follows. If a participant receives (1) the computer model recommendations as a reference point, (2) an explanation of the basis for the different advice, and (3) disclosures explaining how the advisor may benefit from the different advice, the participant has the tools to evaluate the merits of the different advice.

To our knowledge, there has been little use of the PPA computer model rule (and, of course, no use of the 2009 class exemption since it is not yet effective). The PPA computer model, with its extensive requirements, including annual audits, is much more expensive to administer than SunAmerica.

House Education and Labor Committee Bill.

The House Education and Labor Committee recently passed a bill that is structured as follows. First, the bill repeals the PPA investment advice provision with respect to ERISA plans (but not with respect to IRAs or non-ERISA plans). But the bill then goes further. The bill provides new rules under which there are only two permitted methods of providing investment advice to participants or to a plan. (As discussed further below, advice to a plan was not addressed by the PPA provisions or by SunAmerica.)

Generally, under the first method, the advice provider (1) must be registered as an investment adviser under the Investment Advisers Act of 1940, (2) must not be the "plan investment provider", (3) must satisfy the pre-PPA level fee rule, (4) must be a fiduciary with respect to the plan, and (5) must satisfy other requirements, including disclosure of potential indirect benefits related to the advice ("bill level-fee plus rule"). The definition of a "plan investment provider" is not clear. The definition can be read to include any financial institution that creates or manages any investment product in which any defined contribution plan invests, which would generally preclude use of this method by the vast majority of financial institutions. The definition can also be read to only include a financial institution that creates or manages any investment product in which the defined contribution plan receiving the advice invests. Even this narrower reading would invalidate many non-conflicted arrangements satisfying the pre-PPA level-fee rule or the SunAmerica Advisory Opinion.

The second method is very similar to the PPA computer model method, except that it adds additional requirements as a condition of using such approach ("bill computer model rule").

The bill would have some unfortunate effects, as discussed in more detail below. The Education and Labor Committee set out with important goals: to improve the quality of investment advice and to eliminate conflicted advice that is potentially harmful. However, in doing so, it appears that the Education and Labor Committee bill may have gone further than necessary to achieve its original intended objective.

Repeal of the PPA rule. With respect to ERISA plans, the bill would repeal the PPA investment advice provision (i.e., both the PPA level-fee rule and the PPA computer model rule). Even though technically the bill only repeals the ERISA part of the PPA provision, the effect is generally the same as full repeal. Although the PPA provision would remain in the Internal Revenue Code, an ERISA plan must satisfy both the Code and ERISA, so the absence of an ERISA exemption renders the Code exemption ineffective for ERISA plans.

Elimination of most SunAmerica arrangements. As currently structured, SunAmerica arrangements generally do not satisfy the PPA computer model rules, which were designed to address advice developed by entities also offering investment products in the plan. For example, SunAmerica arrangements do not have annual audits (since the advice is implemented by an independent expert) and do not need to be certified by an independent expert (since the advice is developed by an independent expert). Also, SunAmerica arrangements sometimes only take into account a subset of plan options (though this is only permitted if the independent expert confirms that it can render appropriate advice with that subset), and do not need to satisfy several of the other extensive PPA computer model rules. To comply with the PPA computer model rules would be quite expensive, an expense that plan sponsors have indicated to us that they would be very unlikely to incur. More importantly, since SunAmerica provides non-conflicted advice developed by an independent third party, the extra expense is not justified by any corresponding benefit to employees. Given the recent market upheaval, now is especially not the time to unnecessarily restrict independent investment advice.

Some SunAmerica arrangements can be redesigned to use the bill level-fee plus rule. The developer of the computer model could contract directly with the plan and accept fiduciary status. As so restructured, those arrangements can satisfy the bill level-fee plus rule. However, it is our understanding that in most cases, the developer of the computer model will not contract directly with the plan without significant additional compensation. Also, in some cases, the developer may simply not be structured to take on fiduciary duties and liabilities, or to perform the administrative tasks involved in directly implementing a managed account or advice arrangement. So the financial institution offering plan investment options is the fiduciary, and as such, contracts with the developer of the computer model. Those arrangements, which were clearly permissible under pre-PPA law and do not involve conflicted advice, would not satisfy either the bill level-fee plus rule (because the financial institution provides investment products to the plan) or the bill computer model rule (unless significant and costly changes are made) and thus would be invalidated.

Elimination of most managed accounts. Many in the advice industry believe that the most effective means of providing advice is through managed accounts, whereby advice is automatically implemented pursuant to a participant's prior authorization. Most managed accounts are based on SunAmerica.

There is some technical lack of clarity with respect to whether the bill applies to managed accounts. However, many believe that it does, and some understand that that was the Education and Labor Committee's intent. If the bill does apply to managed accounts, it would prohibit all managed accounts unless the developer of the computer model satisfies the bill level-fee plus rule by (1) accepting fiduciary status, (2) not providing investment products, and (3) receiving no compensation from firms that provide investment products. Moreover, an inability to offer such managed accounts with a subset of available plan investment options would eliminate such investment advice for a significant number of plans where incorporation of all investment options is not practicable. As referenced above, managed accounts (or advice) with respect to a subset of investment options should be permitted as long as the subset is broad enough to ensure that appropriate advice can be given, as is required under SunAmerica.

Elimination of many pre-PPA level-fee arrangements. The bill would invalidate many arrangements where the advice satisfies the pre-PPA level-fee rule. In other words, the bill would invalidate many arrangements under which the investment options chosen cannot affect the compensation of the advisor, the advisor's employer, or any affiliate of that employer. How many such arrangements would be invalidated would depend on how the definition of plan investment adviser is interpreted. But in any case, many such arrangements would be invalidated.

Elimination of all (or substantially all) class and individual exemptions. All (or substantially all) existing DOL class and individual exemptions with respect to investment advice would be repealed since they would not fit within the bill's two rules. This is of significant concern since many existing arrangements across the country rely on these exemptions. And these exemptions were the subject of rigorous scrutiny by the DOL under its demanding exemption process.

Moreover, the DOL's authority to grant any future class or individual exemptions with respect to investment advice would appear to be effectively repealed. This would remove a major source of flexibility needed to ensure that advice services for plan participants keep pace with developments in the marketplace.

Elimination of most plan-level advice. The PPA provision was limited to advice provided to participants. However, the bill goes further and very significantly limits advice that may be given to a plan. For example, in certain situations, an advisor may be asked to provide advice to a plan sponsor (especially small businesses) regarding which investment options should be offered to participants.

Guidance regarding which investment options should be offered to participants cannot be given through a computer program, so under the bill, investment advice to a plan can only be given under the bill level-fee plus rule. If the plan investment provider definition is read expansively to preclude the use of the bill level-fee plus rule by a financial institution providing financial products to any plan in the country, virtually all financial institutions would be precluded from providing advice to a plan, regardless of whether such advice is conflicted.

The area of advice to plans is not one that has been the subject of almost any public policy debate, either during consideration of the PPA or now. In the absence of any discussion, the bill's very significant restrictions on non-conflicted advice to plans are of concern.

Elimination of many sources of non-conflicted advice. The bill would prohibit many regulated entities, such as banks, from providing non-conflicted, non-computer model advice, even if the entity would otherwise satisfy the pre-PPA level fee rule and the bill level-fee plus rule. This prohibition would apply because the entity is not registered as an investment adviser under Investment Advisers Act of 1940, but is regulated under a different set of rules.

Public Policy.

The Education and Labor Committee set out to improve investment advice, but the bill went much further and would invalidate the majority of existing advice arrangements regardless of whether such arrangements involve potentially harmful conflicts of interest. This would have a huge adverse effect on participants. Employers are not required to offer investment advice programs and, in this economic climate, there are few employers able to absorb new costs and burdens attributable to a purely voluntary program that is currently working well to provide helpful, non-conflicted advice. Accordingly, informal indications from plan sponsors are that the imposition of new costs and burdens would result in the termination of these critically important, non-conflicted advice arrangements, not expensive redesigns. At the same time, employees need advice with appropriate safeguards now more than ever; we should be encouraging not discouraging such programs.

The impetus for the Education and Labor Committee's actions appears to have been the PPA investment advice provision and the 2009 class exemption. In this context, the public policy debate should be focused on the PPA provision and the 2009 class exemption. The goal of the PPA investment advice provision was worthy and is one that we share: to broaden the availability of investment advice to participants very much in need of advice. Moreover, we urge Congress and this Committee to carefully consider any action that would reduce the availability of investment advice to participants. However, if Congress determines that the PPA provisions and the class exemption provide insufficient protection against conflicts of interest, an appropriate response would be to address those issues directly. But there is no reason to do more than that.

To summarize, the following should be preserved, not prohibited:

- SunAmerica advice, which is based on a computer model developed by an independent third party and thus is clearly not conflicted.
- Advice satisfying the pre-PPA level-fee rule, which is by definition non-conflicted.
- Non-conflicted managed accounts (either under SunAmerica or the pre-PPA level-fee rule), which should be promoted as an effective means of providing advice.
- DOL class and individual exemptions. If DOL would like to reexamine any class or individual exemption, it has the power to do so. Invalidation of all such exemptions without careful review is not appropriate.
- Non-conflicted advice to a plan, which was not addressed by the PPA or the 2009 class exemption, and should not be limited today.
- Advice provided by qualified entities that are not registered investment advisers but are selected by plan fiduciaries after the type of careful fiduciary review required by ERISA.

Mr. NEAL. Thank you, Mr. Chambers.

Mr. Jones is recognized to offer testimony.

STATEMENT OF CHRISTOPHER JONES, EXECUTIVE VICE PRESIDENT OF INVESTMENT MANAGEMENT AND CHIEF INVESTMENT OFFICER, FINANCIAL ENGINES, PALO ALTO, CALIFORNIA

Mr. JONES. Thank you, Mr. Chairman, Congressman Camp, and Members of the Committee.

My name is Christopher Jones, and I am the Chief Investment Officer with Financial Engines.

On behalf of my fellow employees at Financial Engines, we greatly appreciate your continuing efforts to make quality, independent investment advice broadly available to those who need it most and to protect retirement investors from conflicts of interest.

Today, I would like to make three simple points in my remarks.

First, through its innovative and powerful technology, Financial Engines has made personalized, independent investment advice broadly accessible to millions of people in the United States. Our company was founded on the belief that the best practices from modern economic theory and institutional money management should be available to all investors, even those with a few thousand dollars in their accounts, not merely the affluent and the privileged. This is critical to the success of 401(k) participants whose median account balance today is only about $32,000. Without expert help, most of these people are unlikely to achieve retirement security.

Today, Financial Engines provides independent advisory services to more than 7.6 million employees at over 115 Fortune 500 companies. We give individuals specific recommendations on what to do with their retirement accounts, and we recommend the best combination of funds for them, selecting from the investment choices available from their employer.

My second point is that from the beginning we have carefully structured our business to ensure that we have no conflicts of interest which could compromise the objectivity of our investment advice. Under ERISA and the Investment Advisors Act, we have a strict fiduciary obligation to the employees we serve. Our independence is critically important to the employers who hire us to provide advice to their employees.

What does independence mean? Specifically, we do not sell any investment products of any kind. We do not receive differential compensation based on the investments we recommend. We do not receive commissions on any of the investments that we recommend. We do not vary our investment methodology across any of our customers. We are not affiliated with or controlled by any bank, broker-dealer, or any other type of company. And we play no role in the selection of a particular retirement plan fund lineup, nor do we accept any kind of compensation to recommend prospective funds to employers.

What we do provide is personalized, independent, and consistent investment advice to millions of individuals of modest means who would otherwise not receive it. In fact, I have described this consistent methodology in great detail in a book I authored which was published by John Wiley and Sons in 2008 titled, "The Intelligent Portfolio: Practical Wisdom on Personal Investing from Financial Engines."

My third and final point is that getting effective investment advice into the hands of those who need it requires convenient and cost-effective access for employees. Today, Financial Engines reaches its customers in two different ways. In the first method, Financial Engines is directly hired by the employer, the plan sponsor, to advise its employee population. For example, we have been hired by such companies as Delta Airlines, IBM, Motorola, and PG&E under this structure.

In the second method, Financial Engines is hired as a sub-advisor, working with plan record keepers such as Vanguard or JPMorgan. We provide our services under the criteria defined by the Department of Labor's 2001 SunAmerica ERISA Advisory Opinion. This ruling permits the provision of investment advice based on an objective computer model developed and maintained by an independent financial expert. The SunAmerica ruling is important because record keepers are the portal to the 401(k) and play an important role in reaching plan participants. Employees benefit when investment advice is fully integrated into their 401(k) plan communications.

More than 5 million employees, particularly those working for smaller organizations, have access to our independent advisory services through the SunAmerica model. It is important to emphasize that under either structure our investment advice is truly independent and completely consistent.

We understand that some questions have been raised regarding the SunAmerica model. However, the SunAmerica structure provides substantial protections against conflicts of interest, and we strongly support the rigorous enforcement of these protections.

It is important to preserve the ability to provide independent investment advice under the SunAmerica structure. And accordingly, we do not support passage of H.R. 2989 in its current form because it would eliminate this important method of providing independent investment advice to those who need it the most. Without the SunAmerica structure, we believe that employees will have fewer options for cost-effective personalized investment advice to help them reach their retirement goals.

We thank you for your time.

[The prepared statement of Mr. Jones follows:]

Independent Investment Advice

Christopher Jones

Executive Vice President of Investment Management
and
Chief Investment Officer

Financial Engines

Hearing on Defined Benefit Pension Plan Funding Levels
and
Investment Advice Rules

Committee on Ways & Means
U.S. House of Representatives

October 1, 2009

financial engines®

Mr. Chairman, Congressman Camp, and Members of the House Committee on Ways and Means, my name is Christopher Jones and I am proud to serve as the Executive Vice President of Investment Management and Chief Investment Officer of Financial Engines, Inc. Using innovative technology, Financial Engines has made personalized, independent, and high-quality investment advice accessible to millions of people throughout the United States. Since the founding of Financial Engines thirteen years ago, our mission has been to give everyone access to high-quality and objective investment advice. We have adapted the best practices from modern economic theory and institutional money management to meet the needs of everyday investors, regardless of their wealth or experience. Our services have dramatically lowered the cost and increased the accessibility of independent, personalized investment advice. We strongly support the efforts of Congress to protect the interests of those who are investing for retirement and to make quality unbiased investment advice more broadly available to those who need it most.

Financial Engines: Meeting the need for independent investment advice

Financial Engines was co-founded in 1996 by Dr. William F. Sharpe, a recipient of the 1990 Nobel Prize in Economic Sciences for his pioneering work on the theory of financial economics; Joseph Grundfest, a former SEC commissioner and noted Stanford Law professor; and Craig Johnson, a leading Silicon Valley attorney.

The company was established to meet the overwhelming need for independent investment advice, particularly for individuals of modest means. Traditionally, high quality, personalized investment advice had been available only to the affluent. Bill Sharpe's vision was to leverage technology to make high quality unbiased advice available to everyone.

The problems created by the lack of advice are particularly acute among participants in our nation's employer sponsored defined contribution plans (401(k)s), where the median balance is only $31,800[1]. Financial Engines recently looked at over one million participants and found that nearly seven out of ten 401(k) participants had portfolios with inappropriate risk and/or diversification. Moreover, the participants making the most mistakes were those least able to afford them – participants with lower salaries, lower plan balances and those closest to retirement.[2] For example, 53% of those earning less than $25,000 per year had very inappropriate portfolios. The implications of these data are troubling. Without access to affordable, objective advice, a majority of plan participants are failing to make the good decisions required to achieve retirement security. Our analysis showed that, over a period of thirty years, participants with inappropriate risk and/or diversification could have up to 31% less expected wealth at retirement.

Most people do not have the knowledge, time, or interest to make complex financial decisions. A recent survey by Deloitte found that most employers do not think their workers know how to save, with 84% saying their employees are confused about selecting fund options, and 53% saying their employees do not know how much they will need for retirement.[3] Forty-two percent of defined contribution participants participating in a similar John Hancock survey indicated that they have little or no investment knowledge[4].

According to Annamarie Lussardi, an Economics professor at Dartmouth College, financial illiteracy is widespread among the U.S. population and particularly acute among specific demographic groups, such as those with low education, women, African-Americans, and Hispanics. Moreover, close to half of older workers do not know which type of pensions they have and the

[1] EBRI Aug 2009, see http://www.reuters.com/article/pressRelease/idUS151580+04-Aug-2009+PRN20090804
[2] The Financial Engines National 401(k) Evaluation, May 2008.
[3] 2009 Deloitte Benchmarking Survey, conducted by Deloitte Consulting, The International Foundation of Employee Benefit Plans and the International Society of Certified Employee Benefit Specialists.
[4] Lost in Translation, Employee Benefit News, 9/1/2009

large majority of workers know little about the rules governing Social Security benefits.[5]

The health of our nation's retirement system depends upon independent, personalized investment advice that can be cost-effectively provided to participants with as little as a few thousand dollars in their accounts. Our company was founded with this goal in mind.

Our Commitment to Independent Advice

Financial Engines is an independent investment advisor[6].

As an investment advisor registered with the SEC, we owe the employees we serve an ongoing fiduciary duty and are subject to stringent examination requirements. We also act as a fiduciary under ERISA.

We have carefully structured our business to ensure that we have no conflicts of interest that could compromise the objectivity of our recommendations. This is critically important to the employers who hire us to provide advice to their employees. The decision to hire us is a fiduciary decision, meaning that the employer must act in the best interests of their plan participants. We take our responsibilities as an independent investment advisor extremely seriously. In that regard, I would like to emphasize a few points:

- We do not construct or sell any investment products of any kind.
- The fund recommendations in our advice have no impact on the compensation we receive. We do not generate higher income from selecting one fund family versus another, nor do we have any incentive to select specific actively managed funds over passive index funds.

[5] "Household Saving Behavior: The Role of Financial Literacy, Information, and Financial Education Programs," Annamaria Lusardi, (Dartmouth College and NBER), February 2008.

[6] All advice is provided by Financial Engines Advisors, LLC, which is a wholly-owned subsidiary of Financial Engines, Inc. (collectively, Financial Engines).

- We do not receive commissions, 12b-1 fees, revenue sharing payments, or soft dollar payments. We are not affiliated with or controlled by any bank, broker-dealer, registered investment company, insurance company or financial services organization.
- We use the same investment methodology across all customers based on objective criteria contained in a computer model. This model was developed solely by Financial Engines. An individual will receive the same advice regardless of their plan sponsor or plan record-keeper
- We play no role in the selection of a particular retirement plan's fund line-up, nor do we accept any form of compensation to recommend prospective funds to plan sponsors.

We are heartened by the fact that policy makers see the importance of providing help to 401(k) participants and that policy makers continue to encourage the widespread availability of high-quality independent investment advice while protecting participants against conflicts of interest. From a policy perspective we would like to see the facilitation of broad participant access to cost-effective objective investment advice. We also want to see plan participants protected from investment advice compromised by conflicts of interest. Finally, we would like to see policy makers strongly encourage employers to offer objective investment advice to their employees by removing any ambiguity that has been created in the market by conflicting statutory proposals. We believe the health of our nation's defined contribution system depends on helping participants make good decisions with their retirement savings.

Our Role in the Marketplace

Financial Engines has become a leading independent investment advisor and offers personalized advice to participants in 401(k) and other defined contribution plans such as 457 and 403(b) plans. We give individual employees specific recommendations on their 401(k) or other defined-contribution retirement accounts, selecting from the investment choices provided by their employer.

We now work with America's leading employers, and more than three-quarters of the states, to make retirement help available to millions of American workers. Financial Engines is under contract to make our services available at more than 115 of the Fortune 500 corporations, and our services are available to more than 7.6 million plan participants. We offer investment advisory services to more than 250 plan sponsors with greater than 5,000 employees. Our services help all employees regardless of account balances. As of August 31, 2009, 49% of our customers had 401(k) plan balances of less than $20,000.

Services Provided

Financial Engines helps investors with their total retirement picture by offering personalized retirement plans for saving, investment, and retirement income. Our services address some of the most important questions and concerns of participants:

- "Will I have enough money to retire?"
- "How should I invest my money?"
- "When can I retire and how much might I spend when I do?"

Financial Engines offers both online advice and professional management to meet the needs of different investors.

Our online advice service includes interactive access to advanced simulation and portfolio optimization technologies. Users can see a forecast that shows how likely they are to reach their desired retirement goals, get recommendations on which investments to buy or sell, and simulate how their portfolios might perform under a wide variety of market outcomes. They can also explore different levels of investment risk and savings, and can adjust their retirement horizon. They can also receive tax-efficient advice on accounts other than their 401(k). These technologies help participants to reach informed decisions on how to maximize the chance of achieving retirement security.

Financial Engines' Investment Methodology

Our investment process is based on time-tested methods, many of which were pioneered by our co-founder Dr. William F. Sharpe, and are used by large institutional investors, including pension funds and endowments. Dr. Sharpe is the author of leading treatises on investment theory, including *Investors and Markets: Portfolio Choices, Asset Prices, and Investment Advice*; *Portfolio Theory and Capital Markets*; *Asset Allocation Tools*, and *Fundamentals of Investments*.

Our goal is to apply the best practices of institutional money managers and advanced financial economics to help everyday people achieve their retirement goals. Our advice technology platform allows us to cost-effectively service the needs of all individuals, regardless of account balances.

Our technology-based investment approach is distinguished by the following:

- We have a single methodology that is consistently applied for all of our customers. No matter how you reach Financial Engines or interact with our services, you get the same consistent high quality advice. I described this methodology in a book I wrote, which was published by John Wiley and Sons in 2008: *The Intelligent Portfolio– Practical Wisdom on Personal Investing from Financial Engines*.

- This consistent methodology results in recommendations that are highly personalized, chosen from the options available within each plan. We consider the plan participant's individual circumstances including investment horizon, existing investment allocations, 401(k) plan characteristics, and other household assets as well as any anticipated benefit from other employer plans such as cash balance or defined benefit plans. We do not rely on generic, model portfolios that cannot accommodate many real-world complexities.

- On a monthly basis, we model the specific characteristics of more than 30,000 securities, including retail and institutional fixed income, international, and equity funds, guaranteed investment contracts, stable value funds, exchange-traded funds and individual stocks in the plans to which we provide services.

- We take into consideration a variety of factors that impact investment returns such as asset class exposures, expenses (both management fees and the implicit costs of trading behavior), turnover, manager performance and risk, tax efficiency, and other security-specific factors.
- Our methodology is able to take into consideration other assets in a plan participant's household portfolio resulting in advice that appropriately adjusts for the risks and correlations of other financial assets.
- We advise on the entire fund line-up, including employer stock.

We believe that reducing fees is a key factor in increasing wealth over time, and our methodology explicitly takes the impact of fees into consideration, both in our retirement forecasts and in the optimization of portfolios. We often recommend portfolios with lower overall fees to the employee, helping them select investments that will provide the highest expected returns for the level of risk they select.

Traditionally, personalized independent advice like that provided by Financial Engines has been available only to those with hundreds of thousands or millions of dollars in assets. Financial Engines has pioneered the technology to make such advisory services available to those with even the smallest account balances. It is important to emphasize that Financial Engines is providing these services to those who would not have otherwise have access to independent and affordable advice.

How Financial Engines Delivers Its Services

Financial Engines offers its services to employees at many of America's leading companies and to a number of state-sponsored public plans. Financial Engines is either hired directly by the employer (non sub-advisory model) or our services are made available to employers through a plan record keeper under the Department of Labor's "SunAmerica" ERISA advisory opinion (sub-advisory or "SunAmerica" model).

In the non subadvisory model, Financial Engines is hired by the employer (i.e., plan sponsor) to offer its services to participants. Financial Engines assumes the role of a fiduciary to the plan, which means that Financial Engines is obligated to act in the best interests of participants (i.e. the employees). Financial Engines works with the plan provider[7] to set-up the plan and get the necessary data to be able to provide advisory services. When the participant accesses Financial Engines they either login at the plan provider participant portal or directly at Financial Engines.

In the sub-advisory or "SunAmerica" model, the employer hires the plan provider as the investment advisor. The investment advice provided to plan participants is generated by Financial Engines, acting as an independent Financial Expert under the Department of Labor SunAmerica Advisory Opinion of 2001. Both the plan provider and Financial Engines act as fiduciaries to the plan. We would like to emphasize the following SunAmerica requirements, which are designed to protect participants against conflicts of interest:

- As the Financial Expert, we are independent of the Related Party Advisor (i.e., plan provider) based on the factors outlined in the SunAmerica opinion, which include analysis of financial and ownership interests as well as other relationship factors that could impact the ability of the Financial Expert to act independently.[8] The Agreement between us and the Related Party Advisor contains a joint acknowledgment and agreement that we are and will remain independent.

[7] Plan providers provide record-keeping and administrative services to retirement plans.
[8] The Opinion addressed the independence of the Financial Expert as follows:
"[w]hether a party is 'independent' . . .will generally involve a determination as to whether there exists a financial interest (e.g. compensation, fees, etc.), ownership interest, or other relationship, agreement or understanding that would limit the ability of the party to carry out its responsibility beyond the control, direction or influence of the fiduciary."

- As the Financial Expert, we are solely responsible for the development, maintenance and oversight of the computer methodology used to create investment advice.
- Our computer programmers are unaffiliated with the Related Party Advisor.
- Participant online interactions are with our systems. The Related Party Advisor has no role whatsoever with respect to the advisory computer output. All code is maintained and run on Financial Engines systems.

Financial Engines believes that our ability to operate under the SunAmerica Opinion has substantially facilitated the delivery of unconflicted advice to plan participants. The PSCA estimates that 20 million participants currently receive advice under SunAmerica. Of the 7.6 million employees overall who have access to our services, more than 5 million have access through the SunAmerica model. We believe the SunAmerica framework allows Financial Engines to provide convenient and cost-effective access to independent and unconflicted advice to more participants, particularly those working for smaller companies. Employees benefit when investment advice is part of a single fully integrated source for all their 401(k) plan questions.

We look forward to working with Congress and policy makers to insure that our nation's plan participants have broad and convenient access to high quality independent investment advice, and that employers are encouraged to provide the services their participants need to achieve retirement security.

Mr. NEAL. Thank you very much, Mr. Jones.

Mr. Murphy, you are recognized to offer testimony.

STATEMENT OF EDMUND F. MURPHY, III, MANAGING DIRECTOR, PUTNAM INVESTMENTS, LLC, BOSTON, MASSACHUSETTS

Mr. MURPHY. Thank you. Good afternoon, Chairman Neal, Ranking Member Camp, and Members of the Committee. Thank you for inviting me to appear before you today.

I am Edmund Murphy, Managing Director and Head of Defined Contributions at Putnam Investments, a leading global money management firm with $110 billion in assets under management. Prior to joining Putnam, I spent 17 years with Fidelity Investments in a variety of senior management roles in the defined contribution business.

Putnam has long been a leader in the business of retirement through investment products to help individuals prepare for retirement, through bundled, open-architect 401(k) plans that offer investments from Putnam and other fund complexes, and through services we provide to plan sponsors and independent advisors.

Today, I would like to offer my views on the provision of investment advice to participants in defined contribution plans, a service which we believe is vitally needed.

With traditional pension plans and Social Security likely to provide a declining share of post-retirement income for America's workers in the future, it is critical that defined contribution plans be able to make up the difference. To do so, workers must make a lifetime of sound investment decisions. Many, if not most, workers require judicious, unbiased and professional advice and guidance to make such decisions. Investment managers, service providers, and others can and do provide such unbiased advice today, notably under the kinds of arrangements made possible by the SunAmerica advisory opinion.

In our view, that model has provided a large number of plan participants with robust proven protection against conflicted advice. However, some proposals currently under discussion intended to ensure that investment advice is unbiased could have the unintended effect of ending many such existing advice arrangements. Moreover, by restricting who can provide professional investment advice, they might also have the effect of raising costs and limiting expansion of coverage in the future.

The proposals under consideration would restrict the provision of advice to participants to fee-based financial advisors. They would bar asset managers and service providers who might offer cost-effective and scalable advice and package solutions to workplace savers unless that advice is solely generated by a computer program meeting detailed and potentially costly requirements.

Blocking access to well qualified and capable competitors is apt to raise cost in any market; workplace savings is unlikely to be an exception. Among the surely unintended results could be to actually curb the rate of adoption services for advice to plan sponsors and lower the share of plan participants who have access to professional advice.

Some of the language currently under discussion, in fact, would be a step backwards in that it could prohibit the kinds of advice that had been available before the passage of PPA. We at Putnam believe that sufficient safeguards already exist in the PPA and other laws and regulations. Rigorously enforced, they can provide workers with the protection they need. We do not believe that privileging a specific advice model and excluding whole classes of firms from the advice market are necessary to ensure unbiased advice. Instead, we believe that any new legislation or regulations should, number one, reaffirm the pre-PPA level advice rule, which, by definition, is non-conflicted.

Two, reaffirm the use of non-conflicted managed accounts in a way to provide advice.

Three, permit the use of outside computer models, support the SunAmerica opinion, which enables service providers to offer advice to plan participants through an affiliated advisor if the investment advisors use an independently developed computer model. The SunAmerica opinion could be bolstered through rigorous disclosure, auditing, and monitoring developed in concert with the industry.

Four, enable appropriate use of in-house computer models. Permit asset managers and service providers to continue offering unbiased advice based on in-house computer models independently certified as unbiased in accordance with the key Pension Protection Act requirements.

Five, avoid any blanket dismissal of existing Department of Labor class and individual exemptions, letting the Department review exemptions on a case-by-case basis if it is so inclined.

And finally, avoid any new limitations on non-conflicted advice to plans.

We believe these measures, taken together, could provided adequate protection to investors while expanding access to affordable, unbiased, professional advice that America's workplace savers so clearly need. We would also be receptive to other proposals to protect participants' interests, provided they serve to expand competition and access to advice, not contract it.

I have submitted a written statement which extends my remarks. I want to thank the committee for letting us share our views.

[The prepared statement of Mr. Murphy follows:]

Prepared Statement of Edmund F. Murphy, III, Managing Director, Putnam Investments, LLC, Boston, Massachusetts

I am Edmund Murphy, Managing Director and Head of Defined Contribution at Putnam Investments. I am testifying on behalf of Putnam, a global money management firm and leader in the retirement industry.

Prior to joining Putnam, I spent 17 years with Fidelity Investments in a variety of senior management roles within the defined contribution business. Those assignments included leading Fidelity's small market 401(k) business and serving as Executive Vice President of distribution and client management for Fidelity's entire 401(k) business.

Putnam Investments and Retirement

Putnam Investments is a global money management firm with more than 70 years of investment experience. As of August 31, 2009, the firm had $110 billion in assets under management. Putnam has long been a leader in the business of retirement, through investment products aimed at helping individuals prepare for retirement; through bundled, open-architecture 401(k) plans that offer investments from Putnam as well as other fund complexes; and through services we provide to retirement plan sponsors and independent financial advisors.

Putnam currently offers a fully-bundled 401(k) plan solution to small, medium and large companies. This solution includes an open architecture investment platform with funds from Putnam and other fund complexes; plan sponsor communications; employee education and communications; and plan record-keeping services.

Putnam sells into the 401(k) plan market through financial intermediaries including financial advisors and 401(k) consultants. These intermediaries work on behalf of the plan sponsors and generally act in a fiduciary capacity. They are not affiliated with Putnam.

Investment Advice in Defined Contribution Plans

I appreciate the invitation of the Committee to testify. I would like to offer my views on the provision of investment advice to participants in defined contribution plans—a service which we believe is vitally needed by the nation's workers.

Defined contribution plans will play an even more central role in the future as defined benefit plans decline and Social Security's ability to replace pre-retirement incomes is reduced by changes built into current law. For DC plans to successfully fill an expanded role, the amounts in worker retirement portfolios must grow—which means that workers must make a lifetime of sound investment decisions. Many, if not most, workers require judicious, unbiased and professional advice and guidance to make such decisions about complex investments—a need that last year's market events only underscored.

Investment managers, service providers and others can and do provide such unbiased advice today. Several of these were codified under the SunAmerica advisory opinion, which the U.S. Department of Labor issued in 2001. About 20 million participants in 401(k) plans or similar savings vehicles are currently offered advice based on the SunAmerica opinion.

In our view, the model originated by the SunAmerica opinion, as enhanced by subsequent Congressional legislation and regulatory guidance, provides plan participants with the investment advice they need for sound decisions and strong, robust and proven protection against conflicted advice and with no significant issues regarding lack of independence.

Impact of Alternative Proposals under Consideration

However, some legislative and regulatory proposals currently under discussion in Congress and at the Department of Labor could have significant impacts on institutions' ability to provide advice to 401(k) plan participants.

Among the specific impacts of the proposed changes would be the effective repeal of the PPA's investment advice provisions (i.e., both the level-fee rule and the computer model rule); the elimination of most SunAmerica-based advice arrangements; the elimination of most managed accounts, whereby advice is automatically implemented in accordance with a participant's prior authorization; the elimination of many pre-PPA level-fee arrangements; the elimination of all or most class and individual exemptions granted by the Department of Labor; and the elimination of most plan-level advice, which is provided not to individuals but instead to plan sponsors such as small business owners about, for instance, which investment options should be offered to participants.

Ironically, the proposals under consideration, meant to ensure that investment advice is unbiased, could have the unintended effect of ensuring that no investment advice is provided at all. They could have the effect of ending existing arrangements, including pre-PPA arrangements, that provide investment advice.

The proposals under consideration would restrict advice to participants and employers to one of two types. First, "fee-only" advice—advisors cannot offer investments on the plan's menu and cannot receive any compensation from someone who manages or sells plan investments. Or second, advice provided solely through a computer model meeting requirements that are much more detailed than currently required by the Department of Labor's guidance.

As a result, these proposals would effectively bar asset managers and service providers who might offer highly cost-effective and scalable advice and packaged solutions to workplace savers, unless that advice is solely generated by a computer program meeting detailed and potentially costly requirements.

Blocking access to well-qualified and capable providers is apt to raise costs within any market, and workplace savings is unlikely to be an exception. Among the surely unintended results could be to actually curb the rate of adoption of advice services by plan sponsors; lower the share of plan participants who have access to professional advice; and limit the coverage of workplace savings plans.

Some of the language currently under discussion, in fact, would be a step backwards in that it could prohibit the kinds of advice that had been available before passage of the PPA.

Recommendations

We at Putnam believe that sufficient safeguards already exist in the PPA and other laws and regulations. Rigorously enforced, they can provide workers with the protection they need. We do not believe that privileging a specific advice model and excluding whole classes of firms from the advice market are necessary to ensure unbiased advice. Instead, we believe that any new legislation or regulations should:

1. Reaffirm the pre-PPA level-fee advice rule, and strengthen it by requiring an ethical wall to insulate investment advisors from undue influence attributable to variable fees received by other parts of their organization. Such an ethical wall could be similar to the internal policies and procedures that investment bankers adopted in 2003 to provide unbiased research by insulating their researchers from their underwriters.
2. Reaffirm the use of non-conflicted managed accounts as a way to provide advice.
3. Permit the use of outside computer models by supporting the SunAmerica opinion, which enables service providers to offer advice to plan participants through an affiliated advisor if the investment advisors use an independently developed computer model. Because such advice is provided by an independently designed computer model, and because that advice cannot be modified by the plan advisor, the advice is not conflicted and there is no violation of the "prohibited transaction" rule. The SunAmerica opinion could be bolstered through rigorous disclosure, auditing and monitoring developed in concert with industry.
4. Enable appropriate use of in-house computer models. Permit asset managers and service providers to continue offering unbiased advice based on in-house computer models independently certified as unbiased in accordance with the key Pension Protection Act requirements (e.g., independent third-party certification, annual audits and disclosure).
5. Avoid any blanket dismissal of existing Department of Labor class and individual exemptions, letting the Department review exemptions on a case-by-case basis if it is so inclined.
6. Finally, avoid any new limitations on non-conflicted advice to plans and plan sponsors, as opposed to individual plan participants.

Conclusion

We believe these measures, taken together, could provide adequate protection to investors while dramatically expanding the availability of the affordable, unbiased, professional advice that workers need to make the right investment decisions for their retirement.

We also would be receptive to other proposals to protect participants' interests, provided they serve to expand competition and access to advice—not contract it.

Financial institutions are well-equipped and ready to help provide plan participants and plan sponsors with such advice, and have been doing so successfully under existing legislation and regulatory guidance. I hope that Congress and the nation's regulators will take positive steps that ensure the provision of needed professional investment advice continues.

Mr. NEAL. Thank you, Mr. Murphy.

Mr. McCarthy is recognized to offer testimony.

STATEMENT OF JIM McCARTHY, MANAGING DIRECTOR, MORGAN STANLEY, ON BEHALF OF THE SECURITIES INDUSTRY AND FINANCIAL MARKETS ASSOCIATION

Mr. MCCARTHY. Thank you.

Chairman Neal, Ranking Member Camp, Members of the Committee, I am Jim McCarthy, the Managing Director of Retirement Services at Morgan Stanley Smith Barney, and I am testifying on behalf of the Securities Industry and Financial Markets Association.

SIFMA's member firms are engaged in every aspect of the retirement plan industry, including plan creation, investment management, record keeping, and advice and education.

Morgan Stanley Smith Barney is a global financial services firm providing brokerage, custodial, and investment-related services to approximately 3.4 million retirement accounts, and approximately

$370 billion in assets. Like many firms, Morgan Stanley Smith Barney advisors are actively engaged in helping plan sponsors select and monitor retirement plans, as well as assisting our 5 million individual clients with their savings and investment concerns. We do not manufacture record keeping, but rather we use a consultative approach to market the services of approximately 30 manufacturers of retirement platforms.

Let me say at the outset that not a single 401(k) program that we sell has a proprietary fund requirement in favor of one of our affiliated asset managers.

The policy proposals being discussed today would have a significant effect on 401(k) plan sponsors, plan participants, and potentially IRA owners in how they access professional advice to establish plans for their employees, help their employees navigate those plans, and obtain investment guidance.

The need for advice is well-documented. Individuals who do not have access to advice are too risk adverse when they are young and take too much risk when they are nearing retirement. Studies have indicated that workers with access to investment advice earn higher returns and tend to save more.

I hope we can agree that access to more investment advice and getting it into the hands of more workers is an important goal. The Pension Protection Act and the DOL guidance would increase the number of people who are getting investment advice. I would also encourage all types of financial services firms to offer personalized investment advice with appropriate safeguards and accountability and controls to make sure that the advice is competent and focused on the client's needs.

Many participants seek in-person advice rather than just Web-based delivery systems, which work well for a portion of the population, but not for everyone. The PPA was a step in the right direction. It allowed a flexible system for not only 401(k) plans, but IRAs, and carried with it a significant safeguard disclosure and accountability to protect plan participants. It puts the lion's share of the burden of ensuring compliance where it belonged, on the shoulders of the advisors seeking to provide advice, not on the employers who want to do what's best for their employees by hiring advisors, and imposes significant penalties on those entities for any failures.

The DOL has been thorough in its consideration of the perspectives and open to the views during the comment period, is carefully calibrated to minimize conflict, disclose potential conflict, and audit conflict as an added protection. Repealing the PPA provisions before they have been given a chance to work and tested and practiced is misguided. We think this is bad policy, especially in light of the record and the need for participants to have greater availability to advice.

Policymakers should not rush to discard the PPA, the regulations, or the class exemption out of a belief that stamping out all conflicts, even potential conflicts, is warranted absent finding that the advice coverage ratio is not growing—as we are confident it will under PPA and the related regulations—or finding that conflicts have moved beyond the theoretical possibility and are in fact manifesting themselves.

So if H.R. 2989 moves forward, what gets thrown out in the process? As others have mentioned, not just the PPA, but the possibility of having tens of thousands of trained advisors actually take the accountability and provide specific advice in the setting sought by the participants with the proper compliance safeguards. If this is adopted, our own 18,000 financial advisors who are continually trained, backed up by systems for compliance, lawyers, overseen by auditors, risk managers and other controlled personnel, and are the subject of over $30 million a year in professional development spending, are effectively stopped from providing any advice to participants and IRA owners.

What is also eliminated is the protection that employers want in hiring a competent PPA-governed advisor, the assurance that they are not a co-fiduciary with the advisor for every investment recommendation made.

If enacted as defined, H.R. 2989 would create a totally new framework which would automatically disqualify hundreds of firms from providing advice, even those that had no financial conflicts. Banks, for example, would be categorically disqualified. As a result, plan sponsors, instead of a competitive market, may only be able to select from advisors from thinly capitalized companies which don't have the capacity and personnel and geographic diversity, let alone the resources to address problems when they occur.

The PPA included a significant number of safeguards. The DOL added additional safeguards as part of its regulatory process. Yet, these provisions have not been allowed to take effect, and we have not seen the positive result that would have been delivered.

We are concerned that the provisions of H.R. 2989 would vastly reduce the number of professionals able to provide one-on-one investment advice and to discourage plan sponsors from delivering any advice at all. Surely, this will not create more educated and confident plan participants, nor will it strengthen workers' retirement security.

We urge the committee to reject the approach taken in 2989 and carefully monitor the actions that the DOL will take in the coming weeks with respect to the final regulations in the class exemption, which would expand advice to millions of more workers.

Thank you to the committee for inviting us to testify today.

[The prepared statement of Mr. McCarthy follows:]

Testimony of James McCarthy, Managing Director, Retirement Plan Services,

Morgan Stanley Smith Barney

on behalf of

The Securities Industry and Financial Markets Association

Before

The Committee on Ways and Means

Hearing on Defined Benefit Pension Plan Funding Levels and Investment Advice Rules

United States House of Representatives

October 1, 2009

Good Morning, Chairman Rangel, Ranking Member Camp, and Members of the Committee. I am Jim McCarthy, Managing Director, Retirement Services, of Morgan Stanley Smith Barney and I am testifying on behalf of the Securities Industry and Financial Markets Association ("SIFMA")[1]. SIFMA's member firms are engaged in every aspect of the retirement plan industry, including retirement plan creation, investment management, recordkeeping, and advice and education. Morgan Stanley is a global financial services firm, providing brokerage, custodial and investment-related services to approximately 3.4 million retirement plan accounts and approximately $370 billion in assets and 5 million individuals who we are helping plan for their retirement. Like many brokerage firms, Morgan Stanley Smith Barney advisors are actively engaged in helping plan sponsors select and monitor retirement plans as well as assist our individual clients with their savings and investment concerns.

We appreciate the opportunity to testify today on investment advice for retirement savings, on H.R. 2989 which would repeal the Pension Protection Act's (PPA) exemption for investment advice and prior DOL guidance, and the negative effect this change would have on the actual delivery of specific, focused investment advice for retirement clients. Prior to the enactment of the PPA, policymakers consistently cited the need for more professional advice for participants with respect to their retirement savings. There is an even greater need for such advice today, in light of the volatility and precipitous drop and then rise in the markets. Only a small percentage of American workers have the benefit

[1] The Securities Industry and Financial Markets Association brings together the shared interests of more than 650 securities firms, banks and asset managers. SIFMA's mission is to promote policies and practices that work to expand and perfect markets, foster the development of new products and services and create efficiencies for member firms, while preserving and enhancing the public's trust and confidence in the markets and the industry. SIFMA works to represent its members' interests locally and globally. It has offices in New York, Washington D.C., and London and its associated firm, the Asia Securities Industry and Financial Markets Association, is based in Hong Kong.

of professional investment advice from individuals who hold themselves out to be fiduciaries and subject themselves to ERISA's fiduciary requirements. Current market conditions have affected retirement security and employees' confidence in their financial ability to retire. Our member firms hear everyday that benefit plan clients would like additional advice and support on retirement planning, investment allocation and strategies for these assets. Without additional professional advice in the market place, this situation will not change. Our members are very concerned that H.R. 2989 will have unintended, and harmful consequences. First, it will drastically reduce, not increase, the number of advisors available to provide this professional advice. Second, in contrast to the PPA, which put the burden of compliance with the exemption on the investment advice providers, it will force plan sponsors to take on additional fiduciary liability. Rather than making advice available to their employees, plan sponsors will choose not to provide advice programs at all. Respectfully, we believe that H.R. 2989 is a radical solution to the wrong problem – eliminating the appearance of conflicts, at the expense of giving workers the advice that they need.

American workers' retirement savings are increasingly held in participant-directed accounts such as 401(k) plans and in IRAs, either by contribution or through rollovers from employer sponsored retirement plans. Today, about 63 percent of the full time workforce is covered by a 401(k) plan; over the next 10 years, a high percentage of these assets will be rolled over into IRAs. IRA assets totaled $4.13 trillion as of September 30, 2008 – they already exceed assets in defined contribution plans, and are expected to increase further as workers retire in greater numbers and roll over their 401(k) balances. As a larger and larger percentage of these savings accumulate in IRAs which may be invested in the entire range of investment products -- annuities, stocks, bonds, foreign investments, mutual funds and other pooled vehicles -- investment advice on what vehicles/investments will be appropriate for an individual's particular circumstances is even more critical to help retirees through this wide array of investment choices.

ERISA and the Internal Revenue Code, which are the primary rules governing private retirement accounts, define every person who provides services to a plan as a so-called party in interest. As parties in interest, service providers are prohibited from engaging in any transaction or providing any service to a plan or an IRA unless the terms of an exemption are met. The prohibited transaction provisions of ERISA and the Internal Revenue Code (1) make all service relationships "conflicted" to a plan or IRA and (2) require that the conflicts be managed either through a statutory exemption, or through a class or individual administrative exemption which the DOL determines to be in the best interests of plan participants and beneficiaries, and protective of their interests.

Prior to the PPA, the exemptions available to fiduciary service providers were limited to a single investment product, such as bank deposits, or mutual funds, or annuities. There was no single exemption that would allow investment advisory services to be provided by someone whose affiliates might be selling multiple investment products, like securities, or mutual funds, or insurance contracts, or bank investment products, to a plan or an IRA – the only way that such a situation could work to avoid any conflict was that the advisor recommended none of its affiliates' products. In 1975, Congress thought such a restriction was unrealistic, and did not prohibit the DOL from trying to come up with rules to govern these situations, but no comprehensive solution emerged. In 2006, Congress found that the absence of a comprehensive investment advice exemption, either from DOL or from prior legislative initiatives, was largely responsible for the fact that few broad investment advice programs were offered by banks, insurance companies and broker-dealers. Instead, what was offered prior to the PPA was a patchwork of exemptions permitting a fiduciary to provide advice on one or another product type and then sell that product. Each such exemption contains different requirements and each covers only one type of product. These exemptions often do not contemplate the various compensation arrangements in existence today, nor do they cover all of the investment products that 401(k) and IRA holders can invest in. In addition, this approach discourages the introduction of innovative products designed to address longevity, inflation and market risks.

Congress concluded that what was needed in 2006 was a comprehensive exemption that clearly lays out the requirements for advisors to provide advice to plan participants, regardless of what types of investments are being recommended. The PPA addressed that need. It created a system intended to deal with conflicts, not to run away from them. It placed the responsibility for complying with the exemption on the advisors who seek to use the exemption, not on plan sponsors who understandably do not want to take on the risk of continuous monitoring of each and every condition of the exemptions. It gave the Department the authority to interpret and expand on the statutory exemption, using the judgment and experience it has acquired in dealing with these conflict issues since ERISA's enactment. It moved away from an inflexible and participant unfriendly set of rules and toward a realistic method of actually delivering in person advice to participants.

The statutory changes authorized in 2006 directed the Department to issue a separate class exemption with respect to IRAs if it found that there are no computer models capable of taking into account the full range of investment products available to

IRAs. The DOL interpreted the mandate very narrowly and found that a handful of computer models could be utilized for IRAs.[2] However, the DOL recognized that IRA owners have access to an unlimited array of investment products and under its own authority, proposed a class exemption specifically addressing the need to provide more flexibility for IRA owners.

As the Committee evaluates H.R. 2989, we would like to emphasize the following:

<u>1. Nothing Under Current Law, Pre-PPA or Otherwise, Prevents the Hiring of Unaffiliated Advisers</u>: We are strong advocates for the current computerized advice programs provided by advice providers such as Ibbotson, Financial Engines and Guided Choice, who are not affiliated with banks, broker dealers or investment companies. Neither the PPA exemption nor the DOL class exemption is biased against unaffiliated advisers. Indeed, the Department's rules make clear that every participant must be told that he or she may receive advice from an advisor who is not affiliated with any product. This reminder serves to underscore the choices available to participants and to provide a useful alternative for those who would prefer a different course.

<u>2. H.R. 2989 Will Limit The Choices that Plan Participants/Sponsors Deserve:</u> The PPA investment advice provisions would not have been necessary if Congress thought the current delivery system for unaffiliated investment advisers -- which is largely web-based -- would, and actually did, deliver advice to a wide range of individuals. Because web-based systems can be inflexible and impersonal, the current unaffiliated advice programs do not reach enough workers in ways that are comfortable

[2] http://www.dol.gov/ebsa/publications/reporttocongress.html

for workers, to make professional investment advice the norm, rather than the exception. Many advice providers depend on the Internet for the delivery of advice; while that approach may work for some participants, in our experience, plan participants still seek and need personal interaction with a fiduciary advisor. If the rules promulgated under the PPA had been allowed to take effect, plan participants would have had access to advice providers who offer advice on a wide variety of investments – in person or on the phone – in a cost-effective manner. Participants would also be able to receive advice which takes into account all of their savings, including their nonretirement savings, their IRAs and their 401(k) plans. The current models offer no such flexibility, even though the DOL's own guidance repeatedly urges advisors and advice educators to take into account all of a participant's savings.

3. H.R. 2989 Will Substantially Reduce the Number of Participants Who Actually Receive Advice Under the Current Rules: If financial institutions cannot recommend an investment if they or their affiliate serves as a custodian, broker, record keeper, or investment provider to a plan or IRA, rather than increase coverage, roughly 20 million fewer plan participants and IRA owners will no longer have access to existing advice programs, let alone the expanded offerings that PPA was to make available.[3] The lack of advice was Congress' concern in 2006, and there has been no significant increase in fiduciary advice programs since then, in anticipation of the DOL's issuance of regulatory guidance for the PPA. The Department's regulation and class exemption would be a step closer to reaching the stated goal of the PPA's investment advice provisions. Comments received by the DOL from individual participants and

[3] The Profit Sharing/401(k) Council of America reports that 20 million participants are offered advice through Sun America arrangements.

beneficiaries make clear their need for investment advice, particularly in this economy. But to limit advice to providers who have no affiliates selling products to plans and IRAs will continue the status quo – not enough advisors, not enough professional fiduciary advice.

4. IRA Owners Need Access to Flexible Advice Solutions: The delayed DOL class exemption recognizes that, as millions of workers change jobs or move into retirement, they may seek to choose from the many different types of investment products that cannot be modeled effectively with a computer program. IRAs may invest in stocks, bonds, CDs, currency, annuities, and many other financial products. As more of the population nears retirement, employers and financial services firms are working on product innovations that it may or may not be feasible to model. Reliance on computer models that include only one kind of investment product will stifle innovation or leave middle-income families with few choices in retirement. IRA owners are increasingly interested in investments that can't be modeled, such as bank products, securities (including Treasury instruments), annuities and pooled funds. Let me give just one example: without the class exemption proposed by the Department, an advisor at a financial firm could not recommend that an IRA owner invest half his IRA in a product that provides level income for life, and the other half in a laddered Treasury bond program, because there is no model that encompasses both of these products. Nonetheless, this is certainly a program that many IRA owners might reasonably want to consider.

A computer model provider could not respond to questions from participants that go beyond the model's required inputs, such as questions about suitable levels of risk. If the results of the model were unsatisfactory, a participant's only choice would be to run the model again, trying to guess at the inputs that would allow the model to provide choices that meet his or her needs. The class exemption addresses how off-model advice can be provided with sufficient safeguards, including contemporaneous recordkeeping, advance disclosure, and audit requirements that will protect participants and beneficiaries and create a record for ensuring that the requirements of the exemption and ERISA's fiduciary responsibility provisions have been satisfied.

Finally, the PPA final rule and class exemption protect participants. Only individuals subject to oversight of insurance regulators, the SEC, or similar state agencies or banking regulators can provide advice. This adds a layer of oversight and protection to these rules that does not exist under current law, where anyone can provide advice so long as he or she follows one of the methods in the Department's existing guidance. Additional protection is found in the requirement that participants be told that they are always free to seek advice on their own from an advisor whose company does not sponsor investment products, if that is what they prefer. This information will cause all plan participants and IRA owners to focus on how much oversight, and indeed skepticism, they want to exercise with respect to their own retirement savings. Another safeguard is the requirement that if an advisor recommends an investment with higher fees, he must explain why the higher fee investment is better for the participant. The material conflicts in the advisor's advice must be fully disclosed in writing: this focused disclosure is still another protection for participants and IRA owners. A further protection is the dire consequence of failing to meet the requirements of the exemption. Not only will the transactions that failed to meet the statutory requirements have to be reversed and the client restored to the position he or she would have occupied had the investment not been made, but unlike any other exemption the Department has issued, if there is a pattern and practice of failures, all of the transactions during the period of noncompliance will lose the relief provided by the exemption and will have to be reversed, *including those that did not violate the law.*

Still another protection is the annual audit. The final regulation and class exemption require the fiduciary advisor to obtain an independent audit on an annual basis. This audit is protective of plan participants and consistent with other exemptions that the Department has granted in the past. The audit requirement is analogous to the so-called QPAM look alike exemptions and the in-house manager exemption which requires an independent annual audit based on sampling. The audit will be done by professionals; the selection of the auditor will be subject to ERISA's fiduciary standards; and the results of the audit will be made available to plan sponsors, IRA owners, and, where there is evidence of a failure to meet the exemption, to the DOL. We believe this requirement is a strong protection for participants and beneficiaries which make the exemption administrable by focusing the DOL on the situations where independent auditors found evidence of noncompliance.

The final regulations interpreting the statutory exemption and the class exemption have been subject to a thorough process of evaluation and analysis. The DOL issued a Request for Information soliciting public comment before it even began to draft regulations, held two hearings, issued a Field Assistance Bulletin with its views in early 2007, and published a proposed and final regulation and class exemption, as well as a request for comments after the regulation and class exemption had been published in final form. All stakeholders have been heard. While some may disagree with the investment advice exemption in the statute, or with Congress' mandate to the DOL to determine whether models exist that can appropriately model any investment in which an IRA may invest, the final regulation and class exemption are both true to the statute and the class exemption contains the statutory findings necessary for the DOL to exercise its administrative discretion to promulgate relief. This process has been careful, thoughtful, and designed to elicit the views of the entire benefits community.

The final exemption is clear, protective and administrable. Its disclosure requirements are based on sound public policy guidance, and are more extensive than the basic ERISA exemptions that have been in place for more than 20 years, including PTE 77-4 for a fiduciary's use of its affiliated mutual funds, and PTE 86-128 for a fiduciary's use of its affiliated broker-dealer. In addition, unlike these earlier exemptions, the advice exemption provides an audit to the plan participant (similar to certain individual exemptions granted by the Department in recent years), and has a far more dire consequence for a pattern of noncompliance. Thus, the advice exemption, by analogy, has been proved to be administrable over time. But what is most important, these rules will, for the first time, present the realistic chance that widespread, easily accessible, person to person based professional fiduciary advice will be available and used by tens of millions of plan participants and IRA owners. We urge you not to lose sight of this goal. If professional fiduciary advice is to become the norm, we need to encourage those that are capable, trained and regulated to step forward and give this advice in a manner that makes economic sense for their employers. If we fail to do that, we may be consigning millions of Americans to "do it yourself" retirement planning.

We thank you for this opportunity to testify and I'd be happy to answer any questions you may have.

Mr. NEAL. Thank you, Mr. McCarthy. I want to thank our panelists.

Mr. Murphy, you state in your testimony that pending legislation on investment advice may have the unintended effect of ensuring no investment advice is provided at all. Why is this? Is it the complexity or the cost of the rules contemplated by the legislation, or perhaps the time lag in transitioning to a new system of regulating advice?

Mr. MURPHY. I would say it is both, Congressman. I certainly believe that with the requirements that would be placed on the plan fiduciary, and with the added burdens that would come back to providers to provide advice, I just think it is one of those situations where you are going to have less advice players or participants in the marketplace to give advice at a time when clearly right now we need more advice being given in the marketplace, not less.

Mr. NEAL. As you know, that was the answer I was looking for.

Mr. Gilbertson, you mention in your testimony that an investment advisor chosen by an employer assumes an air of credibility for the employee. Some advocate disclosure of any conflicts cures the conflict.

What do you think the average participant reaction would be to such a disclosure when the participant is coming to the advisor for expertise in an area that the participant may not fully understand in the first place?

Mr. GILBERTSON. I think most plan participants appreciate any investment advice that they can get, but they have to have some confidence that that advice is coming, first of all, from someone that is qualified to give that advice, and then secondly, to make sure that there is no conflict of interest going on between the person giving the advice and the advice that is being given. So I think overall, the more advice that you can give to plan participants, the better off in the long run they are going to be. But like I said, it has to be unbiased and free from any kind of a conflict.

Mr. NEAL. Thank you, Mr. Gilbertson.

The Chair would recognize the gentleman from California, Mr. Herger, to inquire.

Mr. HERGER. Thank you, Mr. Chairman.

Mr. Gilbertson, as you are aware, health care is a major component of retirement security for senior citizens and those nearing retirement. Many seniors in my district have expressed to me their concern that AARP is not advocating for their interests in the health care legislation currently being debated in Congress. Let me ask you about some of the positions included in AARP's policy book for 2009 and 2010.

It is my understanding that AARP uses the policy book recommendation as a guide for staff and its advocacy efforts. Page 39, chapter 7, states that "Congress should limit increases in out-of-pocket costs, including increases in Medicare's overall cost-sharing requirements and premiums for current benefits."

The Congressional Budget Office estimated that under H.R. 3200, seniors' Medicare Part D premiums will increase by 20 percent and their Part B premiums will increase by $25 billion. Mr. Gilbertson, do you view these significant premium increases as violating AARP's policy of limiting increases in premiums for current benefits? And based on your background in pensions, do you think such increases would be viewed as significant for seniors on fixed incomes?

Mr. GILBERTSON. Mr. Chairman, Congressman, the National Policy Council of AARP is broken down into three distinct areas. One is economics, which I serve on, another is health care, and then a third component that deals with community living and so on. So I am not prepared to answer your question because I have been placed on the Economic Council to give that kind of advice to the AARP board, but I will convey your concerns to the board and to my counterparts on the Health Policy Committee.

[The information follows:]

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Mr. HERGER. And Mr. Gilbertson, if this is an area that you feel you don't have the expertise, I would appreciate maybe in writing an answer, if we could, from AARP.

My next question is, AARP's policy book for 2009. When analyzing Medicare Advantage cuts found in the House Democrats' bill, H.R. 3200, the CBO stated that the cuts "could lead many plans to limit the benefits they offer, raise their premiums, or withdraw from the program." Similarly, MedPAC stated that these Medicare Advantage cuts would rob one in five seniors of the choice to receive Medicare benefits through a Medicare Advantage plan, and that the value of additional benefits seniors receive through Medicare Advantage would be cut by $252 per year. Yet, again, AARP's Web site claims that it is a myth that health care reform will hurt Medicare, and that it is a fact that "none of the health care reform proposals being considered by Congress would cut Medicare benefits or increase your out-of-pocket costs for Medicare services."

Mr. Gilbertson, is AARP suggesting that CBO and MedPAC are spreading falsehoods or lies about the Democrats' health care reform bill?

Mr. GILBERTSON. Congressman, once again, I was selected to testify on investment-related issues, investment advice, and I don't feel qualified to even attempt to answer your question. But I will relay your concerns to the board, the AARP board and staff, to get back to you answers on those.

Mr. HERGER. In writing. Thank you very much, Mr. Gilbertson.

Thank you, Mr. Chairman.

[The information follows:]

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Mr. NEAL. Thank you, Mr. Herger.

With that, I would like to recognize Mr. Pomeroy.

Mr. POMEROY. Thank you, Mr. Chairman, for this very interesting hearing.

I want to acknowledge Mr. Gilbertson, who was the Director of State Investment Funds back when I was on the State Investment Board, a long, long time ago back in the State of North Dakota. We haven't seen one another for more than a decade. It is good to see you again, Leroy.

I believe that AARP has not appropriately reflected upon the fiduciary standard that attaches in the providing of investment advice under the PPA language. Now, in that situation, I believe there is a clear legal obligation to provide advice solely in the interest of plan participants, and a means to take action against someone that would not do that. I would encourage AARP to reflect upon that language and would love to visit further with you and AARP personnel if they find that language wanting.

It seems to me—and I want to be to polite about this—that the Ed and Labor bill is a solution in desperate search of a problem. I simply have not seen from this panel, including advocates of repeal of PPA language relative to investment advice, a demonstration of massive abuses occurring. And Mr. Davis, let's talk specifically about your testimony. You indicate that economic self-interest inherently is going to skew advice. Well, I might observe that there is an economic interest to you and the members of your organization if a lot of the advice presently occurring under the fiduciary standards of PPA would go away. So I believe that you have a financial interest at stake relative to the testimony you have provided us. That doesn't mean the testimony is not completely honest as you see the world, but it certainly reflects a standard as you note those standards should apply otherwise.

In your testimony you note that there have been rules proposed by the Labor Department that may have gone beyond what was envisioned by the PPA language, those rules pulled back now by the existing Labor Department. You indicate that is a problem with the statute. I believe it is a natural part of administration. One administration was stretching. They didn't get it in place. If they had, they would have been sued. This administration pulled that language back, and I guarantee you are not going to see language like the prior administration advanced under investment advice as they sought to expand SunAmerica to my view of inappropriate dimensions.

So let's really get down to the crux of it. Under defined contribution retirement savings, people have been given an awful lot of responsibility for their own fate, but I don't believe we have taken sufficient steps to make sure they have the information so they can exercise that new responsibility well. This is a very important point in time.

Today's U.S. News and World Report captures the cover, Yes, you can still retire. Your portfolio took a hit, here is how you can get back on track. I believe the cover of this major news magazine reflects we are in a major national teachable moment.

My 401(k) took a hit, a hellish hit. I rebounced somewhat ignorantly, I am now wondering what to do. I need help. This is the cry of millions across the marketplace. And wouldn't it be unfortunate if, in the means of protecting—for the goal, and sincere goal by advocates of the Ed and Labor legislation, the goal of protecting people, we were to snatch away the very advice they need to figure out what they do in light of what the market has been through.

I would like to ask, I guess, Mr. Chambers, representing the Benefits Council, and Mr. Jones' Financial Engines—and I see I have probably filibustered most of my time here, so we are going to have to be brief about it—will moving forward with the kind of legislation proposed by Ed and Labor dramatically impact the availability of advice that the marketplace presently offers to plan participants? And what do you think would be the consequence if that would occur?

Mr. CHAMBERS. Thank you for the question.

In the interest of time, I think that there will be a significant adverse effect if this legislation, in its current form, goes through. And I see the progression in the following way: As I mentioned in my oral testimony, and also in the written testimony, our advice from our members of all three organizations who I am representing today is that there will be a significant number of employers who will decide to back off from providing access to investment advice for their participants. There is just too much else going on in their worlds. You heard that in the first panel today from the CEO of NCR. There is just too much going on. This is not something that, frankly, is high on their agendas.

So what is the result of that? It seems to me that as employers back away, the natural sort of—there are two choices. You have a participant who once again is back being responsible for investing his or her own assets among a panorama of different investments without any investment advice, or they have to go out and they have to find someone on their own—which, by the way, they are free to do today—but they are going to have to go out and find someone on their own who also will be subject to all of the fairly draconian rules that the proposed legislation would provide.

Now, in my view, if you are really concerned about conflicted advice, and if there are people here who think that every rock has people under it who will have nefarious intentions of harming participants, these are people from the employer's perspective who have been vetted. There are presumably sophisticated people at the employer who have been vetting one provider versus another, and who are fiduciaries and have a responsibility to monitor that. But if you put the individual out on his or her own, who is going to be in the marketplace and who, in my case, would go to my brother-in-law—God help me—what would happen, now my brother-in-law is, in theory, supposed to be subject to the same rules, and I guarantee you there is going to be a lot more conflict under those circumstances than there is today.

One final point if I may, which is this, which is we have an existing set of rules. And we have heard discussions today from other people on this panel that say, well, we hear rumors of conflicts out there. Well, we also have a Department of Labor that is very interested in hearing about those conflicts. My suggestion is that rather than create a whole new series of additional layers of compliance, let's try to focus on what we already have and get compliance from that perspective. If there is somebody who is out there who is stretching beyond this, they are outside of the bounds of the exemption, bring them to the attention of the Department of Labor and then other people who might be similarly inclined are not going to be following that course.

Mr. JONES. I would just add a couple of points. I would agree with my co-panelist on many of the major points there.

We do believe that if this legislation were to proceed in its current form, that it would have a negative impact on the availability of advice. One of the things that we are very concerned about in the current environment is the lack of legislative and regulatory clarity on hiring investment advisors, whether they are conflicted under the PPA model or unconflicted, is causing paralysis among plan sponsors, even large ones, where people are saying we are just not sure how the world is going to turn out, we are going to pause and see what happens. This is clearly restricting the availability of advice to folks who really need it. And as you point out, the current point in time is very important in terms of getting advice into the hands of those folks.

I would say that on the margin, the people that are likely to suffer the most are individuals that work for smaller organizations. The big, sophisticated plan sponsors have been hiring independent advisors for many years. I would say it is unlikely that they will choose not to do so even if the legislation were to proceed. However, there are many plan sponsors that receive advice under the SunAmerica model, and if that were to go away, I think the net effect would be a substantial reduction in the amount of advice available.

Mr. POMEROY. Mr. Chairman, thank you for allowing the extension of time.

Basically, as I see it, the SunAmerica model allows a platform for the delivery of independent advice comporting with fiduciary standards to the planned participant. And those with an understanding of the marketplace know this is simply the cheapest way to get a lot of advice out there. Now, some would prefer a one-to-one sit-down model—much more expensive, and there are an awful lot of employers that are not going to do it. So is SunAmerica better than no advice through that kind of platform? In my opinion, clearly yes.

Thank you, Mr. Chairman.

Mr. NEAL. We thank you, Mr. Pomeroy.

We recognize the gentleman from Michigan, Mr. Camp.

Mr. CAMP. Thank you, Mr. Chairman.

Thank you all for your testimony; it is very helpful today.

Mr. Chambers, I think clearly you said we don't want to back off investment advice, we certainly want to make sure that people have an opportunity to get and receive investment advice.

Mr. CHAMBERS. Correct.

Mr. CAMP. In fact, I think in your testimony you say that today more than ever participants need advice to get them back on course toward retirement security. And I think from what I hear from your testimony, your opinion is basically, with regard to SunAmerica, that if it ain't broke, don't fix it. But you believe Ed and Labor Committee's version would really hurt the goal of having access to investment advice. Can you just elaborate why you think that is the case?

Mr. CHAMBERS. Sure. As I mentioned a few minutes ago, I think that the problem with this particular legislation, as drafted—and remember, I am here focusing really exclusively on the pre-Pension Protection Act, SunAmerica and other level fee issues that are out there—I believe that this is going to cause a lot of employers to draw back from providing the opportunity for their employees from vetting providers of that advice. And therefore, that is going to put people in a position where they will either not be getting advice or they will be doing it on their own.

Furthermore, for those employers who do decide that this is a very significant thing for them to do, I actually think that it is going to limit the number of people that are out there who they can actually bring in to provide advice for their plan.

Mr. CAMP. Thank you.

Mr. McCarthy, I think at some place in your testimony you say that as many as 20 million participants in 401(k) plans could lose their access to professional investment advice if the Ed and Labor bill were to become law. Why do you think that is a cause for concern given the recent upheaval in the stock market?

Mr. MCCARTHY. The 20 million number comes from a PSCA—Profit Sharing Council of America—study about the number of people covered currently under SunAmerica arrangements.

So our belief is, as has been echoed by others, that with the invalidation of SunAmerica, you will create a freeze in the marketplace where people will not be willing to move forward, employers will say I have many more things on my plate, and I will put this off at a time where volatility—it is not just that markets are down, they have recovered somewhat, but volatility and the demography that we are facing right at the age wave needs to be dealt with. The number of people whose decision making needs to be good because they have less runway to make corrective action before they leave the workforce and have to be entirely reliant on their accumulated savings is growing.

The last point I would make is, to echo Mr. Chambers' comments, if the belief is that all of the conflicts—and I am not saying that the conflicts are not potential conflicts and they don't exist, but if the belief is that those conflicts are resulting in some conspiratorial plan that is manifesting itself in harm—the harm that Mr. Pomeroy does not see—I would agree with Mr. Pomeroy that the harm is not happening. So Mr. Murphy, to my right, is a vendor of which we distribute his product. We have approximately $270 million between our two firms in that product. And to his chagrin, we have 4/100ths of 1 percent of that asset base in an affiliated asset manager, which is significantly lower than our overall market share in the asset management business. And the only thing I could say to cheer him up is, we have other providers who are actually doing worse, so his 4/100ths isn't even the bottom of the list. So if we were running this conspiracy, you should sleep tight because we are incredibly inept at actualizing the harm.

Mr. CAMP. Thank you.

Thank you, Mr. Chairman.

Mr. NEAL. Thank you, Mr. Camp.

Let me recognize the gentleman from North Carolina, Mr. Etheridge, to inquire.

Mr. ETHERIDGE. Thank you, Mr. Chairman. And I will be brief. I just have one question.

Let me thank all of you for being here. This is a critically important issue, and a lot of people depend on this. And as you have heard today, employees really do need access to help with investment advice. You have heard that from a Member of Congress—I suspect if you ask every Member of Congress, they would probably say they need it too, it would be helpful after what we have been through. But we need to make sure that the advice that they receive is unbiased. I think we can all agree with that.

So Mr. Davis, let me ask you a question, if I could, please, sir. Can you elaborate on your testimony regarding plan sponsors who may think they are receiving advice, but actually are not. My question is, could this issue be addressed by requiring a plan service provider to disclose in plain English—that the average person can read—whether they are acting as a fiduciary to the plan sponsor when giving investment options?

Mr. DAVIS. Thank you, sir. That would absolutely be a positive step in the right direction.

What I was directly commenting on in my comments with those proportions was the disconnect and the different rules that govern different parts of our business that create confusion. ERISA won't let a fiduciary give conflicted advice, yet a broker in a typical situation dealing with a participant doing education is incented to recommend one thing rather than another. So, by definition, the broker-dealer for whom that broker works is going to say we are not giving advice, while the employer hired that person thinking that is exactly what they are doing. That dysfunctionality is simply a picture of the cloudiness of the regulatory and legislative environment in which we function today.

I certainly agree that we need more investment advice. And you are right, Mr. Pomeroy, nothing would feed my family better than to have more of that be delivered by independent advise providers such as our firm.

That being said, I would rather see the rules in the regulatory and legislative environment incent the behavior that you want, which is independence across investment advice. If everyone is self-motivated or self-interested, hopefully that self-interest is enlightened and we will reward those who are doing the thing that you want done, which is independent investment advice, rather than accept some iteration of investment advice simply because it is the best we can do given the construct that we have.

We have a new retirement system for the 21st century funded through defined contribution instead of defined benefit. We need a new education and advice delivery mechanism to reach those needs.

Mr. ETHERIDGE. Thank you, Mr. Davis. I yield back, Mr. Chairman.

Mr. NEAL. Thank you, Mr. Etheridge.

I want to thank our panelists for their good testimony today. We may have follow-up or questions, and I hope you will answer us promptly.

In addition, you can note that this issue is not going to die in the immediate future, and I hope that we will all remain vigilant as we continue this conversation.

Hearing no further comments, the hearing stands adjourned.

[Whereupon, at 2:09 p.m., the committee was adjourned.]

[Questions for the Record follow:]

COMMITTEE ON WAYS AND MEANS

U.S. HOUSE OF REPRESENTATIVES

WASHINGTON, DC 20515

Question: Let me ask you about some of the positions included in the AARP's Policy Book for 2009 and 2010. It is my understanding that AARP uses the Policy Book recommendations as a guide for staff in its advocacy efforts.

1. "Congress should limit increases in out-of-pocket costs, including increases in Medicare's overall cost-sharing requirements and premiums for current benefits." (Chapter 7, 7-39)

The non-partisan Congressional Budget Office (CBO) estimates that under H.R. 3200 seniors Medicare Part D premiums will increase by 20% and their Part B premiums will increase $25 billion. Do you view these significant premium increases as violating AARP's policy of limiting increases in premiums for current benefits? Based on you background in pensions, do you think such increases would be viewed as significant for seniors on a fixed income?

When analyzing the Medicare Advantage cuts found in the House Democrats' health bill (H.R. 3200) the independent Congressional Budget Office stated that the cuts "could lead many plans to limit the benefits they offer, raise their premiums, or withdraw from the program."

Similarly, the non-partisan Medicare Payment Advisory Committee (MedPAC) stated that these Medicare Advantage cuts would rob 1 in 5 seniors of the choice to receive Medicare benefits through an MA plan and that the value of additional benefits seniors receive through Medicare Advantage will be slashed by $252 per year.

Yet AARP's website claims that it's a "myth" that "health care reform will hurt Medicare" and that it's a "fact" that "None of the health care reform proposals being considered by Congress would cut Medicare benefits or increase your out-of-pocket costs for Medicare services."

Is there something that AARP knows that the Congressional Budget Office and MedPAC don't know? Is AARP suggesting that CBO and MedPAC are spreading myths about the Democrats' health reform bill?

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Is there something that AARP knows that the Congressional Budget Office and MedPAC don't know? Is AARP suggesting that CBO and MedPAC are spreading myths about the Democrats' health reform bill?

Answer:

Thank you for your question and your interest in AARP's public policy positions. As you correctly note, AARP's policies are published in our AARP Policy Book each year. Our Policy Book, approved by our all-volunteer Board of Directors, provides guidance to AARP staff in its advocacy efforts. The full Medicare policy statement on this issue is:

"Congress should:

- close gaps in Medicare coverage that lead to burdensome out-of-pocket costs;
- limit increases in out-of-pocket costs, including increases in Medicare's overall cost-sharing requirements and premiums for current benefits; and
- ensure that low-income beneficiaries are protected against high out-of-pocket expenses."

An important AARP policy goal is for all Americans to have access to adequate, affordable high quality health care. These goals are reflected in AARP's efforts to achieve affordable care for our older members with Medicare, including closing the "doughnut hole" in Part D coverage, reducing cost sharing for effective preventive services, and providing more assistance to low income beneficiaries to help with often unaffordable expenses. We believe health care reform proposals now pending in Congress would provide opportunities to improve benefits for our members.

On the question of payments to Medicare Advantage plans, on page 7-57 the AARP Policy Book states:

"Medicare payments should be neutral with respect to coverage option. Congress should set the benchmarks upon which Medicare Advantage (MA) plan payments are based so that they do not exceed fee-for-service costs.

Congress should phase out MA plan payments that exceed fee-for service costs over a four-year period.

Congress should evaluate the impact of the MA reimbursement methodology to ensure reasonable private health plan participation in the Medicare program and appropriate Medicare payments to participating plans.

To ensure that payments to MA plans are set at appropriate levels the Centers for Medicare and Medicaid Services (CMS) should continue to refine the methodology used to adjust MA plan payments. Congress should require that CMS continue phasing out its practice of offsetting the effects of risk adjustment and implement risk adjustment in a budget-neutral manner.

Payment methodologies should align payment with desired performance as determined by an assessment of quality, resource use, and beneficiaries' experiences."

As you know, CBO has stated that Medicare Advantage plans receive payments that, on average, are 114% of the cost for a beneficiary in the traditional Medicare program. MedPAC has consistently confirmed in its annual reports to Congress that the MA program continues to be more costly than the traditional program. Based on this evidence, to ensure the program remains financially viable, AARP supports reductions to excess subsidies to the private insurance plans that participate in the MA program. This position is not new, and has been part of AARP's policies for many years. AARP believes that by reducing these subsidies, we can lower Medicare costs and better ensure all older Americans will have the health coverage they need now and in the future. We also believe that this policy is equitable for all Medicare beneficiaries, including those who are covered in the traditional program.

Some of the savings from reducing subsidies to Medicare Advantage plans will be used to improve benefits that all beneficiaries will enjoy, such as improving coverage for prescription drugs by closing the coverage gap, or "doughnut hole," and expanding coverage to needed preventive benefits. We recognize that, as CBO notes, some plans "could" decide to reduce the extra benefits they offer, raise premiums, or exit the program. As with MA plan offerings every year, these decisions will be made by individual plans. A gradual transition that reduces the subsidies over time will help minimize disruption to the system and to current MA enrollees. AARP has also been a strong advocate for payment reforms that are coupled with policies to reward high quality plans that provide the greatest value to the program and to the beneficiaries they serve.

Despite reductions in excess subsidies to Medicare Advantage plans, no plan can reduce those Medicare benefits required by law and which older Americans have already earned – indeed, changes in the pending legislation will generally improve these benefits for all beneficiaries.

You also raised a question regarding potential Medicare premium increases and impact on beneficiaries. Premiums tell only part of the story, as we need to look at overall costs, as well as benefits. We believe, as stated by the CBO Director in his estimate of prescription drug costs, that beneficiaries' spending on prescription drugs apart from their Part D premiums would fall, on average, as would their overall prescription drug spending, including both premiums and cost sharing. Moreover, Dr. Elmendorf notes that when you combine the effects of the changes to part D -- including closing the coverage gap and changing the rebates paid to prescription drug plans -- CBO estimates that these provisions collectively would save the federal government about $30 billion over the 2010-2019 period. AARP believes these provisions will strengthen the program as well as provide immediate and needed help for current beneficiaries.

Our understanding of the current House bill is that Part B premiums would decline, not rise, as a result of that legislation. However, we recognize that if the Congress acts, as it has repeatedly in the past, on physician payment reform, then part B premiums may rise. Of course, ensuring access to one's doctor continues to be a high priority for Medicare beneficiaries.

[Submissions for the Record follow:]

Statement of the American Council of Life Insurers

The American Council of Life Insurers (ACLI) appreciates the opportunity to present its views to the Committee with respect to the investment advice rules for defined contribution plans. The ACLI is a national trade association of 340 member companies that account for 93 percent of the life insurance industry's total assets in the United States, 94 percent of life insurance premiums, and 94 percent of annuity considerations. In addition to life insurance and annuities, ACLI member companies offer pensions, including 401(k)s, long-term care insurance, disability income insurance and other retirement and financial protection products, as well as reinsurance.

The ACLI appreciates the Committee's attention to this important subject and we urge the Committee to continue to support SunAmerica (and similar advisory opinions) as well as the investment advice provisions in the Pension Protection Act (PPA). Over the last two decades, there has been a sizeable shift away from defined benefit pension plans in favor of "participant directed" defined contribution plans in which each participant manages the investment of his or her plan account.[1] To make these investment decisions, it is important for participants to have access to both investment information and investment advice. With last year's market decline as well as continued economic uncertainty, professional investment advice is more important than ever.

Current Investment Advice Environment: SunAmerica and Other Advisory Opinions

Employers and service providers have relied on long-standing Department of Labors (DOL) advisory opinions, in particular Advisory Opinion 2001–09A, a.k.a. "SunAmerica" (2001) and Advisory Opinion 97–15A, a.k.a. "Frost Bank" (1997), as a cost-efficient way to get non-biased advice to American workers.

Under SunAmerica, a service provider uses a third party's computer model to provide participants with investment advice. This opinion includes several important conditions to ensure the investment recommendations are not biased in favor of the service provider or its affiliates. For example, the third party, who designed the computer program, must be totally independent of the service provider and its affiliates and retain control of the development and maintenance of its program. The service provider must not be able to change or affect the output of the computer program and must exercise no discretion over the communication to, or implementation of, investment recommendations provided under the arrangement. The third party's compensation from the service provider must not be related to the fee income that the service provider or its affiliates receive from investments made pursuant to any recommendations. These opinions have allowed more advice to enter the workplace, and should continue to be upheld. If there are concerns that advice arrangements are not complying with these opinions, the DOL has broad authority to investigate and explore how plan sponsors are implementing these opinions.

Increasing Investment Advice in the Workplace: PPA's Investment Advice Provisions

The ACLI continues to support the investment advice provisions enacted as part of the PPA.

These provisions permit other "non-biased" advice solutions into the marketplace. Recognizing the benefits of expanding advice availability, the PPA provided a new statutory exemption that would permit advice to be provided as follows: (1) through a proprietary computer model certified by an independent expert or (2) under a level fee arrangement.

There are numerous safeguards that apply to an advice arrangement under the exemption. First, only individuals who are otherwise subject to the securities laws, insurance regulation, or banking rules may utilize the provisions. Second, there is an obligation to disclose to participants information ranging from fees and compensation to material relationships. Third, the advisor must affirmatively accept the fiduciary status which requires acting in the best interest of the participant or account holder. Fourth, the participant must take the initiative to implement the advice. Fifth, on an annual basis, the fiduciary advisor must retain an independent auditor to sample the advice provided and evaluate compliance by the fiduciary advisor. Finally, upon failure to follow the requirements of the rules, an advisor must reverse the transaction, make the plan whole, pay a substantial excise tax, and be subject to civil liability under ERISA. These significant costs and potential liabilities for noncompliance are powerful incentives for any financial services firm to comply with the conditions of the exemption. Again, these provisions would be enforced by the DOL.

Although the PPA was passed in 2006, the DOL issued regulations implementing the investment advice provision of PPA on January 21, 2009. However, the Obama Administration delayed implementation of the final regulation for its own review. Recently, the DOL has publicly stated it will re-propose this regulation by mid-November. Final regulations will be an important step in the process of increasing the availability of advice to plan participants.

H.R. 2989 Will Roll Back the Amount of Investment Advice That Is Currently Available

H.R. 2989, "The 401(k) Fair Disclosure and Pension Security Act of 2009," as reported by the House Education and Labor Committee, would eliminate the PPA's investment advice provisions and longstanding DOL guidance permitting "non-bi-

[1] Government Accountability Office, GAO–07–355, "Employer Sponsored Health and Retirement Benefits: Efforts to Control Employer Costs and the Implications for Workers," page 36, March 2007, Available at: http://www.gao.gov/new.items/d07355.pdf.

ased" advice. The ACLI is concerned that this step would significantly limit the amount of advice options available to plan sponsors. Second, it is not clear that there is a sufficient number of "independent advisors" available to support the investment planning needs of American workers. Third, "independent" investment advice may be cost prohibitive to many small employers—resulting in a decline in advice available to workers generally. While we agree that conflicted advice should be prohibited, the "non-biased" advice approach undertaken by PPA and SunAmerica provides workers with an important source of investment information in these difficult economic times.

Of particular note, H.R. 2989 would add additional costs to SunAmerica by requiring the fiduciary to ensure that the third party's computer model be initially certified and audited annually by a fourth party. This step is unnecessary and redundant because the computer model is entirely controlled and maintained by a third party already independent of the service provider or its affiliates. As such, this requirement would only serve to discourage employers currently utilizing such a model by adding significant costs to employers.

The ACLI would urge Congress to delay action on H.R. 2989 until it has had time to review the new Administration's work.

We would reaffirm our support for the investment advice provisions enacted as part of the PPA. As previously stated, the DOL is in the process of reviewing and reissuing the PPA investment advice regulations. We would urge Congress to let that process continue before considering new legislation. The ACLI shares the Committee's interest in ensuring Americans have access to useful, non-biased investment advice.

Defined Benefit Funding Relief Working Group, Letter

TO THE MEMBERS OF THE UNITED STATES CONGRESS:

The undersigned organizations, which provide retirement benefits to millions of workers, urge you to enact legislation this year to provide much needed relief for both single employer and multiemployer pension funds. Ensuring pension contributions are not out of proportion to those required before the market downturn and that benefit restrictions are not allowed to go into place simply because of the recession and sudden market downturn is critical.

We strongly urge Congress to move swiftly to adopt follow-up, temporary provisions that will ease cash flow constraints and make contributions more predictable and manageable. We believe that relatively modest temporary changes can provide greater stability and improved chances of economic recovery for many companies, non-profits, and charitable organizations.

While the Worker, Retiree, and Employer Recovery Act of 2008 (WRERA) provided needed technical corrections and modifications to the transition rule and asset valuation rule, we remain extremely concerned about the viability of defined benefit pension plans during the current economic situation. Because of the importance of this issue to workers' retirement security and the overall U.S. economy, we strongly urge Congress to address this issue immediately.

Even with the relief provided by WRERA and the Treasury Department, minimum contribution requirements for 2010 will still far exceed the minimum contribution requirements for 2008; in addition, many companies are not eligible for the relief and thus face daunting contribution obligations for 2009.[1] To meet these 2009 and 2010 obligations, many employers will be forced to divert cash needed for current job retention and creation and investment in their organizations to their pension plans to fund long-term obligations. For most companies, 2010 funding obligations become fixed as of January 1, 2010, making the 2010 challenge imminent as creditors pressure companies regarding how they plan to meet this looming obligation. Therefore, without further legislative action, these unexpected funding requirements could cause an increase in unemployment and slow economic recovery.

Thank you in advance for your support for this important effort. We appreciate the work and support from both the House and the Senate to move this issue forward, including a hearing to be held in the House Ways and Means Committee and the mark-up in the House Education and Labor Committee, and we stand ready to

[1] According to a Watson Wyatt study, plans that used the relief under both WRERA and the Treasury Department guidance will have minimum contribution requirements in 2010 that will be almost triple of 2008 minimum contribution requirements. For plans that cannot use the Treasury relief, the minimum required contributions are more than double for both 2009 and 2010. (Watson Wyatt Insider, April 2009—http://www.watsonwyatt.com/us/pubs/insider/showarticle.asp?ArticleID=20942).

work now with you and your staff to advance legislation that will promote our nation's economic recovery and reinvestment, while securing sound long-term pension plan funding.

Sincerely,

Agricultural Retailers Association
Alcatel-Lucent
Allegheny Energy
ALLETE/Minnesota Power
Alliance for Children and Families
Alliant Energy Corporation
Alpha & Omega Financial Management Consultants, Inc.
Alston & Bird, LLP
AM General LLC
Ameren Corporation
American Benefits Council
American Electric Power
American Institute of Certified Public Accountants
American Society of Association Executives
Aon Corporation
ArcelorMittal
ASPPA College of Pension Actuaries
Associated Benefits Corporation
Association for Financial Professionals
Avaya Inc.
Avista Corporation
B. Braun Medical Inc.
Ball Corporation
Belo Corp. and A. H. Belo Corporation
Black & Decker
Black Hills Corporation
BP America
Buck Consultants LLC
Buffalo Supply, Inc
Business Roundtable
Caraustar Industries, Inc.
Central Vermont Public Service Corporation
CH Energy Group Inc.
CMS Energy
College & University Professional Association for Human Resources
Committee on Investment of Employee Benefit Assets
Con-way Inc.
ConAgra Foods, Inc.
Conoco, Inc.
Connecticut Hospital Association
Consolidated Edison, Inc.
Constellation Energy
Crawford & Company
Dean Foods
Direct Marketing Association
DTE Energy
Duke Energy
DuPont
Eastern Connecticut Health Network, Inc.
Edison Electric Institute
Edison International
El Paso Corporation
Elford, Inc.
Eli Lilly and Company
Energy Future Holdings Corporation
Entergy Corporation
Exelon Corporation
Fabri-Kal Corporation
Financial Executives International's Committee on Benefits Finance
FirstEnergy Corp.
FMC Corporation
Food Marketing Institute

Fox Entertainment Group
FSG Pension Services, Inc.
General Devices Co., Inc.
Girl Scouts of the USA
Goodrich Corporation
Graphic Packaging International, Inc.
Great Plains Energy Incorporated
Greyhound Lines, Inc.
Hallmark Cards, Incorporated
Hawaiian Electric Company, Inc.
Hillside Family of Agencies
Hooker & Holcombe, Inc.
Hospital for Special Surgery
HR Policy Association
HSBC–North America
Indiana Chamber of Commerce
Indianapolis Power & Light Company
Ingram Industries Inc.
Kansas City Power and Light
King Kullen Grocery Co., Inc.
Kraft Foods
Lockheed Martin Corporation
Lockton Companies, LLC
Lord Corporation
Machine & Welding Supply Company
Manchester Memorial Hospital
Maritz
MassMutual Financial Group
McGuireWoods LLP
MD Helicopters, Inc.
MDU Resources Group, Inc.
Meridian Health
MetLife
Morgan Services, Inc.
Motor & Equipment Manufacturers Association
Motorola, Inc.
National Association of Manufacturers
National Association of Waterfront Employers
National Association of Wholesaler-Distributors
National Council of Chain Restaurants
National Council of Farmer Cooperatives
National Education Association
National Federation of Independent Business
National Grid
National Gypsum Company
National Mining Association
National Retail Federation
Navistar, Inc.
Newell Rubbermaid
Newspaper Association of America
NiSource Inc.
NMB (USA) Inc.
Northeast Utilities
NorthWestern Energy Corporation
NSTAR
Nuclear Energy Institute
OfficeMax, Incorporated
OGE Energy Corp.
Olan Mills, Inc.
Otter Tail Corporation
P–Solve Asset Solutions
Pactiv Corporation
Paul, Hastings, Janofsky & Walker LLP
Peabody Energy
Peerless Machine & Tool Corporation
PenChecks, Inc.
Pepco Holdings, Inc.
PG&E Corporation

Pietzsch, Bonnett & Womack, P.A.
PNM Resources
Portland General Electric
PPG Industries, Inc.
Principal Financial Group
Printing Industries of America
Progress Energy
Public Service Enterprise Group, Inc.
Qwest
Rayonier Inc.
Republic Services, Inc.
Retail Industry Leaders Association (RILA)
Rhodes-Joseph & Tobiason Advisors, LLC
Rockville General Hospital
RSM McGladrey, Inc.
Ryder System, Inc.
RR Donnelley
Safeway Inc
Saint Barnabas Health Care System
Sears Holdings Corporation
Small Business Council of America
Smurfit-Stone Container Corporation
Society for Human Resource Management
Sony
Southern Company
Southern States Cooperative
Spectra Energy
SUPERVALU
TECO Energy, Inc.
Tenneco Inc.
Textron Inc.
The American Public Power Association
The Associated General Contractors of America
The Dayton Power and Light Company
The E. W. Scripps Company
The Empire District Electric Company
The ERISA Industry Committee
The Financial Services Roundtable
The Goodyear Tire & Rubber Company
The Kroger Co.
The Segal Company
The Wagner Law Group
Towers Perrin
UniSource Energy Corporation
Unisys
United Illuminating Company
United Jewish Communities/The Jewish Federations of North America
United Jewish Communities of Metrowest (NJ)
United Neighborhood Centers of America
United Plan Administrators, Inc.
U.S. Chamber of Commerce
Vectren Corporation
Venable LLP
Vought Aircraft
Westar Energy
Westfield Group
Whirlpool Corporation
Willis HRH, North America Inc.
Windstream Communications
Woods Hole Oceanographic Institution
WorldatWork
Xcel Energy, Inc.
Xerox Corporation
YRC Worldwide Inc.

Statement of Department of Labor's Advisory Council on Employee Welfare and Pension Benefit Plans

I am a second generation Sheet Metal Worker, and am currently serving my third term as General President of the Sheet Metal Workers' International Association. I direct 157 Local Unions throughout the United States, Canada and Puerto Rico whose 150,000 members provide skilled services to the sheet metal and air conditioning industry, the kitchen equipment industry, the transportation industry, and to other related manufacturing and service operations. I also serve, among other positions, as a Vice President of the AFL–CIO Executive Council; a Director on the ULLICO Board of Directors; a Vice President of the Building and Construction Trades Department of the AFL–CIO; the Labor Co-Chairman of the Democratic Governors' Association; and President of the Eugene Debs Foundation. I am also a proud Board member of the National Coordinating Committee for Multiemployer Plans (NCCMP). I began my sheet metal career in Indianapolis, IN, completing my apprenticeship in 1969. I have served in union leadership positions since 1973, and during this time I have been a trustee on many pension and welfare plans.

Crisis begets legislation, particularly when it comes to pensions. Studebaker shut down in 1963 and thousands lost pensions. I was a boy then, but I remember the stark effect it had on many of my fellow Hoosiers. In response, President Kennedy formed a cabinet level committee on corporate pension funds. Yet, more than a decade would pass before the Employee Retirement Income Security Act of 1974 (ERISA) became law. To many scholars, ERISA is a major event of American social welfare legislation dwarfed only by Social Security and Medicare.[1] This landmark law created a complex regulatory scheme for pensions. Despite 10 years of study, ERISA's passage was rushed by the impending impeachment of President Nixon. I am told by old Congressional hands that ERISA originally would have taken on health care; imagine that, over 30 years ago.

ERISA spurred interest group advocacy. It also created whole new careers and lines of business. New groups formed, which this Council knows well, like the NCCMP, the Pension Rights Center, Employee Benefits Research Institute, the ERISA Industry Council, to name just a few.

The volume and complexity of pension regulations created new experts—like many of you. The investment of assets under prudent man rules have led to increasing reliance on banks, investment managers, insurance companies and other financial services companies. In my experience, few trustees can make sense of federal pension law without actuaries, accountants, and lawyers. Their guidance through the bureaucratic maze is indispensable. Yet, it does not improve our ability to meet our fundamental responsibility—secure retirement income. Moreover, these experts often comment on proposed legislation and regulations and nudge the process in one direction or another.

After the first economic downturn of this century in 2000 through 2002, Congress passed limited relief in the Pension Funding Equity Act of 2004. This limited bill reflected the inability of stakeholders and politicians to agree on more substantive reform. By 2006, employers, unions, and others—still reeling from the 2000–2002 market downturn—put aside our differences and managed to enact the Pension Protection Act of 2006 (PPA), which was the most sweeping pension reform legislation since ERISA's enactment. Unfortunately, the PPA's reforms were no match for the current "economic tsunami" (as our President describes it) which has pension plans and their sponsors reeling again. By the way, my Union supported PPA's multiemployer reforms, but we did not support the single employer changes.

PPA, like almost all pension legislation since 1974, only addresses problems caused by the latest crisis. It was not designed for the current one. Like most legislation, it was written by bright, well-intentioned, young staffers with little experience or expertise in pension plan design.

Understandably, the President and Congress have been preoccupied with our troubled economy and health care reform. Fixing both the economy and health care are daunting challenges that demand urgent action. These efforts will ultimately not succeed and the nation will not achieve lasting economic growth, unless the President and Congress do something to ensure permanently the economic security of America's current and future retirees. Medical science has significantly extended life expectancies. Aging baby-boomers will further strain our economic resources and the health care system. Retirees can help pay for these resources and help fund health care if they have *financial security.* Past generations who reaped the benefits of our traditional private sector pension system had such security. Over the past few dec-

[1] Christopher Howard, *The Hidden Welfare State,* Princeton University Press, 1999.

ades, our society's shortsighted dismantling of this private source of income will shift these costs directly onto the taxpayer with crippling economic consequences.

It is past time to overhaul our private pension system. Despite the 2008 market and "economic tsunami," some in Congress say we gave pension relief last year. Certain band-aid approaches are suggested—give plans longer to fund this or that, or give temporary relief from funding standards. Reactive legislation again is supposedly all we should expect. Most significantly, current law does nothing to promote new and better pension plan designs or reduce the risks posed to participants *and to employers.* Still, I am heartened that the President's emphasis on seeking long-term structural reform to our economy can be focused on retirement security.

Americans are hard workers. We deserve some semblance of leisure in our later years. Over the past 20 years, most employers, *but not most union employers,* have phased out their traditional defined benefit pension plans, which provide a reliable monthly pension check. Instead, to the extent retirement benefits are provided at all, employers have shifted to defined contribution plans in which *a worker's retirement income is determined at the end of the day by the losses or gains in his/her account.* This latest "unprecedented" economic downturn starkly illustrates how woefully inadequate a retirement system is that is limited to defined contribution plans. Most workers, including those who save religiously, have seen their retirement accounts decimated in just one year. Just look at the folks who thought 2010 would be their retirement year. One large provider's 2010 "target date" fund lost 41% in 2008; most others lost at least 25%. The situation is most dire for middle age and older workers—the baby boomers moving through the latter stage of life like the proverbial pig through a python. It is unlikely that they will recoup their losses before the time that they hoped to retire (if ever). Moreover, many workers may be disinclined to contribute to defined contribution plans in the future, if they fear their money may be gone when they are ready to retire.

We encourage employees to save more, be patient, wait the market out. But employers in the DC Plans have made their decisions. As the Economic Policy Institute's Monique Morrissey has written, "Employers ranging from AARP to Zygo Corporation have suspended their 401(k) matches during the current downturn." [2]

Despite medical advances and better habits, our bodies inevitably decline, making some tasks more difficult and prolonged. Yet, every day we hear of retirement-age folks who have to keep working, or who return to work, because their retirement savings have collapsed or their pensions were dumped on the Pension Benefit Guaranty Corporation (PBGC) and they cannot live on the amount guaranteed by the PBGC. Lacking a secure source of retirement income, a growing number of older workers are now forced to continue working in jobs that younger workers could fill. In some arenas, workforce productivity will suffer if older workers must stay put and younger workers are left out, or their advancement is delayed. Employer provided health insurance will become more expensive as an older workforce demands more medical care. For people that simply are unable to perform their job as they age, additional strains will be placed on our already strained Social Security system. Social Security is not meant to be, nor should it be, the main source of income for our aging population. Especially in light of current high unemployment, we risk fanning the flames of intergenerational conflict as younger workers have fewer job prospects and those that are working have fewer advancement opportunities.

Others may disagree, but it is clear to me that these DC plans do not provide retirement security. In fact, it is clear that defined benefit pensions play a critical role in reducing the risk of poverty and hardship among older Americans. According to a recent study, poverty rates for older households lacking pension income were about six times greater than those with such income.[3] The analysis also finds that pensions reduce, and in some cases eliminate, the risk of poverty and public assistance that women and minority populations otherwise would face. Dr. Frank Porell, one of the lead authors, has said the following:

> "Evidence that pensions contribute to the retirement readiness of older American households has been noted by experts and academics. With our analysis,

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[2] Policy Memorandum #143, "Obama Retirement Policy Falls Short," Monique Morrissey, June 26, 2009, Economic Policy Institute, Washington, DC.

[3] This finding is reported in "The Pension Factor: Assessing the Role of Defined Benefit Plans in Reducing Elder Hardships." The report was authored by Dr. Frank Porell, Professor of Gerontology at the McCormack Graduate School of Policy Studies at the University of Massachusetts-Boston, and Beth Almeida, Executive Director at the National Institute on Retirement Security. The analysis used the U.S. Census Bureau's Survey of Income Program Participation (SIPP) panels from 1996, 2001, and 2004. The study sample included respondents age 60 or older and all households with a head age 60 and older, who had records in both the Pension and Adult Well-Being topical modules of the survey. This totaled 10,259 households.

we now have hard numbers on the people and budget impacts of pensions. The bottom line: pensions help older Americans escape poverty, especially women and minorities who we know are most vulnerable."

Because they have pensions, many older Americans have adequate food, shelter, and health care, and avoid public assistance.[4]

The latest economic downturn demonstrates that reform measures such as the PPA may be expedient, but they do not address the system's fundamental problems. Whatever immediate dangers our pension plans face can be addressed—in the short-term—by modifications to the PPA, a few of which Congress already is considering. A solution to our pension woes, however, cannot be addressed in the short-term. Nor can we continue only to seek pension reform in times of crisis. In 2014, much of the PPA will expire. Pre-PPA laws had already been inadequate. We cannot return to old models. We must use this time wisely to develop new forms of lifetime retirement security or risk revisiting today's economic woes on future generations.

I have been around Washington, almost full-time for over 15 years and a frequent visitor before that. From my layman's perspective, incoherence is a primary characteristic of retirement legislation and regulations. National retirement policy has veered in multiple directions. Access to benefits has expanded and contracted. Congress simultaneously tightened nondiscrimination rules, forcing employers to cover more lower-paid workers while it made voluntary retirement plans, now known as 401(k)'s, more attractive to employers. The government made it easier for workers to retire early by allowing withdrawals at 59 and in-service distributions at 62 while "preserving" Social Security by raising the age for full benefits from 65 to 67 and creating incentives to work even longer.

There are overlapping Congressional jurisdictions among the revenue, labor, and governmental operations committees. Administrative and regulatory authority is distributed among the Treasury Department, Labor Department and PBGC who often work at cross-purposes and which produce conflicting demands on sponsors.[5]

The problems with our current pension system are complex and demanding, but not insoluble. The right solutions, however, require careful thought and analysis, and the input of many diverse sectors of our economy. No one official or department possesses the requisite knowledge and experience to address the enormity of pension reforms. As with other challenges, the nation should turn to a panel of experts to marshal research and make recommendations to elected officials.[6]

The best way forward is a Presidential Commission, chaired by a high-level administration executive, whose task would be to recommend, within a two-year period, a new policy and legislative framework for ensuring long-term retirement security for all Americans. Its members should represent a broad cross section of employers, participants, unions, and benefit and investment professionals. The Commission should investigate and recommend new forms of pensions where risk is fairly borne both by participants and plan sponsors, but also in which a reasonable monthly benefit is fully funded. We need to replace the byzantine rules, which measure funding, tax consequences and required contributions and greatly decrease the exposure of the PBGC. Rather than providing a minimum benefit in the event of plan insolvency, we should have a system that removes obstacles to private sector plan sponsorship. The appropriate Congressional Committees should then examine the Commission's recommendations and retain experts to draft the actual legislation. But we have to do this in two years, to ensure that those whose vision helps shape a new comprehensive retirement policy are in a position to promote and enact the changes that are called for.

This is not a partisan suggestion. A commission is not a solution or even a start to a solution, unless it is followed by action. Who here remembers President Carter's Commission on Pension Policy which recommended sweeping changes to ERISA, including immediate vesting, full portability and mandatory coverage by all employers? The report was issued, the administration changed and nothing happened.

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[4] The study's key findings are compelling. Pensioners in 2006 were associated with:

- 1.72 million fewer poor households and 2.97 million fewer near-poor households
- 560,000 fewer households experiencing a food hardship
- 380,000 fewer households experiencing a shelter hardship
- 320,000 fewer households experiencing a health care hardship
- 1.35 million fewer households receiving means-tested public assistance
- $7.3 billion in public assistance expenditures savings, representing about 8.5 percent of aggregate public assistance dollars received by all American households for the same benefit programs.

[5] Christopher Howard, *The Hidden Welfare State,* Princeton University Press, 1999, p. 132.

[6] See, "Inside the Black Box: The Politics of Presidential Advisory Commissions," Liz Clausen, School of Economic, Political and Policy Sciences, University of Texas at Dallas.

It is time to create a new ERISA and a new retirement structure. Our best and brightest must be called to serve. Thank you for your attention.

Statement of Nicholas Paleveda, MBA J.D. LL.M

My name is Nicholas Paleveda MBA J.D. LL.M, I am a tax attorney, licensed before the U.S. Tax Court for 25 years, and CEO of Executive Benefits Design Group.

Executive Benefits Design Group is one of the largest pension service providers in the United States, servicing more defined benefit plans than Merrill Lynch, T.Rowe Price and Putnam (in terms of numbers of plans). This committee needs to be aware of what is taking place in the Defined Benefit area especially as it relates to small plans, less than one hundred employees. Many plan sponsors are interested in setting up plans for their employees and funding the defined benefit plans with guaranteed annuity contracts. This prevents the plan from losses that take place if the funds were invested in the stock market. At the same time, the IRS has created a campaign to wipe out these plans using 6707A, a penalty that is non-reviewable before any court and creates fines in excess of $200,000 for each plan.

The plan sponsors, in many cases never entered into any "listed transaction" or in some cases fall into inadvertent "listed transactions." The IRS audits in many cases are time consuming and expensive for the small business owner. The taxes and law in the pension area can be, in many cases, misstated and misrepresented by the IRS.

This whole process creates an atmosphere where the small companies do not want to set up pension plans for their employees. This atmosphere will in turn create less savings for retirement and shift more of a burden on the social security system.

The solution needs to come from Congress by:

1. Establishing a small plan audit and compliance section of the IRS where "substantial compliance" becomes the rule. This will encourage small businesses to set up plans and lessen the burden of social security.
2. Amend 6707A to allow for Judicial review of plans and impose a tax or penalty relative to the error that the plan created such as 10% of the amount deducted as opposed to $200,000 on a $20,000 deduction.
3. Make this law retroactive to 2004 where the American Jobs Creation Act was passed.

Please find a sample battle in Tax Court that is a waste of time for the taxpayer and the small business owner.

1. This can happen to any small business.

2. The notice of deficiency, a copy of which including its annexed computation and explanation pages, is attached hereto as Exhibit A, was mailed to Any small business on March 9, 2009 by the Department of the Treasury Internal Revenue Service.

3. The deficiency as determined by the Commissioner is in income tax for the calendar year 2005 in the amount of $56,000 and in the year 2006 of $25,665 of which part of this amount is attributable to the denial of a deduction to a qualified retirement plan is in dispute.

4. In 2005, Any small business Inc. decided to create a retirement plan for the benefit of all their employees. The employees were in their 40s and 50s and did not want to take risk in the stock market. The corporation set up a fully insured defined benefit plan under section 412(i).

5. A section 412(i) plan is a defined benefit plan that is exempt from the minimum funding standard under Section 412 as the plan is funded with guaranteed annuity and life insurance contracts.

6. A defined benefit pension plan provides a participant at retirement with the benefit stated in the plan. The cost of benefits payable from such plans are funded on an annual basis over the preretirement period I.R.C. Sec. 404, 412 Contributions made to the plans, within certain limits, are deductible. Sec. 404(a)(1) Earnings on the contributions are not taxed as they accumulate. Sec. 501(a) Plan assets are taxed to participants only as they are paid out as benefits. Sec. 402(a)(1) The payments of benefits under a qualified plan are limited. Sec. 415 *Lear Eye Clinic Ltd. et al.* v. *Commissioner of Internal Revenue* 106 T.C. 23 (1996).

7. The Any small business plan was for the benefit of all their employees and funded the plan with guaranteed annuity contracts and guaranteed whole life contracts which built up cash value for retirement and provided a death benefit to the survivors if an untimely death. The annuity and insurance contracts were obtained from A+ Life Insurance Company. The plan (exhibit 1) established a Trust that purchased the annuity and insurance contracts, and the plan had a trust agreement

in place with a favorable determination letter (exhibit 2) from the Internal Revenue Service. The Trust (exhibit 3) was a volume submitter plan and participants were given summary plan descriptions describing the lifetime income retirement benefits, death and disability benefits from the plan. The Trust met the rules of the Internal Revenue Service including plan amendments such as The Final 401(a)(9) amendment, (exhibit 4), the Pension Funding Equity Act amendment (exhibit 5), the Code 401(a)(9) Model amendment pursuant to announcement 2001–82 (exhibit 6), the EGTTRA "good faith" plan amendment (exhibit 7), the Regulation Section 1.401(a)(4)–3(b)(5)(iv) plan compliance agreement (exhibit 8) and corporate resolution (exhibit 9) ratifying the plan. The plan owned the annuities and life insurance policies (exhibit 10) and filed 5500 returns as required under ERISA (exhibit 11). The plan is also a PBGC plan (exhibit 12) after receiving a determination status letter from the PBGC on medical technicians.

8. The Commissioner's determination that a plan did not exist and the income tax set forth in the deficiency is owed is based upon misstatements of facts and errors of law including but not limited to the following:

> The Commissioner erred in determining the defined benefit plan set up by the corporation did not satisfy the requirements of section 412(i). Section 412(i) is the code section that provides an exemption for the minimum funding standards of Section 412 as the plan is funded and maintained based upon the guaranteed interest and crediting rate of a major insurance company as opposed to risk taken in the stock market. In the determination letter issued by the Internal Revenue Service, the Service stated the plan did not satisfy all of the following requirements. The Service states as follows Section 412(i):

(1) The plan is funded exclusively by the purchase of individual insurance contracts.
(2) Such contracts provide for level annual premium payments to be paid extending not later than the retirement age for each individual participating in the plan, and commencing with the date the individual became a participant in the plan, (or in the case of an increase in benefits commencing at the time such increase becomes effective).
(3) Benefits provided by the plan are equal to the benefits provided under each contract at normal retirement age under the plan and are guaranteed by an insurance carrier . . . to the extent premiums are paid. This is the area under dispute.
(4) The benefits for each participant provided under the 412(i) plan that holds individual insurance contracts must be equal to the benefit provided under the participant's individual contracts at the participant's normal retirement age under the plan.

This was placed in the deficiency letter and is a misstatement of law.
Section 412(i)(4) does not say this at all. In fact Section 4 states:

(5) Premiums payable for the plan year, and all prior plan years, under such contracts have been paid before lapse or there is reinstatement of the policy.

The Service also misstates 412(i) Section 5. Section 5 actually states:

(6) No rights under such contracts have been subject to a security interest at any time during the plan year.

The Service also misstates 412(i) Section 6.

Section 6 actually states:

(7) No policy loans are outstanding at any time during the year.

412(i) Section 1, 2, 4, 5, and 6 have all been met by the taxpayer. The only section in dispute is 412(i) Section 3 and misstated Section 4. Since Section 4 is not part of the statute, (and appears to be made up), the court should determine if the plan meets 412(i) Section 3.

The Service argues that the life insurance and annuity contracts provide benefits which exceed the benefits under the plan; the premiums to the excess benefits are not deductible. Assuming there are contributions that exceed the benefits these excess contributions should not be allowed. Petitioner agrees with this statement—excess premiums are not deductible. Petitioner disagrees that the entire contribution to the trust should be disallowed. In the instant case, Respondent disallowed all the deductions under 404(j) which is legally not correct. 404(j) states:

(1) NO DEDUCTION IN EXCESS OF SECTION 415 LIMITATION.

I.R.C. Code Section 404(j) does not say there will be no deduction for the entire plan if plan contributions exceed Section 415. The plain wording of the statute makes this clear as the statute refers to "no deduction in *excess* of the 415 limit". In construing a statute, courts generally seek the plain and literal meaning of its language. *United States* v. *Locke,* 471 U.S. 84, 93, 95–96 (1985); *United States* v. *American Trucking Associations, Inc.* 310 U.S. 534,543 (1940). For that purpose, courts generally assume that Congress uses common words in their popular meaning. *Commissioner* v. *Groetinger,* 480 U.S. 23, 28 (1987); see also *Addison* v. *Holly Hill Fruit Prods., Inc.* 322 U.S. 607,618 (1944). Moreover, words in a revenue act generally are interpreted in their 'ordinary, everyday sense'". *Commissioner* v. *Soliman* 506 U.S. 168, 174 (1993). In the instant case, the statute is not ambiguous, Congress intended to disallow only deductions that exceed the 415 limit-not the entire contribution.

Congress has affirmed this position in the House Committee Report H. R. Rep. No. 107–51 pt. 1 in granting relief to excise taxes on Defined Benefit plans

> "The Committee believes that employers should be encouraged to adequately fund their pension plans. Therefore, the committee does not believe that an excise tax should be imposed on employer contributions that do not exceed the accrued liability full funding limit".

The deficiency letter ignores the intent of Congress to encourage employers to fully fund their defined benefit plans by disallowing the entire plan if contributions are made in excess of allowable limits when the remedy is clearly to make the contributions that are excess-non-deductible.

The deficiency letter from the service goes on to say "Under Section 404(a) (1), the limitation on deductions for a defined benefit plan is calculated using the same funding method and actuarial assumptions that are used for the purpose of funding the plan under IRC Section 412." This is not a correct statement of Section 404(a) (1) which actually states:

(1) PENSION TRUSTS.—

(A) IN GENERAL- In the taxable year when paid, if the contributions are paid into a pension trust (other that a trust to which paragraph 3 applies), and if such taxable year ends within or with a taxable year of the trust for which the trust is exempt under section 501(a), in an amount determined as follows:

(i) the amount necessary to satisfy the minimum funding standard provided by section 412(a) for plan years ending within or with such taxable year (or for any prior plan year), if such amount is greater than the amount determined under clause (ii) or (iii) (whichever is applicable with respect to the plan).

(ii) the amount necessary to provide with respect to all of the employees under the trust the remaining unfunded cost of their past and current service credits distributed as a level amount, or a level percentage of compensation, over the remaining future service of such employee, as determined under regulations prescribed by the Secretary, but if such remaining unfunded cost with respect to any 3 individuals is more than 50% of such remaining unfunded cost, the amount of such unfunded cost attributable to such individuals shall be distributed over a period of at least 5 taxable years.

(iii) an amount equal to the normal cost of the plan, as determined under regulations prescribed by the Secretary, plus if past service or other supplementary pension or annuity credits are provided by the plan, an amount necessary to amortize the unfunded costs attributable to such credits in equal annual payments (until fully amortized) over 10 years, as determined under regulations prescribed by the Secretary.

In determining the amount deductible in such year under the foregoing limitations the funding method and the actuarial assumptions used shall be those used for such year under Section 412, and the maximum amount deductible for such year shall be an amount equal to the full funding limitation for such year determined under Section 412.

The Service makes a legal error that the taxpayer followed none of the requirements of section 412—and should be following Section 412. Taxpayer is not required to follow Section 412. In fact section 412(h) specifically states, "412(h)

EXCEPTIONS—This section shall not apply to any insurance contract plan described in subsection (i)."

The Service made a factual error stating that the taxpayer did not use an enrolled actuary to certify the funding. An enrolled actuary is not needed to certify the funding, however the taxpayer did use an enrolled actuary to determine the funding. The remaining statements by the service are without merit as they apply to traditional defined benefit plans. The taxpayer did use a reasonable method for calculating the amount of funding to provide the benefits. The funding provided for level annual premiums to normal retirement age and the benefits of the plan equaled the guaranteed cash surrender value of the life insurance and annuity converted to a lifetime income using the annuity conversion rates from the annuity contracts purchased under the plan. Contributions are reduced to the extent any excess dividend or interest is paid to the contracts and the plan is correctly funded. As this is a traditional section 412(i) plan, established by Congress in 1974 and reaffirmed in 2006, the remainder of the service's argument that it is a non-qualified plan is without merit. In any event, if the plan did not meet the qualifications of section 412(i), the plan would lose 412(i) status and become a traditional defined benefit plan. It is nearly factually impossible for a plan funded solely with annuity and insurance contracts, as in the instant case, not to meet section 412(i) as the contracts themselves demonstrate the guaranteed cash value build up and guaranteed lifetime income. It is factually possible for this plan to contain more assets than allowed under Section 415, or be operationally non-compliant

Delinquency Penalty-failure to File. Section 6651(a)(1). Petitioner's Counsel is unaware of the time the tax return was filed and requests the penalty to be reduced to reflect the allowable deduction to the retirement plan.

Civil Fraud Penalty. Section 6663

Petitioner's Counsel is unaware of the alleged Fraud in connection with certain previously agreed and assessed adjustments. Fraud must be pleaded with particularity and in fact was not plead at all. Petitioner request the Fraud penalty should be abated.

Accuracy Related Penalty Section 6662.

Petitioner request this penalty be abated as the deduction for the retirement plan was properly taken on the return. No facts have been pled that would impose 6662. There was no substantial underpayment of income tax, there were no valuation misstatements nor did taxpayer disregard the rules and regulations. In fact taxpayer followed the rules as promulgated by Congress in Section 412(i) and did not "misstate the law" as the Service did to this court either intentionally or unintentionally by adding a section to 412(i) that does not exist. Taxpayer created a qualified plan document, had an approval letter from the service and funded the plan to meet the objectives of the plan.

Similarly, and with respect to the previously agreed and assessed adjustments, Petitioner reasonably and justifiable relied on its tax advisor and return preparer in connection with the preparation of its Form 1120 for the years ended December 31, 2005 and December 31, 2006. Consequently, there was reasonable cause for the underpayment of tax associated with and resulting from the previously agreed and assessed adjustments.

The Accuracy Related Penalty 6662A.

The Service incorrectly determined the plan to be a listed transaction. The Service originally stated that all three participants had "excess insurance" and the entire plan was a listed transaction. Upon further review, the Internal Revenue service stated only one participant created a listed transaction. In a review of the computations by enrolled actuaries it was discovered that, the area auditor from the IRS incorrectly used a lower salary than was actually paid to the participant and incorrectly used an annuity conversion rate that was not in the plan for this one participant. If the lower salary and higher annuity conversion rate was used, the plan met the guidelines for a "listed transaction". A penalty of $200,000 was sent to the taxpayer in addition this penalty was imposed.

(2) Whereas Petitioner respectfully request this court and prays for relief as follows:

1. Determine that this plan is a Section 412(i) plan and the contributions are deductible under Section 404.
2. Determine that the commissioner erred in disallowing the deduction to the retirement plan.

3. If there were excess deductions, the deduction for the plan remains in tact and only the excess deductions are disallowed as per section 404(j).

4. Abate any penalties and deem this plan, a traditional 412(i) plan, not to be a "listed transaction".

5. In the alternative, if the plan does not meet the standards of section 412(i), the plan would become a traditional defined benefit plan not a non-qualified plan as proposed by the Service.

6. Abate imposition of the penalty under Section 6663.

7. Abate imposition of the penalty under Section 6662.

8. Abate imposition of the penalty under Section 6662A.

9. Give such other and further relief or recovery to which any small business may be entitled.

Please enact legislation that stops this nonsense.

STATEMENT OF GIRL SCOUTS OF THE USA

OVERVIEW

On behalf of the Girl Scouts of the USA, its 109 councils across the country, 13,000 active and former employees and 3.5 million girl and adult members, we are pleased to submit the following statement about the Pension Protection Act, the recent economic downturn and their combined impact on the Girl Scouts' defined-benefit pension plan. We commend the Ways and Means Committee for its attention to this issue and look forward to working with Congress to enact legislative relief for plan sponsors.

For more than 35 years, Girl Scouts of the USA has partnered with Girl Scout councils across the country to provide a defined-benefit pension for approximately 13,000 active, past, and retired employees. Even as many corporations have moved away from defined-benefit plans, Girl Scouts has remained committed to providing this important form of retirement security for our employees, 90 percent of whom are women.

Unfortunately, implementation of the Pension Protection Act, when coupled with the unprecedented economic downturn and the increasing liabilities of our pension, has created a "perfect storm" that is significantly impacting Girl Scouts' ability to continue providing a defined-benefit pension to our employees. Absent prompt Congressional relief, Girl Scouts will have to freeze its plan, cut programs, lay off staff, and engage in other cost-cutting measures that will significantly inhibit our ability to achieve our mission of creating girls of courage, confidence and character who make the world a better place.

ABOUT GIRL SCOUTS

Girl Scouts is the world's preeminent organization dedicated solely to girls, serving 3.5 million girl and adult members in every corner of the United States, Puerto Rico, the Virgin Islands, and ninety-five countries worldwide. For almost 100 years, Girl Scouts has helped girls discover the fun, friendship, and power of girls together. Girl Scouting helps girls develop their full individual potential; relate to others with increasing understanding, skill, and respect; develop values to guide their actions and provide the foundation for sound decision-making; and contribute to the improvement of society through their abilities, leadership skills, and cooperation with others. More than 50 million American women enjoyed Girl Scouting during their childhood—and that number continues to grow as Girl Scouts continues to inspire, challenge, and empower girls everywhere.

As an employer, Girl Scouts offers flexible benefits packages to suit our employees' needs. We truly believe in investing in our employees, and our benefits and compensation packages reflect that commitment. In addition to our defined-benefit pension plan, many Girl Scout councils offer our employees a range of benefits such as Medical/dental, vision, life, short- and long-term disability insurance, 403B/401K, a variety of alternative work arrangements and many other benefits. This approach allows us to attract, recruit and retain talented, qualified, and dedicated staff.

This issue is important to us, not just as an employer, but as an organization that is dedicated to protecting the interest of girls and women. In general, older women are at greater risk of poverty than men because they typically live longer, earn less, and spend less time in the workforce than men do. As a result, they are more reliant on the income security offered by a defined-benefit pension plan.

As it is, too few women have access to a defined-benefit plan. Women receive about half the pension benefits retired men count on.[1] Furthermore, women rely on their employers to help with retirement planning—almost a third of working women cite lack of a retirement plan at work as a barrier to saving.[2] At a time when women are projected to account for 49 percent of the increase in total labor force we should be working toward policies that promote and protect their retirement security—not threatening a critical safety net.

THE PENSION PROTECTION ACT AND ITS IMPACT ON GIRL SCOUTS

The Pension Protection Act of 2006 (PPA) was enacted in response to the default in recent years of several large defined-benefit pension plans and the increasing deficit of the Pension Benefit Guaranty Corporation (PBGC). The PPA established new rules for determining whether a defined-benefit pension plan is fully funded, the contribution needed to fund the benefits that plan participants will earn in the current year, and the contribution to the plan that is required if previously earned benefits are not fully funded.

Defined-benefit plans like Girl Scouts' were never the intended target of this new law. Congress enacted the law in an effort to stem abuses by corporations who were try to shirk their pension responsibilities, or companies that were on the verge of collapse. As Girl Scouts is approaching its 100th year, it is in no danger of closing its doors. Even as we merge and realign some of our smaller councils, the Girl Scouts Movement continues to be a thriving, vibrant part of our communities and our nation.

Moreover, Girl Scouts has always been a responsible, conservative steward of our pension plan. As recently as January 1, 2007, the National Girl Scouts Council Retirement Plan (NGSCRP) was funded at 142 percent. Even after implementation of the Pension Protection Act, which modified the way plans calculate assets and liabilities, our NGSCRP was funded at 112 percent in early 2008. Thanks to our strong fiscal management, Girl Scouts was able to fund the NGSCRP in part by using carry-over balances (i.e., savings generated from larger-than-necessary contributions in prior years, as well as income generated from investments). This practice allowed councils to keep their pension costs relatively low—approximately 3.8 percent of payroll in 2008.

With the economic downturn in late 2008, however, the NGSCRP experienced significant losses. This affected both our pension balance, as well as the carry-over balance we had accrued over the years. Overall, our assets lost almost 30 percent of their value in the last year. At the same time, an aging workforce and increased liabilities are making it more and more difficult for Girl Scouts to maintain this benefit. Combined with the more stringent requirements of the Pension Protection Act, this confluence of events has resulted in a "perfect storm," that will have a devastating effect on our councils.

THE HUMAN TOLL

Absent further Congressional relief or a sharp, near-term rebound in investment markets, under existing PPA rules, it is projected that Girl Scout councils will be required to contribute on average $60 million per year—or 25 percent of covered payroll and 7.7 percent of Girl Scout revenue beginning in 2011—for several years. The unfunded liability is projected to increase to $195 million in that same timeframe, as compared to an overfunding position of $58 million we held at the beginning of 2008. This reflects the more stringent PPA rules to fully fund the plan in a shorter time period, as well as to make up for market losses incurred in 2008, and lower interest rates used to value liabilities.

Girl Scout councils are ill-equipped to manage this significant increase in operating expenses in such a short timeframe. The attached spreadsheet clearly defines, on a state-by-state basis, the financial impact this situation will have on councils in the next few years. To make up for this funding shortfall, councils will need to cut programs, scale back activities, and lay off staff.

In more human terms, consider that it costs approximately $280 per girl to provide a year of Girl Scouting. Girl Scout dues, however, remain very affordable to our members at $12 per year. The remainder of these costs must be covered through fundraising, corporate contributions, merchandise sales, and other revenue generators. Any shift in revenue to cover pension costs comes directly from sources that

[1] CRS: Older Workers Employment and Retirement Trends, Sept 7, 2007.

[2] *National Center on Women and Aging 2002 National Poll Women 50+,* National Center on Women and Aging, The Heller School for Social Policy and Management Brandeis University *November 2002*.

would otherwise be spent on girl programming. In short, this increase translates into approximately 214,000 girls losing the benefits of Girl Scouting.

LEGISLATIVE RELIEF

Girl Scouts of the USA commends the Ways and Means Committee for its attention to this important issue. We share your commitment to protecting the viability of defined-benefit pension plans generally, and the NGSCRP specifically. We are especially grateful to Congressman Earl Pomeroy (ND) for his outstanding leadership on this issue. His draft legislation offers much-needed relief to defined-benefit plans.

Furthermore, the need for relief is urgent. Without *immediate* relief, Girl Scouts will have to freeze our plan, and even then, will have to find revenue savings to meet ongoing requirements of the PPA. As the law requires that plan sponsors must notify participants of changes in the plan by November 15, 2009, Congress must act quickly to provide legislative relief.

During these difficult economic times, Girl Scouts' mission is more critical than ever. Girls are struggling with the impact of the economic downturn in their families, schools and communities. The benefits of Girl Scouts—programming that helps them build their skills, confidence, financial literacy, and career possibilities—are more critical than ever. We must ensure that Girl Scouts has the resources, through its benefits structure and its staff, to continue delivering on that mission. We encourage Congress to promptly enact legislation that provides relief from this economic crisis.

Statement of the Illinois Education Association

As an employer sponsoring a Defined Benefit plan for a large number of our employees, we appreciate the opportunity to comment on the above issue.

During the last economic downturn (2000–2002), our association's defined benefit plan portfolio sustained major losses. Instead of following the lead of many other organizations and eliminating or "freezing" our plan, we addressed the challenge by raising membership dues by over fifty dollars, by cutting staff, and by reducing services to our members. Our staff assisted in the effort through the collective bargaining process by accepting reductions in benefits. Through these means, and by contributing millions of dollars in excess of the minimum requirements over the past five years, our plan became funded at nearly 100%.

Despite all of these efforts, which involved significant sacrifice from both our members and our staff, the 2008–2009 market decline has severely impacted our funding situation. We are once again planning on dues increases, service reductions and compensation reduction in order to rebuild our portfolio, but we strongly feel that help from Congress in the following areas is necessary in order for us to ensure that our plan continues to be financially viable:

1. Allowing a longer smoothing period for the plan's investment gains and losses. A 3 to 5 year smoothing makes sense in a period of volatile market conditions.
2. Allow a special "set aside" amortization for the five month period of extraordinary losses by pension plans across the country due to the stock market collapse in 2008–2009. Giving plans the flexibility to amortize those losses over a period of 15 years will allow sponsors time to recover without threatening the stability of plans, ensure that obligations are met, and require the losses (if not completely covered with future positive investment results) to be funded in a way that allows sponsors sufficient time to budget and fund the plan properly.

These two actions will give sponsors needed flexibility without compromising the stability and viability of their plans. In fact, these actions will make it easier for employer sponsors like ourselves to responsibly meet our obligations, continue to offer a Defined Benefit plan, and do so while looking out for the financial wellbeing of our organization. These changes are a positive action for the protection of DB pension plans and sponsors. That should be the goal which guides all congressional action regarding pension security and we strongly urge Congress to take these positive steps as soon as possible.

Thank you for your attention to this urgent matter.

Statement of Independent Sector

Independent Sector thanks Chairman Rangel and members of the House Ways and Means Committee for using this important hearing to look for ways to avoid the looming threats to the vital services provided by the countless nonprofit organizations throughout our nation that offer their employees defined benefit pension plans. These organizations are on the front lines in helping millions of families who are suffering through our ongoing financial crisis and who come to our nation's nonprofits for food, shelter, medical care, and financial and crisis counseling.

Many nonprofit organizations that offer defined benefit pension plans are striving to meet the growing need for their services despite diminishing private contributions, increasing delays in state and local government reimbursements for contracted services, and reduced access to credit. These nonprofits include both large and small human service agencies, educational institutions, and arts organizations that operate at the local, national, and international level. All have long-standing presences in their home towns. They provide pensions not as an opportunity to take a tax deduction—they are already tax exempt—but as a cost-effective means for attracting and retaining qualified employees committed to serving their communities.

These nonprofits have endeavored to meet the significantly increased minimum funding obligations imposed by the Pension Protection Act of 2006 while maintaining programs upon which individuals and communities rely. The abrupt market decline last year turned those pension funding obligations into a severe problem never anticipated when the act was drafted. The funding rules now threaten not just the viability of the pension plans, but the survival of the organizations themselves. Consider the following examples:

- Family Service of Greater Boston, a 174-year-old human service agency that serves over 5,800 mostly poor and working poor families each year, offers a defined pension plan to employees responsible for carrying out programs for healthy child development, structured residential programs for teen mothers and their children, and intense behavioral health programs for severely abused and neglected children. The funding status of Family Service's pension plan dropped to 72 percent as a result of the market decline, creating projected future minimum annual contributions of almost $500,000 for this small agency. The agency has already significantly reduced or eliminated other benefits, increased the employee share of health insurance premiums, frozen wages for a 2-year period, eliminated positions through attrition and consolidated administrative functions. Now it is facing further actions that could impede its ability to sustain critical services.
- A human services agency in the Midwest with fewer than 400 employees saw its pension funding level decline by 30 percent in 2008. The organization has been unable to secure bridge loans due to its $5.5 million pension funding shortfall, further limiting its ability to meet pension funding obligations, much less its ongoing operational costs.
- A large Northeastern nonprofit maintains a multiple-employer pension plan that provides retirement security to approximately 10,000 current and former employees. Due to the severe recession, the plan is facing an increased contribution of $5.3 million this year, and annual increases of $11 million in the following several years, 70 percent more than its base contribution of previous years. Without legislative relief and other cutbacks, the organization states that the increased cost of the defined benefit plan "would significantly impair our charitable mission to help those who are poor and vulnerable and place [the organization] and its agency system in financial peril."
- A large national charity that has sponsored a defined benefit plan for six decades is facing an increase in pension contributions of more than 250 percent for 2010 due to the investment losses. The organization has already reduced staff by 15 percent and, because it has no endowment, will be forced to borrow much of the $4.4 million needed to satisfy its unexpected pension obligations.

The budgets of nonprofits serving multiple needs in their communities are already stretched too thin, and, as the recent cuts described above demonstrate, additional expenses will mean eliminating or reducing existing programs. Most nonprofit organizations that sponsor defined benefit plans do not have endowments or other sources of funds to cover these unexpected pension obligations. A December report of the Urban Institute (*Maintaining Nonprofit Operating Reserves****: An Organizational Imperative for Nonprofit Financial Stability,*** December 2008) found that nearly fifty percent of nonprofits located in Washington, D.C. had operating reserve ratios *of less than* 3 months of their annual expense budget. More worrisome, 32 percent had reserve ratios of zero to three months. Without immediate relief from the pension obligations arising from the market losses of 2008, the current rules will force nonprofits that sponsor defined benefit plans to divert substantial financial resources away from vital community services at a time when they are desperately needed.

We urge Congress to enact temporary funding relief for nonprofit organizations and other sponsors of defined benefit pension plans that will allow them to recoup the shortfall for 2008 over a longer, more manageable period. By stretching out payments for these unexpected losses, such relief will permit organizations to maintain services and jobs, while continuing to fund their pension plans.

We thank you for your consideration, and look forward to working with you and your staff to develop and pass legislation that will help our organizations continue to serve communities across the nation while providing secure retirements for our employees.

Independent Sector is a national, nonpartisan charitable organization with approximately 550 members, including public charities, private foundations, and corporate giving programs, collectively representing tens of thousands of charitable groups in every state across the nation. Our coalition leads, strengthens, and mobilizes the charitable community to fulfill our vision of a just and inclusive society and a healthy democracy of active citizens, effective institutions, and vibrant communities. IS members represent a broad cross-section of our nation's nonprofit community, which exists to meet society's needs, frequently in partnership with government, in diverse areas such as the arts, education, human services, community development, and health care.

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Statement of the Investment Company Institute

The Investment Company Institute, the national association of U.S. investment companies,[1] which companies manage more than 40 percent of all 401(k) and IRA assets, is pleased to submit this statement.

Executive Summary

In the nearly 30 years that it has existed, the 401(k) plan has become a powerful engine for providing retirement security to millions of American workers who participate in plans. The system would work even better, however, if more participants had increased access to investment advice and if ERISA rules both assured that participants receive disclosure concerning key information about all investment options in their plans, and set out clearly the information employers need to consider about plan service arrangements.

The need to expand access to investment advice is clear. Access to a financial adviser is much more common for investors outside retirement plans than for those saving in 401(k) plans, despite the amount of assets in those plans, and the importance of those savings to plan participants. The current financial crisis, which has made many Americans want to take stock of their financial picture, underscores the need for robust investment advice services for those savers. The Pension Protection Act of 2006 (PPA), which we supported, created a new exemption to expand access to advice to allow plan and IRA savers to obtain advice from companies familiar to those savers—the companies providing services or investments to the plan or IRA. Congress included strict conditions and protections, including that the advice be *unbiased* and offered under fully transparent arrangements and from someone who accepts ERISA's full fiduciary responsibility.

After a long regulatory process, the Department of Labor under the Bush Administration adopted a regulation to implement the exemption and resolve ambiguities

[1] The Investment Company Institute is the national association of U.S. investment companies, including mutual funds, closed-end funds, exchange-traded funds (ETFs), and unit investment trusts (UITs). ICI seeks to encourage adherence to high ethical standards, promote public understanding, and otherwise advance the interests of funds, their shareholders, directors, and advisers. Members of ICI manage total assets of $11.02 trillion and serve over 93 million shareholders.

about the meaning of the PPA statutory language. While the Institute believes these regulations reasonably implemented the PPA provision in a manner that provides clarity and makes it possible for plans and providers to offer new investment advice programs, we understand the Obama Administration's desire to take a fresh look and issue a new proposal for notice and comment. We urge DOL in its regulatory process and Congress in its consideration of investment advice to encourage the appropriate expansion of avenues for investment advice and preserve pre-PPA guidance that allows various forms of advice and education programs on which many plans now successfully rely. We do not support the advice provisions in H.R. 2989, the "401(k) Fair Disclosure and Pension Security Act of 2009," because the bill would not only repeal the PPA statutory exemption but would require significant revision of pre-PPA programs, which have been operated successfully.

The Institute strongly supports efforts to enhance existing rules providing for disclosure to participants and employers. The Obama administration has said it will complete two regulatory projects that will close gaps in its disclosure regime, and we support those projects. Two bills referred to this Committee for consideration (H.R. 2779 and H.R. 2989) would address the same disclosure gaps in defined contribution plans. As the Ways and Means Committee looks at the bills and considers whether legislation is necessary in light of DOL's proposals, we urge that the Committee be guided by the following principles:

- Participants in all self-directed plans need simple, straightforward disclosure focusing on key information, including information on fees and expenses, which allows comparisons among a plan's investment options. Comparability of fees is best achieved through use of percentages or basis points or through a representative example (such as the dollar amount of fees for each $1,000 invested).
- The disclosure should cover all investment products available in plans, including providing comparable disclosure for products that provide a fixed or promised return.
- Employers should get clear information that allows them to fulfill their fiduciary duties.
- Plan fiduciaries are responsible for determining the investments that are appropriate for participants and Congress should not upend ERISA's framework. It is not appropriate for the government to pick investment options for private 401(k) plans.
- The disclosure rules should be precise and clear so that service providers and plan fiduciaries know what disclosure is required of them. These rules also should be designed to prompt correction of minor or inadvertent errors.

I. Introduction

The success of the defined contribution plan system is evidenced by wide employer and participant adoption and participant feedback. Latest available official Department of Labor data indicate that in 2006, there were 645,971 private-sector defined contribution plans with more than 65 million active participants.[2] Institute research on Americans' attitudes towards 401(k) plans tells us that Americans strongly support the current 401(k) system and greatly value the tax incentives 401(k)s provide.[3] Almost nine in 10 households surveyed rejected the idea that the government, and not individuals, should make investment decisions for retirement accounts. Even households without 401(k) or IRA savings see value in the 401(k) system and do not want drastic changes. Reports indicate that, despite the bear market of late 2008 and early 2009, 401(k) participants are staying the course and not abandoning their plans.[4]

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[2] See U.S. Department of Labor, Employee Benefits Security Administration, *Private Pension Plan Bulletin: Abstract of 2006 Form 5500 Annual Reports* (Dec. 2008), available at http://www.dol.gov/ebsa/PDF/2006pensionplanbulletin.pdf. The bulk of these plans were 401(k) plans, with 465,653 plans and more than 58 million active participants.

[3] The Institute surveyed 3,000 U.S. households. The survey was conducted in late October through December 2008—that is, during some of the most jarring days in the history of our financial markets. See Investment Company Institute, Retirement Saving in Wake of Financial Market Volatility (Dec. 2008), available at http://www.ici.org/pdf/ppr_08_ret_saving.pdf.

[4] See, e.g., Vanguard, *How America Saves 2009, A Report on Vanguard 2008 Defined Contribution Plan Data,* available at https://institutional.vanguard.com/iam/pdf/HAS09.pdf; Vanguard Research Commentary, "Participants calmer than you'd think amid market turmoil," (Dec. 2, 2008), available at https://institutional.vanguard.com/VGApp/iip/site/institutional/researchcommentary/article?File=NewsPartCalm; Fidelity, "Participants Continue to Stay the Course Amidst Market Downturn," available at http://content.members.fidelity.com/Inside_Fidelity/fullStory/1,,7669,00.html; The Principal, Retirement Trends Report, *The Total View 2009,* available at http://www.principal.com/about/news/totalview.htm.

Defined contribution plans could be improved, and the Institute has offered a number of suggestions for changes that, in our view, would strengthen the system by which employers and workers have entrusted and will continue to entrust trillions of dollars of retirement savings to these plans.[5] This statement addresses two ways to better serve those saving for retirement in 401(k) plans: expanding access to quality investment advice, and ensuring that plan fiduciaries and participants have the information they need to make the decisions charged to them under their plans.

II. Investment Advice

A. *The Need for Advice*

While the need for increased opportunities for investment advice to participants is clear, relatively few participants have access to or use investment advice today. According to the Profit Sharing/401k Counsel's annual survey, about half of all plans offered investment advice to participants in 2008, and only 28% of participants utilized advice when it was offered.[6] While pre-PPA programs have been effective in reaching some plans and some participants, more work is needed to create cost-effective advice solutions that would encourage adoption by employers and utilization by participants. Although the PPA exemption adopted in 2006 held great promise for encouraging more advice programs in plans, the absence of clear rules for using the exemption has deterred new offerings of advice.

Compare the relatively low offering and utilization of advice in 401(k) plans with what mutual fund investors outside 401(k) plans and IRA savers experience. Among households holding fund shares outside plans, 77 percent owned shares through professional financial advisers in 2008.[7] Among households owning traditional IRAs in 2008 who took a withdrawal in tax-year 2007, 59 percent consulted a professional financial adviser to determine the amount to withdraw in tax-year 2007.[8] A survey the Institute conducted in 2007 of recent retirees about how they used their defined contribution proceeds at retirement showed that respondents pursued a range of outcomes reflecting their own personal needs, in many cases rolling some or all of their account balances over to IRAs.[9] In making their distribution decision, retirees with a choice of options often consulted multiple sources of information. Forty-two percent indicated they sought advice from a professional financial adviser that they found on their own.

The recent financial crisis, which has made many Americans want to take stock of their financial picture, underscores the need for clarity in making advice more broadly available to participants. Investment advice services can help participants in ERISA plans and IRAs understand the long-term nature of retirement savings and assemble and maintain a diversified portfolio. During the financial crisis, many participants sought help and reassurance from their 401(k) providers. One Institute member with a large recordkeeping business reported to us that participant calls increased 60 percent, and website visits increased by 65 percent, during the market volatility in late 2008. Another large retirement service provider reported that the volume of calls during the most volatile period (late September and early October 2008) spiked to over 100,000 calls per day.[10] Without clear rules from DOL, it is difficult for 401(k) providers to offer real assistance to nervous participants. Obtaining clarity on the rules that govern investment advice under the PPA exemption would allow providers to better serve participants when they reach out for reassurance.

B. *Pension Protection Act of 2006 and Implementing Regulations*

In 2006, Congress enacted the Pension Protection Act to expand access to investment advice for plan and IRA savers by allowing the companies they are already

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[5] In recent testimony to the Education and Labor Committee, ICI recommended seven policy improvements that could be made to strengthen the U.S. retirement system. See Testimony of Paul Schott Stevens, Hearing on "Strengthening Worker Retirement Security," House Education and Labor Committee (Feb. 24, 2009), available at http://www.ici.org/policy/ici_testimony/09_house_401k_tmny.

[6] See Profit Sharing/401k Council of America, *52nd Annual Survey Reflecting 2008 Plan Experience* (2009).

[7] Investment Company Institute, *2009 Investment Company Fact Book, 49th Edition,* available at http://www.ici.org/pdf/2009_factbook.pdf.

[8] Holden and Schrass, *The Role of IRAs in U.S. Households' Saving for Retirement, 2008,* ICI Fundamentals, vol 18, no. 1(Jan. 2009), available at www.ici.org/pdf/fm-v18n1.pdf.

[9] Sabelhaus, Bogdan, and Holden, *Defined Contribution Plan Distribution Choices at Retirement: A Survey of Employees Retiring Between 2002 and 2007,* Investment Company Institute Research Series (Fall 2008), available at www.ici.org/pdf/rpt_08_dcdd.pdf.

[10] See http://content.members.fidelity.com/Inside_Fidelity/fullStory/1,,7669,00.html.

familiar with—those providing services or investments to the plan or IRA—to provide advice programs under strict conditions and protections. These conditions require that the advice be *unbiased,* in that either the adviser's compensation does not vary depending on the participant's investment choices, or the advice is rendered through an unbiased computer model. Additional safeguards require that (1) the adviser must agree to be subject to ERISA's strict fiduciary duty and acknowledge fiduciary status in writing; (2) the advice program must be audited annually by an independent auditor for compliance with the conditions of the exemption; (3) computer model advice must be pursuant to a model certified by an independent expert; (4) the fiduciary adviser must provide robust disclosure of fees, material affiliations and conflicts of interest, past performance, use of participant information, and more; and (5) the fiduciary adviser must maintain records demonstrating compliance with the exemption for six years.

The PPA required DOL to issue regulations implementing a number of the investment advice provisions. In addition, there were a number of textual ambiguities in the statutory language that needed clarification. After a regulatory process extending over thirteen months, which included two requests for information, a Field Assistance Bulletin, two public hearings, and notice and comment on proposed regulations, DOL issued final regulations at the end of Bush administration.

While the final regulations did not include most of the changes that the Institute had requested in its comments to DOL, we believe that the final regulations reasonably implement the PPA exemption in a manner that will encourage plans and providers to offer investment advice programs to assist participants and beneficiaries of ERISA plans and IRA investors in managing their accounts.

We appreciate, however, that the Obama administration wishes to take a fresh look at these rules to assure itself that the rules are appropriate and in the public interest. Assistant Secretary Phyllis Borzi has stated DOL will issue a new proposal so that interested parties can comment.[11] In its efforts, DOL should adopt policies that promote the provision of investment advice and preserve pre-PPA guidance that allows various forms of advice and education programs on which many plans now successfully rely. This pre-PPA guidance either provides an exemption with conditions that protect participants and beneficiaries or finds that if an arrangement operates as described in the guidance, there would be no prohibited transaction requiring exemptive relief.

Congress should follow the same principle: adopt policies that expand, not reduce, the number of participants with access to investment advice. For this reason, we do not support the advice provisions in H.R. 2989, the "401(k) Fair Disclosure and Pension Security Act of 2009," because the bill would not only repeal the PPA statutory exemption but would require significant revision of pre-PPA programs. These programs have operated successfully and there is no need to subject arrangements that do not involve prohibited transactions or those under prohibited transaction exemptions to additional conditions that add unnecessary cost and might cause plans or providers to no longer offer the programs.

III. Improving Disclosure

A. *Why Disclosure Reform is Needed*

The Institute has long supported meaningful and effective disclosure to 401(k) participants and employers, as Institute President Paul Stevens testified before this Committee two years ago.[12] We stated then and continue to believe that initiatives to strengthen the 401(k) disclosure regime should focus on the decisions that plan participants and employers must make and the information they need to make those decisions.

In addition to supporting disclosure reform, we have sought to shed light through our research on 401(k) fees and the factors that drive fees. A recently completed and detailed survey of 130 plans of various sizes by the ICI and Deloitte Consulting LLP found that the median fee (including investments and recordkeeping) across all

[11] See "Labor Department moving ahead on advice proposal, Borzi says," Pensions and Investments (Sept. 23, 2009), available at http://www.pionline.com/article/20090923/DAILYREG/909239990.

[12] See http://www.ici.org/policy/regulation/products/mutual/07_house_401k_tmny.

plans surveyed was 0.72 percent (or 72 basis points) as a percentage of total assets,[13] significantly less than some critics of 401(k) plans have claimed.[14] While fees vary across the market, 90 percent of all plans surveyed had an all-in fee of 1.72 percent or less.

The research showed that a plan's number of participants and average account size (which together constitute the total plan size) are the two most significant drivers of the plan's overall cost. Other factors that correlated with a lower total fee included higher participant and employer contribution rates, lower allocation of assets in equity-oriented asset classes; use of auto-enrollment; fewer plan sponsor business locations reducing the servicing complexity; and other plan sponsor business relationships with the service provider (e.g., defined benefit plan or health and welfare plan). The factors that were *not* significant drivers of fees include the type of provider the plan utilized (insurance company, mutual fund company, bank, third party administrator) and the extent to which investments of the 401(k) provider were utilized.

Examining mutual fund assets, ICI research shows that 401(k) investors concentrate their assets in lower-cost mutual funds. The average asset-weighted total expense ratio incurred by 401(k) investors in stock mutual funds was 0.72 percent in 2008, about half the 1.44 percent simple average for all stock funds and substantially less than the industry-wide asset-weighted average of 0.84 percent.[15]

Disclosure reform should address two gaps in the current 401(k) disclosure rules, the first relating to participant disclosure, and the second to that received by the employer (plan sponsor). First, unlike current DOL participant disclosure rules, which cover only certain plans and do not require disclosure about all investment products, participants in *all* self-directed plans should receive key information about *all* products. Second, disclosure reform should clarify the information that service providers must disclose to an employer on services and fees. The Institute supports disclosure of payments a service provider receives directly from plan assets and indirectly from third parties in connection with providing services to the plan. Where the service provider's services include access to a menu of investment options, employers should receive from that provider information about the plan's investments, including information about fees.

B. *Department of Labor Proposals to Address Disclosure Gaps*

The Department of Labor has two proposed regulations that will address both of these gaps. The first proposal will require that all participants in 401(k) plans receive basic and comparable information, including fees, on all the investment options available to them.[16] Participants would also receive at enrollment a description of any fees that they may pay in addition to the costs of the plan's investments. DOL's proposal uses a layered approach to ensure each participant receives key information, with more detail available online and upon request for those participants who want it.

Participants would receive, at enrollment and annually thereafter, a chart listing each investment on the plan's menu and comparing each investment's type (i.e. large cap, international equity, etc.), 1-, 5-, and 10-year historical performance compared against a benchmark, and fees. DOL's proposal includes a model comparative chart plans can use. Participants would be referred to a website for more information on each investment, including the investment's strategies and risks, the identity of the investment issuer or provider, portfolio turnover, and the assets held in the portfolio. More detailed documents, like a copy of a prospectus or similar document, would be available upon request. Participants' quarterly statements would display any administrative fees deducted from their accounts during the quarter.

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[13] Deloitte Consulting and Investment Company Institute, *Defined Contribution/401(k) Fee Study* (Spring 2009), available at http://www.ici.org/pdf/rpt_09_dc_401k_fee_study.pdf.

[14] This figure represents the median fee for the 130 plans in the survey. The survey used a sampling technique known as nonproportional quotas. Knowing that the universe of 401(k) plans includes more than 450,000 plans, and that smaller plans are harder to find, the survey was specifically targeted across the spectrum of asset sizes and stayed in the field until specific quotas for plans of different sizes were filled. Although the plans are intended to be representative, the median fee should not be projected to the entire population of U.S. 401(k) plans. Weighting the reported fees in the 130 plans by the actual distribution of participants in all 401(k) plans results in a total fee of 0.86 percent. See the Study for more information on the plans surveyed.

[15] Holden and Hadley, *The Economics of Providing 401(k) Plans: Services, Fees, and Expenses, 2008,* ICI Fundamentals, vol. 18, no. 6 (August 2009), available at http://www.ici.org/pdf/fm-v18n6.pdf. While the Deloitte/ICI study described above covers all plan costs, this research only covers mutual funds held in 401(k) plans because ICI does not have the information necessary to study other investments.

[16] See 73 Fed. Reg. 43014 (July 23, 2008).

The second DOL proposal would require plan service providers to disclose to employers the services that they provide and the direct compensation they receive from the plan and employee accounts.[17] Service providers also must disclose in detailed fashion all indirect compensation, broadly defined to include anything of value paid from any source other than the plan, employer, or the recordkeeper. This would include finder's fees, soft dollar payments, float, brokerage and other transaction-based fees, and payments that an affiliate of the recordkeeper receives in connection with the plan. In addition to fee disclosures, the regulation will require comprehensive "conflict of interest" disclosure to employers. Under these new disclosure regulations, a plan fiduciary will be able to assess all of the compensation paid to a 401(k) plan service provider before any contract is entered into. Violations of the new disclosure scheme are enforced by tough penalties on the service provider.

These projects were not completed by the Bush Administration, and Assistant Secretary Borzi has announced she intends to finalize them.[18] The Institute strongly supports these initiatives and has urged DOL to complete these projects as quickly as possible.

C. *Congressional Proposals to Enhance Disclosure*

This Committee has been referred for consideration two bills intended to close the disclosure gaps described earlier: H.R. 2779, the "Defined Contribution Plan Fee Transparency Act of 2009" and H.R. 2989, the "401(k) Fair Disclosure and Pension Security Act of 2009." As noted earlier, H.R. 2989 also contains extensive reworking of the rules for providing investment advice to participants. In analyzing these proposals, and considering whether legislation is necessary in light of the Department of Labor's proposals, we urge the Committee to apply the following principles.

Participants in all self-directed plans need simple, straightforward disclosure focusing on key information, including information on fees and expenses, which allows comparisons among a plan's investment options. This key information includes an investment option's investment objective, risks, historical performance, and fees. Comparability is particularly important with respect to fees. Mutual fund investors have for years had access to a simple, standardized measure of fees—the expense ratio—as well as a representative example showing what the expense ratio means in dollar terms for a typical investment. H.R. 2989 requires plan fiduciaries to translate asset-based investment fees into dollars on a quarterly basis. Because contributions and distributions are continually being made into and out of 401(k) accounts, creating systems that could provide this disclosure could be very expensive, and in addition, the requirement complicates comparing among the plan's investment options. For example, if a participant has 90% of his or her account invested in a fund with a 0.40% (40 basis point) expense ratio and 10% invested in a fund with a 1.00% (100 basis point) expense ratio, the participant presented with the dollar amounts of fees for each investment might think the first fund is relatively expensive and the second is cheaper. The best way to achieve comparability is through use of percentages or basis points or through a representative example (such as the dollar amount of fees for each $1,000 invested).

The disclosure should cover *all* investment products available in plans, including providing comparable disclosure for products that provide a fixed or promised return. All of the current legislative and regulatory proposals would cover all products. Both legislative approaches include a provision requiring regulations to ensure comparable disclosure for insurance and other products that provide a fixed return (like annuities). However, H.R. 2779 appropriately makes the issuance of these regulations mandatory; H.R. 2989's provision is optional for DOL.

Employers should get clear information that allows them to fulfill fiduciary duties. Employers should receive information from service providers on the services that will be delivered, the fees that will be charged, and whether and to what extent the service provider receives compensation from third parties in connection with providing services to the plan. These payments from third parties, sometimes inaccurately referred to as "revenue sharing" but which are really *cost sharing,* often are used to defray the expenses of plan administration. We support requiring their disclosure by service providers.

We do not support provisions in H.R. 2779 and H.R. 2989 that force providers to disclose fees in various service categories even if there are no separate charges for the services and the services are not available on a standalone basis. This approach favors one business model—firms that just bundle together recordkeeping and other administrative services—over another business model—firms that offer record-

[17] See 72 Fed. Reg. 70988 (Dec. 13, 2007).

[18] "Lifting the fog: Face to Face with Phyllis C. Borzi," Pensions and Investments (Sept. 7, 2009), available at http://www.pionline.com/article/20090907/FACETOFACE/309079996.

keeping and administration as well as investment management services, by imposing additional disclosure burdens on the full-service model. More importantly, employers need information that they can *use*, and this presents them with information—an unbundled number for a service that is not offered separately—the usefulness of which is unclear and which could create liability concerns for employers and service providers.

If Congress should determine nevertheless to require providers to allocate fees among categories even when services are not separately available, it must recognize the difficulties (and liability risks) of disclosing a fee for a service that is not offered separately and allow service providers to allocate in a manner that is reasonable and in good faith. At a minimum, the legislation should provide for safe harbor methods a service provider could, but would not be required to, use for the allocation. This would offer certainty for providers that want to rely on a pre-approved allocation method but offer flexibility for providers to develop and use other reasonable methods. Finally, disclosure should provide flexibility in the form of disclosure (percentage of assets, total dollars, amount per transaction) so that providers can disclose fees accurately in the manner in which they are charged.

Congress should leave to plan fiduciaries the responsibility of determining the investments that are appropriate for participants. H.R. 2989 sets a dangerous precedent by effectively requiring plans to include an indexed investment option meeting specific requirements. This goes far beyond disclosure. It is not appropriate for the government to begin to pick investment options for private 401(k) plans. Decisions about the investment menu of a 401(k) plan are best made by plan fiduciaries who can consider all options available now or in the future in designing plan offerings that will enhance employees' retirement security.

The disclosure rules should be precise so that service providers and plan fiduciaries know what disclosure is required of them and do not need to interpret the law broadly to avoid penalties. Unless the rules are clear, the resulting disclosure will be confusing to plan fiduciaries and participants and unnecessarily costly to prepare. H.R. 2779 is more clearly written and therefore avoids a number of difficult interpretive issues presented by H.R. 2989. For example, H.R. 2989 defines a 401(k) plan's *services* subject to the bill so broadly that it could cover service providers to the plan's *investments.* As a result, service providers to investment products like mutual funds and insurance contracts (such as accountants, printers, and custodians), who have no direct relationship with a plan, could suddenly be subjected to detailed fee disclosure for one class of investors, the cost of which will be passed on to retirement plan savers investing through a workplace savings plan. In addition, this suggests that plans must have a personalized contract with each investment product in which it invests, which violates the basic securities law principle that all mutual fund shareholders must be treated equally.

In addition, because of the difficult compliance burdens that the disclosures in H.R. 2779 and H.R. 2989 would require, the bills should include provisions that allow one service provider to rely on information provided by another entity unless the provider knows or should know that the information is inaccurate or incomplete, and that allow inadvertent errors to be corrected within a reasonable time without penalty. Provisions along these lines, which are contained in H.R. 2779, will enhance compliance and correction of minor or inadvertent errors.

As the Institute said when it last testified before this Committee, we applaud the Committee for examining how we can make the 401(k) system even more effective in providing retirement security. We look forward to continuing to work with this Committee and its staff on these issues.

Maryland State Education Association, letter

On behalf of the 70,000 member Maryland State Education Association (MSEA), I am please to submit these comments on funding defined benefit pension plans.

While our members are all public sector employees, our Association and the defined benefit pension plan we provide to nearly 100 employee-participants fall under private sector rules.

We are committed to maintaining and adequately funding our defined benefit plan. In addition, we encourage our employees to supplement their retirement savings by participating in our 401(k) defined contribution retirement plan. We offer a generous employer match for those who do.

The Pension Protection Act's intent was to stabilize defined pension plans and ensure their adequate funding. Unfortunately, its outcome was to make defined pension plan funding more volatile and the plans themselves unaffordable to many employers.

MSEA felt the impact of the Pension Protection Act's funding changes. For example, over the past two years we made the full contributions recommended by our actuaries, transferring more than eight percent of our revenue into our defined benefit plan. Simultaneously, our accountants informed us that FAS 158 required us to adjust net assets downwards by nearly four million dollars. This turned what would have been a million dollar two-year increase in our beginning balance into a three million dollar reduction!

That hit us pretty hard. But the worst aspect was that it occurred prior to the staggering market losses of late 2008 and early 2009. Absent significant and speedy relief from the onerous funding requirements in the PPA, we will soon need to curtail staff, reduce programs, or both.

MSEA joins the National Education Association (NEA) and many of its state affiliates in supporting legislation being drafted by Representative Pomeroy of North Dakota. Representative Pomeroy understands that we need more time to offset the recent market losses. He also understands that providing this flexibility to private sector DB plan sponsors will allow them to maintain—not terminate—existing plans, thereby relieving funding pressure on the Pension Benefit Guarantee Corporation.

Defined benefit pension plans are good for the economy. They provide valuable retirement security for workers. Their sponsors utilize smart, balanced investment policies (in terms of equities and fixed income) and long-term horizons, improving returns for their employees while adding stability to our nation's markets. Unfortunately, the PPA discourages such an approach, deeply penalizing employers for placing plan assets in equities. It is quickly driving the remaining defined benefit plans out of existence.

Please support Representative Pomeroy's legislation and help us in our efforts to properly fund our obligations, thereby providing our employees the retirement security we've promised them.

Thank you,

David E. Helfman
Executive Director

Statement of Matthew D. Hutcheson

INTRODUCTION

Chairman Rangel, Ranking Member Camp, and Members of the Committee on Ways and Means. Thank you for the opportunity to deliver this testimony today.

My name is Matthew Hutcheson. I am a professional independent fiduciary. In some instances, employers that sponsor 401(k) and other pension benefit plans may determine that, due to day-to-day workload, or unavoidable conflicts of interest, it is better simply to sponsor the plan instead of both sponsor *and* manage it. In those cases, an employer may choose to appoint an independent fiduciary to ensure a professional level of fiduciary decision, oversight, and accountability. That is the role I play; employers appoint me to become the primary decision maker, accountable to plan participants.

EXPERIENCE

It has been my experience that 401(k) plan participants feel financially vulnerable. It is difficult for them to make sound investment decisions. This year, I have asked thousands of rank and file employees and professionals alike, all who have been participating in their 401(k) plan for many years, whether they could take the funds in their retirement accounts and construct a meaningful portfolio with expected long-term rates of return and expected levels of risk. Not one of the thousands of participants or professionals ("professionals"—read Attorneys, CPA's, Engineers, Physicians, etc.) could answer the question in the affirmative. Not one of them could even partially answer, or explain the principles of Modern Portfolio Theory that is the foundation of making such decisions. The ensuing discussions revealed a significant lack of investment understanding.

Those experiences confirm to me that most participants either do not have the aptitude for understanding complex investment concepts, or they do not have the time or inclination to learn. Nevertheless, the Employee Retirement Income Security Act of 1974 (ERISA) affords iron clad protections to participants and their beneficiaries that must not be discounted. In other words, under ERISA provides an expectation that the participant's portfolio is free from conflicts of interest, and is economically sound at its core.

A prominent attorney and investment fiduciary pursuant to ERISA section 3(38) explains it this way:

> ERISA was the first body of law to apply key tenets of modern portfolio theory to the management of assets by investment fiduciaries. In a Department of Labor regulation issued in 1977 [Labor Reg. § 2550.404a–1 (42 FR 54122, 1977)], the DOL decided that ERISA fiduciaries responsible for investing and managing the assets of qualified retirement plans such as 401(k) plans must do so according to the principles of Modern Portfolio Theory. Not only the DOL but also the courts have decided that ERISA's investment provisions are grounded in Modern Portfolio Theory.
>
> The language of Modern Portfolio Theory found in another ERISA regulation [ERISA Reg. § 2550.404a–1] instructs investment fiduciaries of 401(k) plans to avoid thinking in terms of "bits and pieces"—that is, a non-portfolio mindset. Notwithstanding ERISA's regulations, an overwhelming number of fiduciaries responsible for 401(k) plans demonstrate this kind of mindset—whether or not they're even aware of it—by offering plan investment options with risk and return characteristics that do not take into account the fact that they function within the context of a portfolio.
>
> Keeping in mind the primacy of the portfolio, independent fiduciaries must focus consciously on the risk and return tradeoffs of plan portfolios. As ERISA Interpretive Bulletin 94–1 puts it, in part: "any models or materials presented to participants or beneficiaries will be consistent with widely accepted principles of modern portfolio theory, [which] recogniz[e] the relationship between risk and return."
>
> This is important because, in fulfilling their duty to provide a prudent menu of investment options, investment fiduciaries of 401(k) plans must find a tradeoff for each portfolio that will achieve the highest return for a given level of risk or the lowest risk for a given level of return. Achievement of this goal helps independent fiduciaries introduce truly prudent investment options to 401(k) plans.[1]

Given the preexisting right a 401(k) participant has to an economically sound, unbiased, prudent portfolio, Congress must augment that existing right through policy that clearly prohibits biased or conflicted investment advice.

ADVICE TO 401(k) PARTICIPANTS

401(k) plan participants have a well founded reason to believe that any advice they receive will lead them to a prudent portfolio that would be equal in every way to a portfolio created by an investment expert familiar with such matters.[2] It would be best if all participants were simply "given" such a portfolio, as the duty owed to participants is the highest duty known to the law.[3] Notwithstanding, the current 401(k) environment permits most participants the opportunity to construct their own portfolio from an available list of funds. That requires advice, guidance, etc. Although participants need the advice, most choose not to use it.

[T]he Department pointed out repeatedly in support of investment advice legislation, this model simply did not work because very few investment providers adopted the models and *even fewer participants actually used them.*[4] (emphasis added)

To further clarify, advice is available to participants, but the participants choose not to utilize the advice, despite their recognition that they are vulnerable and given the conventional participant directed environment, participants need to rely on advice from "someone."

Dr. Gregory Kasten explains:

> Over the Past 20 Years 401(k) Plan Features Have Steadily Increased. Daily valuation multiple fund families, web based calculators, target date funds, electronic trading, rapid loan processing, simple "gap" reports, better communication materials, Financial Engines, Morningstar reports, asset allocation soft-

[1] Statement of Scott Simon, JD, AIFA® during Independent Fiduciary Symposium, Boise State University, September 24, 2009.

[2] ERISA section 404(a)(1)(B), 29 U.S.C. 1104(a)(1)(B).

[3] Donovan v. Bierwirth, 680 F.2d 263, 272 (2d Cir. 1982.

[4] SIMFA testimony Marc E. Lackritz President and Chief Executive Officer Securities Industry and Financial Markets Association Before The Employee Benefits Security Administration United States Department of Labor.

July 31, 2007 http://www.sifma.org/legislative/testimony/pdf/ComputerModelHearing.pdf.

ware, quarterly reports, auto enroll, PPA 2006, increasing fund choices, sector funds, brokerage accounts. *Yet with more "features"—retirement confidence has steadily fallen* (citing Source EBRI: The 2009 Retirement Confidence Survey: Economy Drives Confidence to Record Lows; Many Looking to Work Longer).[5] (emphasis added)

The reality that participants do not use the advice or "features" available to them is confirmed by a study performed by Ruth Helman; Mathew Greenwald & Associates; Jack VanDerhei of Temple University and EBRI Fellow; and Craig Copeland, EBRI. ["The Retirement System in Transition: The 2007 Retirement Confidence Survey" EBRI Issue Brief No. 304 April 2007.]

They found that:

- 46% don't want advice;
- 5% ignore all of the advice;
- 36% implement some of the advice; and, just
- 13% implement all of the advice

Indeed, fewer than half of participants choose to use *any* advice, and therefore are left to their own devices to try to figure out one of the most complex financial matters in modern life. The question that should be asked is not whether advice should be available in a participant directed plan. Rather, the question is why aren't participant's utilizing that advice? What is it that concerns them?

Independent Fiduciary Adviser, Chad Griffeth, AIF®, makes the following observation:

> If the provider of the advice is being paid by the mutual funds in any way, trust is damaged dramatically. The reality of the situation is that the advice provider must earn participants' and management's respect, and the story of true independence, fiduciary prudence, and thus acting in the sole interest of the participant's best interest is critical to the success of the advice provider, and thus the participants. If participants do not trust the source of the advice and account management, they will not use it, even though they need it. Thus, participants will likely not experience the success they need for a dignified retirement.[6]

There exists under the SunAmerica and PPA participant advice models, a level fee requirement. That means compensation received by the individual or entity providing the advice not be tied directly to subsidies offered by mutual funds or other financial instruments, nor may compensation be higher for selecting one individual fund over another.

Although that "prior advice" policy or regulation seems reasonable on its face, participants can sense that something is "off." That explains why the advice is not being used by participants.

To gain insight into the visceral concern of 401(k) plan participants, we can look to 2003 Congressional testimony given by Department of Labor officials:

> Current ERISA law raises barriers against employers and investment firms providing individual investment advice to workers. As a result, millions of rank and file workers do not have the information and advice necessary to make sound investment decisions to enhance their long-term security and independence.

The President's Retirement Security Plan would increase workers' access to professional investment advice. By relying on *expert advisers who assume full fiduciary responsibility* for their counsel and disclose relationships and fees associated with investment alternatives, American workers will have the information to make better retirement decisions.

Here we find the answer to the riddle. Participants intuitively know, suspect, or worry that the person or entity giving the advice is not an adviser that will or can assume *full* fiduciary responsibility for the advice given. Rather, in all too many cases participants can discern that the person or entity rendering the advice is doing so under exemptions, exceptions, or under the appearance of full fiduciary loyalty, but avoiding the full meaning of that term.

To summarize, it is somewhat irrelevant what advice model is advanced as "best policy" if the advice model is not widely trusted by participants. That requires a true duty of loyalty without conflicts of interest—i.e. advice must be given by invest-

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[5] Statement of Dr. Gregory Kasten, MD, MBA, CPC, AIFA® during Independent Fiduciary Symposium, Boise State University, September 24, 2009.

[6] Email from Chad Griffeth, AIF®, July 28, 2009.

ment fiduciaries who are independent of those managing the portfolios and selecting the underlying funds.

RESTORING TRUST IN THE 401(k) SYSTEM AND THE ROLE OF H.R. 2989

The fiduciary duty is highest duty known to the law. The assistance we give participants, whether in the form of advice or discretionary action taken by a fiduciary, must conform to that "highest" duty.

In other words, the advice must be the "highest" possible advice; namely, advice that carries with it the highest ideals of society and does not carry with it exemptions, exceptions, conflicts, or biases that favor the advice giver. That is very clear. Given that there are many professional investment fiduciaries giving unconflicted, unbiased advice, independent of the investment fiduciaries managing the portfolios, we know it can be done, and must be required for all other advice givers.

Participants are vulnerable due to the complexities of the world of finance. Those vulnerabilities require a participant who wants advice to *rely* on others, with an *expectation* of loyalty. Participants expect those that are brought in to provide advice will have been vetted and screened for conflicts of interest by their plan sponsor; they are expecting and relying on that sponsor to protect them. However, they currently are uncertain and unsettled; there's a lack of confidence that the advice giver is truly willing to assume full responsibility for the advice given.

Participants will use advice if they are certain that the advice giver is an investment fiduciary with a duty of loyalty that is "eye-single" to the interests of the participant and the participant's beneficiary.

H.R. 2989 creates that environment of loyalty. If we as a society of future retirees will ever benefit from unbiased advice, such advice must first be *used.* To foster the trust in an advice based system, we will need to adopt and implement a system that satisfies the broad discernment of over fifty million American workers. That means getting rid of exemptions and bringing a true fiduciary duty to advice given; as the Department of Labor conveyed to Congress in 2003.

It will be necessary to adopt and implement policy that requires advice givers be Registered Investment Advisers defined under the Investment Advisers Act of 1940 (such advisers are investment fiduciaries), or individuals directly under the oversight and management control of a Registered Investment Adviser.

Principal decision making fiduciaries like me have the opportunity to hire an investment manager as defined under ERISA section 3(38). To the extent that participants desire to construct their own portfolios, a separate advice giver other than the investment manager hired at the plan level, will be permitted to give participants advice so long as they are independent of the ERISA 3(38) investment manager, and are willing to accept full fiduciary responsibility for the advice given.

Professional fiduciaries will not accept or hire an investment professional under any other conditions. The investment advice component of H.R. 2989 is trust building policy, and should be advanced to law. When this legislation becomes law, it will pass the "smell test" of those who need advice, and who, in turn, will have increased confidence in the 401(k) system as a means to provide them with retirement income security.

The following paper from the Journal of Pension Benefits further elaborates on the vulnerabilities and expectations of 401(k) participants, and facilitates an understanding of the favorable impact H.R. 2989 will have on American workers.

Statement of National Association of Insurance and Financial Advisors

The National Association of Insurance and Financial Advisors (NAIFA) appreciates the opportunity to share with you, the members of the House Ways and Means Committee, our views in connection with your hearing on defined benefit pension plan funding levels and investment advice rules. Our comments are focused on investment advice rules, which are important to many NAIFA members who operate as investment advisor representatives, and to the consumers whom we serve. For the reasons discussed more fully below, we urge you to maintain current law, allowing advisors to provide much-needed information to participants in 401(k) plans.

Founded in 1890 as the National Association of Life Underwriters, NAIFA comprises more than 700 state and local associations representing the interests of approximately 200,000 agents and their associates nationwide. NAIFA members focus their practices on one or more of the following: life insurance and annuities, health insurance and employee benefits, multiline, and financial advising and investments. The Association's mission is to advocate for a positive legislative and regulatory environment, enhance business and professional skills, and promote the ethical conduct of its members. NAIFA's website can be accessed at www.naifa.org.

As part of their business plans, many NAIFA members work with their small business clients to establish 401(k) plans to provide a means for employers and employees to build retirement income security. Since passage of the Pension Protection Act (PPA) in 2006, NAIFA members who are investment advisor representatives have been able to provide much-needed assistance and advice to participants in 401(k) plans. The 2006 Act modified ERISA prohibited transaction rules that barred financial institutions that sponsor their own investment products from recommending those products to plan participants when asked to give recommendations, and provided legal protections to employers who offered investment advice to employees participating in their 401(k) plans. The changes resulting from the 2006 Act allow professionals to offer investment advice to 401(k) plan participants, whether or not they are independent of a plan investment provider, subject to certain protective conditions. Thus, advisors are now permitted, again, under certain protective conditions, to answer questions, recommend changes to investment selections, and generally assist participants in understanding their 401(k) investments.

NAIFA supported the changes ushered in by the PPA, and opposes the provisions in proposed legislation, H.R. 2989, that would change current law by prohibiting investment advisers who represent companies providing investments to 401(k) plans from providing advice to plan participants. The pending legislation would recreate the "advice gap" that existed prior to the 2006 reforms—resulting in investors being less informed as they make critical decisions about their financial futures.

Professional assistance is crucial to help people figure out how best to allocate the hundreds and even thousands of dollars that they and their employers deposit in their 401(k) plans annually. The need for advice from trained and licensed professionals to 401(k) plan participants has increased with the ever growing shift from defined benefit plans to defined contribution plans, and is arguably even greater in light of the precipitous drop in the market over the last year and continuing market volatility. Yet, as we have seen from experience, a significant number of 401(k) plan participants do not have an investment advisory service available to them through their retirement plans. In many cases, this occurred because employers were unwilling to risk legal liability prior to the enactment of PPA in 2006. This is problematic for all participants, but particularly troublesome in light of the fact that many novice retirement plan participants direct their own account investments.

There is no dispute that there exists a huge need for sound investment advice for most workers. Planning for retirement is a complex task, taking into account numerous variables years, even decades into the future. This makes it difficult for most people—not just rank and file workers, but other groups one would expect to be more investment savvy. According to news reports, more than half of 401(k) participants allocate their money either into overly conservative or overly aggressive investments. Many—including an estimated 50% of Harvard's faculty and staff, as well as the 3 million plus members of TIAA–CREF—simply allocate their money to money market accounts, or, once allocated to specific funds, never adjust them.

This is changing. A recent report by the Profit Sharing/401k Council of America (PSCA) notes that the availability of investment advice for 401(k) plan participants continues to increase. For the first time, more than half of all plans (51.8 percent) offer investment advice options to participants. More small companies offer investment advice options than large companies. (*PSCA 52nd Annual Survey of Profit Sharing and 401(k) Plans,* September 28, 2009.) This is good progress that should be encouraged to continue. Unfortunately, current legislative proposals—specifically, H.R. 2989—would likely reverse any gains made since enactment of the PPA in 2006.

That is why NAIFA opposes the proposed rolling back of the changes made by the PPA. We believe such a move would significantly hurt plan participants—the average American worker and investor—because it would reduce their access to an informed adviser whose purpose is to help them understand their retirement plan and make informed choices about their 401(k) investments. Moreover, we believe the current rules provide adequate consumer protections that would not be enhanced by the new proposals.

Here is a brief explanation of how the current marketplace works: The typical NAIFA member represents a plan investment provider in connection with 401(k) plans. The NAIFA member, an investment advisor representative (IAR), interacts with the plan sponsor on behalf of the provider. In that role, the NAIFA member/IAR provides a number of services to the plan sponsor, including (under current law) providing investment advice regarding investment options to the sponsor's employees.

The IAR generally is compensated for all services provided in connection with a plan based upon a certain percentage of assets under management. In our experience, these are generally very small amounts—up to 25 basis points is common—and are included in the general fee charged by the plan investment provider. Moreover, our experience indicates that the compensation generally does not vary if the plan participant chooses one fund over another. There is, therefore, no incentive for the IAR to recommend a particular fund, whether it is a proprietary fund of the plan investment provider or any other investment. The incentive, to the extent there is one, is to provide the best advice possible to the participant in order to increase the size of assets under management. And given the very small percentages, that goal benefits the plan participant far more than the IAR.

Under the proposed legislation, this would change. To the extent a plan sponsor engages an investment adviser for its plan participants, the adviser would be required to be independent of the plan investment provider. This independence comes at a cost. The independent adviser would charge a fee—likely to be 1–1.5% of assets. This fee would be in addition to the fee charged inside the product, be it insurance, mutual fund or collective trust. Experience has shown that many plan sponsors are unwilling to incur the additional cost, leaving participants to seek out and pay for their own investment advice or go without.

Moreover, even to the extent a plan sponsor incurs the cost of engaging an independent adviser, the adviser is at no advantage to an IAR because the adviser is limited to the same group of funds within the plan—that is, an independent adviser is making recommendations from the same menu of funds that an IAR would select. Given that there is no financial incentive to an IAR to select one fund over another, there is no reason to believe an independent adviser would be less conflicted or do a better job.

Thus, rolling back current PPA provisions would very likely result in less information—and potentially, less helpful information—in the hands of investors:

- Plan participants are not likely to seek out advice on their own because they cannot (or will not) pay for it. We note that there is nothing in current law that prohibits plan participants from engaging an independent adviser if they would prefer to work with someone who is not affiliated with the plan investment provider. Indeed, the Department of Labor's proposed regulations, which have now been withdrawn, would have required that participants be notified in writing of their ability to do so. Having said that, it is our experience that most plan participants do not have the means or inclination to engage an adviser on their own, and there is nothing to suggest that this would change.
- Plan sponsors, who currently pay for the advice provided by IARs through the fees they pay plan investment providers, would violate ERISA by arranging for an adviser to provide investment advice to their employees unless they engage independent advisers. Even hiring an independent adviser places all the liability for the adviser's compliance with the requirements of the statute on the sponsor. Having said that, however, there is no requirement that a plan sponsor provide any investment advice to participants—whether through an affiliated or non-affiliated adviser. Thus, faced with additional costs charged by independent advisers and facing potential legal liability, we believe employers are likely to forego providing advice altogether, leaving participants to fend for themselves once again.
- Plan investment providers and their IARs, who have the closest relationships with plan sponsors and participants, would be prohibited from sharing their knowledge and expertise for the benefit of participants.

The practical effect of rolling back the PPA's investment advice provisions and replacing it with a requirement that participants be provided with independent advisers—or no advice at all—is that many, if not most, rank and file employees will not have access to affordable, professional advice with respect to how to invest their 401(k) plan contributions. We do not believe this is in anyone's best interest, particularly those of plan participants. The financial markets are incredibly complicated. Investors are confused and it is difficult to determine the best course of action. That results in inaction and/or uninformed action on the part of plan participants. Current law has helped to provide better, more complete information to plan participants, to assist them in making informed choices based on their needs and risk tolerance. The proposed legislation, instead of fostering an increase in accessible, professional advice, is very likely to do just the opposite with serious adverse consequences.

Thank you for your consideration of our views.

Statement of the National Council of Farmer Cooperatives

The National Council of Farmer Cooperatives (NCFC) appreciates the opportunity to submit this statement in response to the Committee's hearing: "Defined Benefit Pension Plan Funding Levels and Investment Advice Rules."

Since 1929 NCFC has represented the interests of America's farmer cooperatives. There are nearly 3,000 farmer cooperatives across the U.S. whose members include a majority of our nation's more than two million farmers. We believe farmer cooperatives offer the best opportunity to achieve farmer-focused agricultural policy because farmer cooperatives allow individual farmers the ability to own and lead organizations essential for continued competitiveness in both the domestic and international markets.

America's farmer cooperatives provide a comprehensive array of services for their members. These diverse organizations handle, process and market virtually every type of agricultural commodity produced. They also provide farmers with access to infrastructure necessary to manufacture, distribute and sell a variety of farm inputs. Additionally, they provide credit and related financial services including export financing. Earnings derived from these activities are returned by cooperatives to their farmer-members on a patronage basis, thereby enhancing their overall farm income.

Farmer cooperatives generate benefits that strengthen our national economy, providing jobs for nearly 250,000 Americans with a combined payroll of over $8 billion. Many of these jobs are in rural areas where employment opportunities often are limited. The pension funding crisis has placed many of these rural jobs in jeopardy, however. The economic crisis and the collapse of the stock market have caused unprecedented losses in defined benefit pension plans all across the country, and requirements for defined benefit pension plans of farmer cooperatives are reaching unsustainable levels.

Due to increased funding requirements, farmer cooperatives may be forced to lay off workers, postpone investments in new products and services, and take other drastic measures in order to meet current funding requirements.

NCFC surveyed members from all parts of the country and asked them whether the market downturn has had an impact on their defined benefit plan funding requirements. Nearly all of those surveyed reported dramatic increases in funding requirements. In fact, for single employer plans, the anticipated increase in average annual contribution (2006–2008 vs 2009–2014) is more than 75 percent. Prior to the market downturn, many of those plans had sizeable cushions from discretionary contributions or were approaching full funding.

In order to address this severe funding problem, farmer cooperatives are taking or considering the following actions:

- Eliminating jobs and reducing salaries.
- Reducing patronage payments to members, impacting both members and rural communities.
- Reducing capital investments.
- Reducing spending on marketing, travel, training, etc.
- Suspending 401(k) employer-match contributions.
- Canceling annual salary increases.
- Canceling annual incentive programs.

Farmer cooperatives are not asking for relief from, or a reduction in, pension funding obligations; instead, they are asking for additional time to allow for a positive stock market correction. Time is of the essence, however, and we urge you to act quickly to address this problem. The vast majority of single employer plan sponsors' funding obligations will be determined on January 1, 2010, regardless of stock market performance in the remainder of the year. Farmer cooperatives and other businesses must plan now for the substantial funding liabilities in the new year.

NCFC is very pleased that Representative Earl Pomeroy has issued a discussion draft of legislation providing relief to plan sponsors and workers. The discussion draft provisions would allow more time for employers to manage losses from the recent stock market downturn. That additional breathing space for employers would help to ensure economic recovery in rural America and the continued viability of our nation's farmer cooperatives.

Conclusion

Thank you for the opportunity to share our views. NCFC looks forward to working with the Committee to address the ongoing challenges in defined benefit pension plan funding. We appreciate this statement being included in the official hearing record.

New Jersey Education Association, letter

Dear Mr. Chairman:

On behalf the 203,000 members of the New Jersey Education Association, we appreciate the committee's interest in the future of defined benefit pensions and wish to submit the following comments, for the record, on Defined Benefit Pension Plan Funding Levels and Investment Advice Rules.

NJEA strongly believes in the value of a defined benefit pension as the most secure retirement benefit for American workers. In addition, we believe that properly regulated defined benefit plans are the most responsible and stable retirement benefits employers can offer to their employees.

These policy positions are modeled by NJEA through its sponsorship of a single-employer, private defined benefit pension plan for our own employees and retired employees. As a responsible plan sponsor, NJEA has consistently met all federal funding requirements for its Plan, ensuring the retirement security of more than 470 Plan Members and beneficiaries.

However, like many other defined benefit plan sponsors, NJEA is facing the challenge of continuing to fully fund our Plan in the wake of deep investment losses in 2008–09 while meeting more stringent funding requirements under the Pension Protection Act of 2006. This has caused us to defer planned staff expansion and capital projects, and to reduce other expenditures, impacting the local economy, as we have shifted resources within our budget in anticipation of a required employer contribution that could be three to five times our previous annual funding requirement.

We recognize that some measure of pension funding relief was enacted under the Worker, Retiree, and Employer Recovery Act of 2008 (WRERA), and we greatly appreciate changes to the original asset smoothing method in the PPA.

In addition, WRERA and subsequent regulatory measures by the IRS provide flexibility to plan sponsors in setting the interest rates on which their plan liabilities are valued. While this can have a dramatic effect on current liability for this plan year—and help prevent a spike in required employer contribution—it is a short-term and somewhat artificial fix. The fact remains that our Plan's assets declined almost 16% from September 1, 2008 to August 31, 2009, and plan sponsors with calendar fiscal years saw far steeper declines.

While rate relief will allow us to measure our Plan liabilities much lower, it may only defer the spike in employer contribution for a year. Corporate bond yields—on which the target liability yield curve is based—are already falling, which will likely cause our Plan's liability to be measured at a dramatically higher level next year. At the same time, the Plan's assets will have to be at 96 percent of liability (versus 94 percent this year) under the PPA funding target phase-in.

We strongly encourage Congress to enact additional relief measures, including a provision for plan sponsors to separately value and amortize their 2008 and 2009 investment losses over 30 years. This would alleviate volatility and spikes in employer contributions without forgiving any plan liability.

This proposal and others have been advanced by the National Education Association, in concert with many other organizations. We urge the Committee to consider and act favorably on NEA's proposals.

Sincerely,

Barbara Keshishian
President

Oklahoma Education Association, Letter

Dear Chairman Rangel and Members of the Committee on Ways and Means:

Please allow me to introduce myself as the Executive Director of the Oklahoma Education Association (OEA), a state affiliate of the National Education Association (NEA). I am writing to respectfully submit the comments of the OEA to the Ways and Means Committee in conjunction with a draft proposal by Representative Pomeroy that will provide relief for defined benefit pension plan funding levels and investment advice rules.

The OEA was established in 1889 prior to Oklahoma statehood and currently represents approximately 40,000 active and retired public sector education employees. Over 50 hard working Oklahoma citizens are directly employed by the OEA to carry out our mission. Those employees are private sector employees and consist of support, professional, and management staff.

The OEA maintains a single employer defined benefit retirement plan for its employees. Our plan currently has 53 plan participants and I think it is fair to describe our plan benefits as "modest" at best. Our defined benefit plan is based on a 2% factor and we do not have any cost of living provisions, nor do we provide any post-retirement health care or other post-retirement benefits. We do however believe that our plan provides basic economic security for our employees who vest in the plan and retire from service at the OEA.

The OEA has always been a fiscally responsible sponsor of its defined benefit pension plan, despite requirements to make substantial additional monetary contributions to the plan in order to provide the maximum funding levels implemented by the recently enacted Pension Protection Act (PPA). We are proud to sponsor a defined benefit plan that is annually funded at the maximum allowable level and sincerely believe in our obligation to provide reasonable and affordable retirement benefits to our hard working employees.

However, the inflexible and stringent rules mandated by the PPA and the recent downturn in the financial markets have created an environment where we are facing a catastrophic financial crisis. Unless we have relief in the form of more flexible funding requirements for the defined benefit plan—particularly in the area of funding investment losses over a longer period of time than is currently available under the PPA—or drastically cut back regular services to our members, staffing, and normal capital improvement expenditures, the OEA will not be able to sustain its annual budget. Under the current PPA rules, the total impact of our defined benefit plan on our most recent fiscal year budget is 43% of our total revenues.

The OEA will not be able to continue to maintain its defined benefit plan under the current funding requirements without suffering substantial financial damage. We are currently faced with the unpleasant dilemma of either breaking our promise to continue sponsoring a defined benefit plan for our employees, or breaking our promise to continue to provide the very best services available for our members. Changes in the current funding requirements are necessary to make plan funding more predictable and affordable, which in turn will allow organizations/employers such as the OEA to maintain defined benefit pension plans in the future.

The draft proposal by Representative Pomeroy provides sensible short term funding relief for defined benefit pension plans without jeopardizing the long term funding protections for these plans. I urge the Ways and Means Committee to support the Pomeroy proposal and to expeditiously enact legislation that will provide much needed relief to sponsors of defined benefit plans in the private sector.

Thank You,

Lela Odom, *Executive Director*

Statement of The ERISA Industry Committee

As the representative of America's major employers on retirement issues, The ERISA Industry Committee ("ERIC") appreciates the Committee's focus on the issues of funding relief for pension plans and investment advice in defined contribution plans.

ERIC is a nonprofit association committed to the advancement of the employee retirement, health, incentive, and welfare benefit plans of America's largest employers. ERIC's members provide comprehensive retirement, health care coverage, incentive, and other economic security benefits directly to some 25 million active and retired workers and their families. ERIC has a strong interest in proposals affecting its members' ability to deliver those benefits, their costs and effectiveness, and the role of those benefits in the American economy.

SUMMARY: DEFINED BENEFIT PLAN FUNDING RELIEF

ERIC strongly supports and has urged both the Congress and the Administration to provide immediate, temporary and meaningful funding relief for defined benefit plans. Employers have not asked and are not now asking for relief in the form of direct financial support from the government. Rather we are merely asking for more time to make unexpected and larger contributions to defined benefit plans as a result of the unprecedented financial and economic problems that stem from the ongoing global financial meltdown.

Companies that sponsor defined benefit plans, including those that had made significant contributions to comply with the new more stringent funding rules of the Pension Protection Act of 2006 (PPA), suffered significant and unexpected losses in their pension plan investment portfolios as a result of the "once in a generation" investment crisis. Because of the worst recession since the Great Depression, many have been forced to freeze their pension plans, reduce financial support for 401(k) plans, curtail employment, and significantly reduce investment.

Unlike other sectors of the economy, however, companies sponsoring defined benefit plans are not asking for a taxpayer bailout; instead we are merely asking for more time to make contributions to match long-term liabilities inherent in the pension plan system. There is ample precedent for such a solution: in 1974 when the Employee Retirement Income Security Act (ERISA) was enacted, companies were given 30 years to amortize existing liabilities.

SUMMARY: PARTICIPANT ADVICE

Millions of Americans rely on their 401(k) plan and other defined contribution plans for retirement security. ERIC member companies who sponsor 401(k) plans offer investment advice products and services to plan participants as permitted under current law. Many utilize the regulatory framework approved by the Department of Labor known as "SunAmerica," whereby participants receive investment advice based on a computer model designed by a third party with no financial stake in the underlying investments in the plan and is independent of the service provider or financial institution providing the investment advice.

ERIC supports investment advice rules that carefully balance the need of the participant to receive effective and useful investment advice from the company plan sponsor and/or its service provider as well as the need for the employer to have clear and consistent rules under which to legally offer the advice. ERIC's members have a vital interest in assuring that the rules and regulations issued in connection with investment advice achieves its objective in a way that encourages voluntary investment advice programs without exposing employers to an undue risk of fiduciary liability.

Defined Benefit Plan Funding

As Congress and the Administration focus on efforts to stimulate the economy, real relief for America's pension plans is an absolute necessity. There is general agreement among those directly concerned with business, employment, and retirement administration that failure to provide meaningful relief will increase unemployment, slow economic recovery, and put retirement security at risk. The drop in the value of pension plan assets and the credit crunch, together with the new accelerated funding requirements of the Pension Protection Act of 2006 (PPA), has placed employers in a difficult position.

At a time when companies need cash to keep their business afloat, retain and recruit employees, build product in American factories, the new funding rules under the PPA coupled with the economic meltdown require extraordinary and unexpected cash contributions to their defined benefit plans, to fund liabilities that are many years in the future.

As a result, companies, including those that need to continue to manufacture goods and build inventory, will divert much needed cash to make pension plan contributions, cash that would otherwise be spent on current job retention, job creation, and capital investments. Many of these companies fear that they will be forced to increase off-shore resources—with its permanent impact on jobs—in order to reduce costs to make up for these contributions. These funding challenges apply to both frozen and non-frozen plans (those that continue to accrue new benefits for employees). Unless Congress intercedes with reasonable rules that will promote retention of pension plans, the result will be an increase in unemployment—some of it permanent—and a slower economic recovery.

The Worker, Retiree, and Employer Relief Act of 2008 corrected a number of technical errors in the PPA and clarified some points of contention between plan sponsors and the regulatory agencies. It did not, however, adequately provide the substantive relief needed to force plan sponsors from making an unfortunate choice between funding their pension plans and retaining current employees, hiring new employees, and the capital investments necessary to stimulate the economy and improve the lives of millions of Americans.

The Treasury Department has recently provided some needed regulatory relief in this area. However, due to statutory constraints, the Treasury relief was not provided to all pension plans, leaving some plans, particularly fiscal-year plans (as opposed to calendar-year plans) suffering grave economic hardship. Simply stated, Congress needs to act, quickly and decisively in order to support the remaining defined benefit plans still offering retirement security to participants. Any relief that Congress provides must be made available to both frozen and non-frozen plans in order help companies transition out of this deep recession.

As you are aware, the last four months of 2008 posed a significant challenge for defined benefit pension plans that, in compliance with the PPA 2006, had reached or were close to full funding. A dramatic and unexpected decline in the value of the equity markets significantly reduced the assets held by these plans through no fault of the PPA. As a result, pension plans that were fully funded only one year ago are now substantially underfunded under the standards set by the PPA 2006.

The PPA significantly tightened the nation's pension funding rules. Congress, not anticipating the financial crisis, made no provision in the Act that that would have provided relief from the crisis. Plan sponsors have spent the two-plus years since the legislation was enacted preparing to meet the new law's funding requirements, but they, like Congress when the law was enacted, did not and could not anticipate the financial crisis through which the nation is now progressing. The confluence of tighter funding laws and the current economic environment created a "perfect storm" that requires relief.

Many major employers that have responsibly funded their pension plans are now facing statutorily required contributions in the coming year that exceed the previous year's contributions by magnitudes of hundreds of percent. The sheer size of the contributions leaves employers in an untenable position: they must either cut jobs and delay hiring and investment, or allow their plans to go underfunded, in many cases, resulting in restrictions on the benefits that workers can claim as they retire. In some cases, the pension liabilities that must be met under the requirements of the PPA may exceed the net worth of the company. We do not believe that Congress intended to allow companies to close their doors as a result of inability to meet the funding requirements of the PPA coupled with the Great Recession.

Looking ahead to 2010, companies expect increased required contributions to their pension plans, barring an enormous market recovery or another unusual spike in interest rates that would reduce minimum contributions. These increased minimum contributions apply to both frozen and non-frozen plans because of investment losses and interest rate assumptions.

Because companies suffered enormous investment losses in 2008, current investment returns are not sufficient to reverse the dramatic negative investment returns of the last quarter of 2008. Those losses, the low return on investments, coupled with the fact that interest rates are substantially lower than in October 2008, results in an increase in the computation of pension plan liabilities (based on current interest rates). Higher liabilities result in higher minimum contributions to the plans, thus continuing the cash-crunch cycle into 2010 and forcing companies to choose between funding pension plan trust funds, that represent long-term liabilities, and ending workforce reductions, rehiring workers and/or making infusions of capital into their core business interests.

A failure to provide funding relief will undoubtedly have real pension implications including an increased risk to the PBGC and the loss of pension benefits and plan freezes (as well as curtailment of 401(k) plans in order to raise cash) for many workers, the repercussions will stretch far beyond pensions to the whole of economic growth. With required contributions for many employers reaching tens and hundreds of millions of dollars, the job and investment consequences of failing to act are real. We urge you to provide real, temporary relief that allows plan sponsors additional time to fully fund their pension plans.

Pension plan sponsors are not asking for a bailout—we are not asking that the government provide plan sponsors with cash or take on plan sponsors' liabilities. Plan sponsors simply need additional time over which to make their pension contributions. Plan sponsors need more time to amortize the 2008 losses as well as rules that reflect the true long-term nature of the pension plan liability.

In these uncertain economic times, employers are forced into making hard and difficult choices—in some cases cutting retirement benefits in order to retain jobs. Many employers eliminated 401(k) matches in order to divert the cash to cover other expenses, including payroll, and defined benefit plan funding. These employers hope to and in some cases are slowly returning to providing the employer match. However, as we have learned from this economic crisis, employers need the flexibility to make business decisions regarding cash allocation quickly and without depending on Congress.

One short-term result of the economic crisis, and government failure to date to provide needed flexible relief, is that employers are hesitant to take on long-term financial commitments. For instance, employers are wary of making long-term commitments that require maintenance of short term funding to cover what are in fact, long term liabilities. The current financial crisis not only impacts workers today, but also will have severe, short-term negative effects on the pension plans in which they participate, reducing benefits, undermining retirement security and will continue to impact the ability for large employers to maintain current workforce levels.

We understand that there are some, in and out of government, who contend that there are no econometric studies to illustrate that if companies are required to make statutorily required pension contributions they will be forced to curtail spending for jobs and investment. We find this contention so out of balance with common sense that it is without merit of consideration.

Investment Advice

The Education and Labor Committee approved a bill this summer that would drastically change the way employers offer investment advice to workers participating in their 401(k) plans. The PPA included investment advice provisions that expanded the ways in which employers could provide investment advice to their workers through their 401(k) plans. The effective date of the final regulations on investment advice issued by the Bush Administration has been delayed upon further review by the Obama Administration.

Employers need clear rules that apply when an employer chooses to make investment education or investment advice available under a participant-directed defined contribution plan. Congress should recognize, however, that plan sponsors and fiduciaries are increasingly targeted in class action lawsuits that propose expansive theories of fiduciary liability and seek substantive damages. Even when these lawsuits are without merit, as is often the case, they are expensive to defend and they divert time and attention from the employer's business. As a result, any employer that considers whether to adopt an investment advice program must weigh the potential benefit to plan participants against the very real risk of costly and time-consuming litigation.

Employers will voluntarily offer investment advice programs only if the rules governing these programs are clear and objective, do not open the door to increased fiduciary liability, and provide safe harbors whenever possible.

The Education and Labor's bill approved out of the Committee this summer, would significantly disrupt the manner in which employers provide investment advice to plan participants. Specifically, this legislation would prohibit employers from providing investment advice under most "SunAmerica" models, which has provided a framework for employers to provide investment advice for eight years.

Many ERIC members provide investment advice under the SunAmerica model. Our members have indicated that if the rules under which employers may offer participants investment advice in 401(k) plans are completely revamped so as to preclude most SunAmerica arrangements, many would not undertake the expensive and time-consuming exercise of overhauling their investment advice programs. In addition, these changes would also result in uncertainty and increased exposure to liability for employers.

ERIC strongly supports the SunAmerica investment advice framework. It appears that the Education and Labor Committee has concerns regarding the PPA investment advice provision as well as the Bush Administration final regulations on investment advice. ERIC urges a full and fair debate on this issue within the Committee. However, by casting doubt on SunAmerica arrangements, Congress would force employers to review and reconsider whether providing investment advice results in litigation jeopardy. Employers would limit and or eliminate investment advice programs resulting in fewer Americans receiving investment advice through their employer-sponsored 401(k) plans.

ERIC appreciates the opportunity to present this statement. If the Committee has any questions about our statement for the record, or if we can be of further assistance, please let us know.

The ERISA Industry Committee

Statement of the Michigan Education Association

The Michigan Education Association (MEA) respectfully submits these comments to the Committee on Ways and Means in conjunction with the October 1, 2009 hearing on defined benefit pension funding levels and investment advice rules.

MEA is a labor organization with more than 160,000 members consisting of active and retired employees of public elementary and secondary schools and institutions of higher education in the state of Michigan. Although MEA members are not subject to the funding rules governing private sector defined benefit pension plans, the MEA has a defined benefit pension plan that covers over 700 employees of MEA and its associated organizations.

MEA strongly supports legislation being drafted by Representative Pomeroy that will provide appropriate funding relief for sponsors of private sector defined benefit pension plans. The extraordinary economic downturn that has been experienced during the past 12 to 18 months in Michigan and throughout the United States creates substantial funding challenges for employers, like the MEA, that have defined benefit pension plans for its employees. Congressman Pomeroy's proposed legislation would significantly assist MEA and other defined benefit plan sponsors by providing extended amortization of certain funding shortfalls, expanding the smoothing corridor for assets that have experienced serious declines in value, and protecting an employee's right to choose a social security leveling benefit payment option.

MEA is facing significant increased minimum contributions to its pension plan in the next few years due to the unusually severe downturn in the economy. The ability to elect to amortize funding shortfalls over a 15 year period and an expansion of the smoothing corridor for assets greatly enhances MEA's ability to fund the pension plan and protect the benefits of its employees. The plan has had a Social Security leveling benefit option for its employees for many years. The ability to retain that option for its employees is a significant benefit of the proposed legislation.

The Pomeroy draft legislation assists in addressing the funding crisis arising out of the economic recession, while ensuring the protection of employees' benefits. MEA fully supports this legislation and urges the members of the Ways and Means Committee to approve it expeditiously.

Statement of the National Education Association

The National Education Association (NEA) respectfully submits these comments to the Committee on Ways and Means for the record in conjunction with the October 1, 2009 hearing on defined benefit pension plan funding levels and investment advice rules.

NEA strongly supports legislation being drafted by Representative Pomeroy that will provide the funding relief desperately needed by sponsors of defined benefit pension plans in the private sector. The bill is appropriately calibrated to help plan sponsors recover from the cataclysmic market losses that occurred during the five-month period stretching from the summer of 2008 through the winter of 2009, when the assets of defined benefit pension plans suffered an average market value loss of 40 percent. Without the short-term, targeted funding relief provided by the Pomeroy draft, many employers will not be able to continue in business, let alone maintain their pension plans. Accordingly, NEA commends Representative Pomeroy for sponsoring this bill and urges the House Ways and Means Committee to move the bill to the House floor intact and to send with it an urgent message about the need for speedy passage of the bill in both the House and Senate.

NEA is a leading advocate for financially stable, employment-based, defined benefit pension plans in both the public and private sectors of the economy. Although nearly all of NEA's members are employed by public school employers not subject to the funding rules governing private sector defined benefit pension plans (and therefore would not be affected by the funding relief provided by the Pomeroy bill), NEA understands that passage of the legislation is vitally important to the survival of employment-based defined benefit pension plans in all sectors of the economy. Without funding relief, the relatively inflexible funding rules imposed on sponsors of private sector defined benefit plans would make sustaining those plans, given the stresses of the once-in-every-other-generation market upheaval of the end of last year and the beginning of this one, nearly impossible for many employers. For those employers, the cost of sustaining their defined benefit pension plans under the funding rules without relief will force them to retrench their operations severely, causing losses in economic activity and jobs in their core businesses. And, as private sector defined benefit pension plans become rarer, the defined benefit pension plans maintained for our members will inevitably become harder for public sector employers to sustain.

NEA's knowledge about the severe challenges that private sector employers are facing in maintaining their defined benefit pension plans has been gained first hand through the experience of its own affiliated associations throughout the country, nearly all of whom maintain defined benefit pension plans—on both a single employer and multiemployer basis—for their own employees. For the most part, NEA's affiliates are financially stable, mature organizations with predictable cash flow.

These organizations take pride in providing retirement security for their staff employees by maintaining well-funded defined benefit pension plans. Yet, the application of the new stringent funding rules of the Pension Protection Act ("PPA")—which generally increase the unpredictability of funding requirements year-to-year—to plans that have suffered, over a five-month period, a drastic and unpredictable market drop in the value of their funding, has suddenly made sustaining those plans a nearly unbearable burden.

And it is not just the plans that are jeopardized by this funding crisis: many of NEA's affiliated associations are being forced to postpone, curtail, or eliminate regular services, staffing, and capital improvements, often on top of increases in member dues. This is because, absent relief, in 2009 the average NEA affiliate will be faced with the immediate obligation to make funding contributions equal to 37 percent of its payroll, just to maintain its defined benefit pension plan. This huge funding obligation is not the result of past irresponsible funding behavior; on the contrary, these organizations have been uniformly fiscally responsible sponsors of their defined benefit plans, and many have been making markedly increased contributions to their plans over the last few years. Not one of these associations has taken contribution holidays or paid only the minimum contribution required by existing funding rules. Financially sound, long-term membership organizations such as these—like many other businesses in the private sector—should be financially able to maintain defined benefit pension plans. But, unless these employers are given some temporary flexibility in how to recoup the severe investment losses of the last two years suffered by their plans, many of these plans will not be sustained, and the organizations will be substantially damaged financially as well.

Representative Pomeroy's proposal will have a major beneficial impact by providing sponsors the opportunity to fund the investment losses that their defined benefit plans incurred at the end of 2008 and the beginning of 2009 over a longer period of time. This one temporary change in the funding rules will permit many defined benefit pension plans to remain viable; and it will free up needed investment capital for the sponsors' core businesses and allow these employers to begin hiring again. The Pomeroy proposal provides this temporary relief in the form of two alternative funding rules, either of which sponsors may elect voluntarily to comply: (1) an option to defer for two years the amortization of the shortfalls occurring in 2009 and 2010; or (2) an option to amortize the shortfalls occurring for the first time in 2009 and 2010 separately over a 15-year period. NEA is most pleased by the inclusion of the latter alternative in the bill, because it will provide greater relief for sponsors' contribution obligations in the earlier years. NEA is similarly pleased with the bill's temporary funding relief for multiemployer plans, which employers would be permitted to elect voluntarily during 2009 or 2010 either: (1) to restart the amortization of unfunded liabilities over a 30-year period; or (2) to establish a separate amortization base for investment losses recognized from the fall of 2008 through the fall of 2010 and to fund this liability over a 30-year period.

The bill's "maintenance of effort" requirements, which are linked to its temporary funding relief provisions for single employer plans, are appropriately calibrated to incentivize sponsors to continue to provide benefits to plan participants during the same period in which they are receiving relief. As no plan sponsor is required to accept the temporary funding relief, and the bill provides different methods of complying with the maintenance of effort requirements, the temporary limitation on the sponsors' flexibility to curtail plan benefits or to enhance executive nonqualified plan benefits is both justified and fair.

The genius of the bill is that it provides temporary funding relief without undoing the principles of the Pension Protection Act, which were designed to ensure that defined benefit pension plans were better funded. Under the bill, no employer would be allowed to make contributions for 2009 and 2010 that are less than those made for prior years. And no liabilities will be hidden; that is, the accounting statements made on behalf of the plan will fully reflect the value of the liabilities and the longer time period during which sponsors will fund them.

Further, the changes that the bill does make to the PPA will help sponsors maintain better funded defined benefit pension plans. All of the temporary and permanent changes to the PPA are well-designed to make plan funding more predictable and affordable, making it much more likely that sponsors will be able to maintain their defined benefit pension plans in the long run. By doing so, the bill improves the financial outlook of the plan sponsors and the Pension Benefit Guaranty Corporation.

For all of these reasons, NEA fully supports the Pomeroy proposal and intends to advocate vigorously for the bill's enactment. We urge the members of the Ways and Means Committee to pass it expeditiously.

Thank you for the opportunity to submit these comments.

Statement of the North Dakota Education Association

The North Dakota Education Association (NDEA) respectfully submits these comments to the Committee on Ways and Means for the record in conjunction with the October 1, 2009 hearing on defined benefit pension plan funding levels and investment advice rules.

The NDEA is firmly in support of legislation being drafted by Representative Pomeroy that will provide desperately-needed funding relief to defined benefit pension plans in the private sector. Representative Pomeroy's proposed legislation will provide necessary and appropriate relief to both single and multi-employer pension plans. The recently-enacted Pension Protection Act (PPA) did not envision the cataclysmic melt down of financial institutions and investments. Through no fault of their own, trustees of private pension plans saw their funds depleted by as much as 40 percent. The strict requirements of the PPA could cause the closure not only of many pension funds, but the closure of many private businesses and non-profit organizations that are responsible for these pensions. Such events could not only exacerbate the wounds inflicted upon the nation's economy, but they could also slow down efforts in speeding up the economic recovery.

The NDEA participates in the NEA Pension Fund, a private, multi-employer defined benefit plan. The required contributions to keep this plan solvent have forced us to radically reduce our budget for the 2009–2010 fiscal year. Projected increases for the 2010–2011 year, up to 37percent of payroll, could force us to reduce staff. We know that our experience is similar to all other companies that are trying to maintain this valuable benefit for their employees.

Representative Pomeroy's proposal will grant the trustees of pension plans the ability to segregate these once-in-a-century losses in a way that will grant employers time to recoup the losses without damaging the pension plans. Time is the friend of all pension plans, and Representative Pomeroy's plan gives employers the time necessary to recover from the unforeseen and unprecedented losses of 2008–2009. This temporary relief comes in the form of two alternatives, either of which employers are free to choose: (1) an option to defer for two years the amortization of the shortfalls occurring in 2009 and 2010; or (2) an option to amortize the shortfalls occurring for the first time in 2009 and 2010 separately over a fifteen-year period. The NDEA is especially supportive of the second alternative because it will provide greater relief for sponsors' contribution obligations in the earlier years.

The NDEA is in strong support of the bill's temporary funding relief for multiemployer plans. Under this plan employers would be permitted to elect voluntarily during 2009 or 2010 either: (1) to restart the amortization of unfunded liabilities over a thirty-year period; or (2) to establish a separate amortization base for investment losses recognized from the fall of 2008 through the fall of 2010 and to fund this liability over a thirty-year period.

The "maintenance of effort" provisions of the proposed legislation are especially important for pension relief and viability. These provisions encourage and allow plan sponsors to keep their benefit promises to employees, while fixing the long-term problem. The temporary limitation on plan sponsors' flexibility to diminish plan benefits or to enhance executive nonqualified benefits is equitable and fair.

What makes Representative Pomeroy's bill so powerful and just is that it provides necessary pension funding relief without undoing the principles of the PPA. The PPA is still intact and pension plans are allowed to recover from the harsh economic events of 2008–2009. Employer contribution levels cannot be reduced from prior years. And the transparency for pension plans required by the PPA will still be intact.

Congressman Pomeroy's proposed legislation will prevent further economic damage from the investment and banking problems of 2008–2009. It will allow plans to recover without violating or vitiating the effects of the PPA.

The NDEA wishes to go on record in support of the Pomeroy proposal. We urge the members of the Ways and Means Committee to pass this bill as quickly as possible.

We appreciate the Committee's prompt attention to this critical issue.

Statement of the Pennsylvania State Education Association

The Pennsylvania State Education Association (PSEA) respectfully submits these comments to the Committee on Ways and Means for the record in conjunction with the October 1, 2009 hearing on defined benefit pension plan funding levels and investment advice rules.

PSEA and Pension Plan Funding

Background

PSEA's mission is to advocate for strong effective schools on behalf of our membership of 191,000 public school teachers, educational support professionals, healthcare workers, retired educators, and students preparing to become educators. Both our members and staff appreciate the value and security of a traditional final average pay defined benefit (DB) pension plan. PSEA is a committed DB pension plan sponsor, with a pension plan designed to appeal to all employees.

Prior to the Pension Protection Act (PPA), our normal cost for pension benefits (not including plan expenses) was $2.6 million, or 11% of payroll. With the advent of PPA, our normal cost increased by $1.5 million to $4.1 million, or 17% of payroll. Given our annual budget of approximately $60.0 million, this increase is significant, however, it has not served to make our plan unsustainable.

Concern

PSEA's most significant pension issue is the potential for annual volatility in our funding requirements due to the methods and procedures required by PPA for recognition of pension funding shortfalls. Based on the recent downturn in the investment markets, we have seen just how quickly the tide can turn. As of July 1, 2007, our pension plan's Funding Target Attainment Percentage (FTAP) was 100.6%. One year later at July 1, 2008, our FTAP had dropped to 94.4%, and our most recent valuation indicates a July 1, 2009 FTAP of 94%. While these funded levels may sound higher than those generally being reported in the press, it is only because we have made extraordinary contributions on the order of 50% of payroll for the past two years in order to maintain these funding levels ($12.75 million contributed in the period from July 1, 2007 to June 30, 2008, and $11.9 million contributed in the period from July 1, 2008 to June 30, 2009). Since July 1, 2009 we have been contributing over $1 million per month in order to continue to address the funding shortfall in our pension plan. A recent funding projection indicates that our minimum requirement will be nearly $8 million per year as we continue to pay down the shortfall. These extraordinary contributions are not sustainable and have significantly reduced our reserves to precarious levels.

Organizational Impact

We hope that two things are evident from the above. First, PSEA has and continues to responsibly fund its pension plan in an attempt to close the funding shortfall, and second, the recent levels of extraordinary contributions are not sustainable within our annual budget. PSEA maintains a DB pension plan in order to attract high-quality staff who will carry out the mission of our organization. However, based on recent circumstances, maintaining and managing our pension plan has become a mission in and of itself and has severely limited our ability to carry out the organization's mission. The following are examples of organizational cutbacks and postponements that have been made in direct response to increased pension funding requirements:

- PSEA has placed all capital improvement projects on hold including $3 million in projects that were budgeted for the 2008–2009 fiscal year. The capital improvements placed on hold include shovel ready construction projects for which numerous contractors had submitted bids.
- PSEA has eliminated a number of staff positions and carefully considers each vacant position to determine whether or not it will be filled.
- PSEA cut the 2008–2009 budget by $1.8 million in the middle of the fiscal year to provide additional resources to fund the pension plan. The cuts were across the board.

These are just a few examples to highlight the fact that the funds previously allocated to staff positions, capital projects, and other expenditures are now being directed to the pension plan and are not being used to stimulate the economy, and to create jobs within PSEA and within the state.

Pomeroy Proposal

Background

In late 2008, the Worker, Retiree and Employer Recovery Act (WRERA) was enacted, providing DB pension plan sponsors with some temporary relief from the extraordinary market losses that occurred in conjunction with the new and untested PPA funding rules. WRERA undoubtedly preserved jobs and was a lifeline to some companies that maintain DB pension plans. However, the hoped-for recovery in the wider economy has not happened yet, leaving DB plan sponsors still facing the difficult position of downward pressure on revenue and significant increases in pension funding requirements.

Thus, we were pleased to review the discussion draft of Representative Pomeroy's proposal for pension funding relief. In our view, the proposal will allow DB pension plan sponsors the ability to maintain their plans, which is a win/win/win situation for plan sponsors, plan participants, and also very importantly for the Pension Benefit Guaranty Corporation (PBGC), since healthy plan sponsors are a source of premium income for the PBGC and do not add to the PBGC's liability. We will focus on the two provisions of the Pomeroy proposal that would provide PSEA with the greatest short-term flexibility in dealing with the pension funding shortfall, while allowing us to establish a sustainable long-term pension funding strategy in conjunction with carrying out our organization's mission. Neither of the provisions change the underlying concepts of PPA; both are pragmatic responses to unprecedented events in modern times for DB pension plan sponsors.

Amortization Period

Under PPA, losses occurring in a given year are amortized and funded over a 7 year period. In the event of swift and significant asset losses such as has occurred recently, the annual amortization payments needed to pay off the losses can reach levels that cause extreme stress on the sponsoring organization. Pension plan funding is a long-term proposition, and the 7 year period specified in PPA is simply an arbitrary number—other numbers that are not inherently better or worse could have been selected. Section 101 of the Pomeroy proposal offers plan sponsors alternate amortization options and requires "maintenance of effort" on the part of the plan sponsor. We strongly support both components and will address them in turn below.

A longer amortization period results in a lower annual payment, at the cost of higher total contributions overall. It is important to note that extending the amortization period does not change the amount of the initial shortfall—no liability is being removed or avoided. This situation is similar to the mortgage on a house, where increasing the term of the loan results in lower payments each month, with a higher total amount paid over time due to additional interest charges. However, the length of the loan and the total amounts paid over time do not change the original purchase price of the house.

The "maintenance of effort" requirement on the part of the plan sponsor is an important component of this section that protects the retirement security of plan participants. This provision also protects the PBGC in that it does not allow troubled plan sponsors to curtail benefit accruals and extend amortization periods to simply defer contributions and get deeper in the hole prior to turning the plan over to the PBGC.

In the case of the PSEA Pension Plan, where benefit accruals are ongoing, the optional extension of amortization period would move us from a situation where we pay our normal cost each year plus an amortization payment that severely stresses the organization, to a situation where we pay our normal cost each year plus a lower and more manageable amortization payment that extends over a greater number of years.

Asset Smoothing

Prior to PPA, pension plan sponsors commonly "smoothed" annual investment gains and losses by recognizing them on a pro rata basis over a 5 year period. In doing so, the smoothed asset value used to determine the contribution requirement progressed each year with much less volatility than in the underlying market value of assets. The prior rules limited the smoothed asset value to a range of 80% to 120% of the market value of assets.

Under PPA, the maximum period for smoothing annual investment gains and losses was reduced from 5 years to 3 years, and the allowable corridor around market value was reduced from 80%/120% to 90%/110%. Both of these changes significantly increase the volatility in the smoothed asset values that will emerge in future years.

Section 102 of the Pomeroy proposal expands the corridor to 80%/120% for the 2009 and the 2010 plan years. The 80%/120% corridor was in existence for decades and worked well during that time. The proposal does not change the 3 year smoothing period, and does not change the ultimate goal of PPA, rather it allows plan sponsors short-term relief to cope with the existing shortfalls and to phase in the provisions of PPA. We strongly support this phase-in to PPA asset smoothing.

Conclusion

Under either the current PPA rules or the Pomeroy proposal, PSEA will pay our normal cost each year and will make positive progress each year toward paying down our unfunded liability. The fundamental question is one of speed—is one time frame superior to the other?

In the current economic climate we do believe so. Under the PPA rules we will pay down our unfunded liability more quickly, at the cost of staff reductions and delayed capital investments. Under the Pomeroy proposal, we will pay down our unfunded liability over a longer period, freeing up current funds to carry out our core mission.

Given that we will be continually reducing our unfunded liability in either scenario, we do not believe that our plan poses a greater risk to the PBGC under the Pomeroy proposal than under the current rules. On the contrary, we believe that over the long term, the macroeconomic benefits of having PSEA and other DB plan sponsors invest in our people and our businesses will be more beneficial to society and to the PBGC than if we curtailed our programs in order to meet specified short-term pension funding thresholds.

For all of the reasons discussed in our comments above, PSEA fully supports the Pomeroy proposal. We urge the members of the Ways and Means Committee to pass the bill expeditiously in order to provide greatly needed short-term flexibility and relief to DB pension plan sponsors, thereby allowing for a renewed focus on our mission in conjunction with setting a sustainable long-term strategy for pension plan funding under PPA.

Thank you for the opportunity to submit these comments.

Statement on Investment Advice and Defined Benefit Plan Funding

The U.S. Chamber of Commerce and the National Association of Manufacturers would like to thank Chairman Rangel, Ranking Member Camp, and Members of the Committee for the opportunity to provide a statement for the record. The issues raised at today's hearing—defined benefit funding and investment advice—are crucial to the continued success of the private retirement system.

The U.S. Chamber of Commerce is the world's largest business federation, representing more than 3 million businesses and organizations of every size, sector, and region. More than 96 percent of the Chamber's members are small businesses with 100 or fewer employees, 71 percent of which have 10 or fewer employees. Yet, virtually all of the nation's largest companies are also active members. We are particularly cognizant of the problems of smaller businesses, as well as issues facing the business community at large. The Chamber has substantial membership in all 50 states.

The National Association of Manufacturers is the nation's largest industrial trade association representing small and large manufacturers in every industrial sector and in all 50 states. The NAM's mission is to advocate on behalf of its members to enhance the competitiveness of manufacturers by shaping a legislative and regulatory environment conducive to U.S. economic growth and to increase understanding among policymakers, the media and the general public about the vital role of manufacturing in America's economic and national security for today and in the future.

The success of the current employer-provided retirement system is evident in the numbers. In 2007, private employers spent $199.9 billion on retirement income benefits.[1] 81.9% of eligible employees participate in their 401(k) plan.[2] By 2008, 55.1% of all plans and 70.5% of plans with 1,000 or more employees permitted immediate

[1] EBRI Databook on Employee Benefit, includes both defined benefit and defined contribution plans.

[2] Profit Sharing/401(k) Council of America survey of 1,011 plans with more than 7.4 million participants and $730 billion in plan assets.

participation in their 401(k) programs, up from 24% of plans in 1998.[3] Defined benefit retirement plans cover 43.8 million participants. Moreover, defined contribution plans have been on the rise, and now cover 79.8 million participants, up from 47 million in 1995.[4]

Nonetheless, the current economic environment has created specific challenges for employers that want to maintain retirement plans. In addition to complying with the normal set of rules and regulations, plan sponsors must make tough decisions about their retirement plans and their businesses based primarily on economic survival. Therefore, the more certainty that plans sponsors have about the rules surrounding retirement plans, the better they will be able to make these important decisions.

The hearing today focuses on two areas where plan sponsors need greater certainty. Defined benefit funding relief is a direct result of the financial crisis and the issue that requires the most immediate attention. Without definitive action from Congress, plan sponsors must take action based on the current law. Issuance of regulations pertaining to investment advice is necessary to provide certainty about the rules to plan sponsors and to provide participants with information useful in making decisions about their plan investments. Thus, we urge Congress to maintain the investment advice provisions under the Pension Protection Act of 2006 ("PPA") and encourage the Department of Labor to issue final regulations.

Defined Benefit Plan Sponsors Need Funding Relief

On August 17, 2006, the Pension Protection Act of 2006 ("PPA") was signed into law. The act fundamentally changes the funding rules for both single-employer and multiemployer defined benefit plans. A major impetus behind the PPA funding rules was to increase the funding level of pension plans. Consequently, most plan sponsors entered 2008 fully ready to comply with the new funding rules and based contribution estimates on these rules. However, the severe market downturn at the end of 2008 drastically changed the situation.

At the beginning of 2008, the average funded level of plans was 100%. Data from a study published by the Center for Retirement Research at Boston College[5] indicates the following as of October 9, 2008:

- In the 12-month period ending October 9, 2008, equities held by private defined benefit plans lost almost a trillion dollars ($.9 trillion).
- For funding purposes, the aggregate funded status of defined benefit plans unpredictably fell from 100% at the end of 2007 to 75% at the end of 2008. (See footnote 5 of the study).
- Aggregate contributions that employers will be required to make to such plans for 2009 could almost triple, from just over $50 billion to almost $150 billion.

Various reports showed that as a result of the unprecedented downturn in virtually all the investment markets, across the board, pension funding ratios fell significantly. In addition, corporate bond interest rates fell dramatically during December of 2008, triggering a significant increase in pension liabilities.

In December of 2008, Congress took an important first step by passing The Worker, Retiree, and Employer Recovery Act of 2008 ("WRERA") which provided needed technical corrections. However, the business community was very clear that additional legislative relief would still be necessary to fully address the economic downturn and its impact on employee retirement plans.

Third quarterly payments for the unexpectedly high 2008 contribution requirements are due on October 15 and fourth quarterly payments are due January 15, 2010. Moreover, even with the relief provided by WRERA and the regulatory flexibility provided by the Treasury Department, minimum contributions requirements for 2009 and 2010 will still significantly exceed the minimum contribution requirements for 2008.[6]

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[3] Profit Sharing/401(k) Council of America survey of 531 companies of all sizes and region.

[4] PBGC Pension Insurance Data Book 2007, and BLS Abstract of 2006 form 5500 published in December 2008.

[5] "The Financial Crisis and Private Defined Benefit Plans" (November 2008, Number 8–18), Alicia H. Munnell, Jean-Pierre Aubry, and Dan Muldoon.

[6] According to a Watson Wyatt study, plans that used the relief under both WRERA and the Treasury Department guidance will have minimum contribution requirements in 2010 that will be triple the contribution required in 2008. For plans that cannot use the Treasury relief, the minimum required contributions are almost triple for both 2009 and 2010. (Watson Wyatt Insider, April 2009—http://www.watsonwyatt.com/us/pubs/insider/showarticle.asp?ArticleID=20942).

Because of the importance of this issue to workers' retirement security and the overall U.S. economy, we continue to urge Congress to adopt follow-up, temporary provisions that will ease cash flow constraints and make contributions more predictable and manageable in 2009 and 2010. We believe that relatively modest temporary changes can provide greater stability and improved chances of economic recovery for many companies, non-profits, and charitable organizations.

We encourage Congress to implement funding relief without attaching conditions that could ultimately hurt the defined benefit system. Requiring a maintenance of effort as a condition of receiving relief will limit the legislation in two ways. First, many companies will choose to forego the relief due to concern that if economic challenges continue they will be unable to meet the obligations set forth by Congress. Secondly, and more importantly, a maintenance of effort provision jeopardizes the voluntary nature of the defined benefit system that has served employers and workers so well. If companies believe that the government might eliminate a company's ability to change or suspend its pension plan down the road, they will be more reluctant to continue their current defined benefit plans and certainly unlikely to begin a new defined benefit plan. Other efforts to penalize companies through executive compensation restrictions or targeting some companies over others will not achieve the intended effect, which is in fact to protect and encourage continuation of employer-provided retirement plans.

Without further legislative action, these unexpected funding requirements will continue to require that companies choose between funding their pension plans (which are long-term obligations) and laying off workers, closing plants, and postponing capital investments. This could result in increased unemployment and more harm to the economy.

Current Investment Advice Provisions Should be Maintained

The PPA modernized ERISA by better enabling employers to provide workers with access to investment advice pertaining to their retirement plan. Defined contribution plans, which largely did not exist when ERISA was enacted in 1974, require greater employee participation than traditional defined benefit plans, in which the employer pays for the entire benefit and takes on investment risk. With defined contribution plans, employees make investment decisions and take on that risk. Clearly, the need for education and advice on how to invest that money is an important complement to the defined contribution retirement model.

In light of the financial crisis of the past year, it is more important than ever for participants to have access to professional investment advice. The provisions in the PPA will allow plan sponsors to more easily provide employees access to investment advice from regulated professionals. To reduce the potential for a conflict of interest should the retirement plan service provider also be the provider of investment advice, the legislation requires disclosure of fees as well as any potential conflicts.

The PPA was a negotiated compromise between all interested parties. While we were not in agreement with all of the provisions implemented, we have agreed to maintain the compromises as negotiated. We urge Congress to do the same. As such, no legislative changes should be made to the investment advice provisions under the PPA and the Department of Labor should be encouraged to issue and implement final investment advice regulations.

Conclusion

The current economic situation has put a significant strain on the employer-provided retirement system. Therefore, plans sponsors and participants need certainty about the rules surrounding retirement plans to make appropriate decisions. We appreciate the opportunity to share our thoughts and concerns with you and look forward to future discussion on this issue.

United Jewish Appeal–Federation of New York, letter

Dear Chairman Rangel:

UJA–Federation of New York is the largest Jewish communal philanthropy in New York State and in the nation. Last year, despite a severe national recession that reduced contributions to our annual campaign by over 11 percent we were still able to raise $215 million in support of our mission to care for those in need and strengthen the Jewish community. A significant portion of the money we raise supports the work of 100 health and human service and community agencies within our catchment area of New York City, Long Island and Westchester County. These agencies include Jewish Home Lifecare, Metropolitan Council on Jewish Poverty, Jewish Board of Children and Family Services, as well as many Jewish community centers and councils. As you know, our agency network provides services to all individuals and families that request their assistance.

For the last 58 years, UJA–Federation has maintained a multiple-employer, defined benefit plan that includes 39 of our affiliated agencies as participants. Through this defined benefit plan we provide approximately 10,000 current and former employees with the assurance of retirement income, providing them sufficient income in their retirement years to maintain a suitable standard of living.

Unfortunately, the severe economic recession of the past two years threatens the future of UJA–Federation's defined benefit pension plan. From a base of $16 million our contribution this year will rise to $21.3 million, an increase of $5.3 million. Without plan changes or federal pension relief legislation our annual pension payment is expected to rise to $27 million per annum for the following several years, $11 million—nearly 70%—more than our base contribution of previous years. These increased payments are simply unaffordable. Given this reality, UJA–Federation must consider all options including seeking federal legislative relief (e.g. spreading payments over a longer period of years) and reducing the future benefits of both current employees and employees newly enrolled in our pension plan. Doing nothing is not an option as the increased cost of our defined benefit plan left unaddressed would significantly impair our charitable mission to help those who are poor and vulnerable and place UJA–Federation and its agency system in financial peril.

We look forward to working with you and the other members of the House Ways and Means Committee to address the difficulties now faced by defined benefit pension plans in both the private and non-profit sectors.

Sincerely,

Irvin A. Rosenthal
Chief Financial Officer

Ron Soloway
Managing Director
Government and External Relations

United Jewish Communities of Metro West New Jersey, letter

Dear Honorable Chairman Rangel:

Imagine not helping a person who lost his job and was so embarrassed he didn't tell his wife as he went to work each day, briefcase in hand. The ensuing marital discord, compounded by lack of income, needs the professional services provided by our agencies. Yet, because of the drain on our resources stemming from the current pension funding requirements, we will be forced to cut counseling and employment services.

I am Max Kleinman, chief executive officer of the United Jewish Communities of MetroWest, New Jersey ("UJC"), and I write to urge Congress to pass meaningful defined benefit pension plan funding relief legislation so that UJC can continue to serve community needs and retain its valuable employees.

Who We Are and What We Do in the Communities

United Jewish Communities of MetroWest New Jersey is the Jewish federation serving New Jersey's Essex, Morris, Sussex, and parts of Union counties. Our federation is ranked as the ninth largest in North America, representing a community of over 90,000 Jews who are part of the more than 1.4 million people who live in our service area.

UJC is the largest Jewish philanthropy in New Jersey. Our United Jewish Appeal campaign raised over $20 million in 2009 (significantly reduced from almost $24 million in 2008, prior to the economic downturn). As a Jewish federation, we are the central fundraising organization on behalf of Jewish community needs locally and abroad. Locally, we fund our network of agencies directly, and we are their largest source of philanthropic support. Our major local beneficiary agencies include a nursing home, Jewish community center, vocational and family service agencies, and Jewish educational institutions. Through our agencies and program services delivered directly by our organization, the UJC serves as a focal point for Jewish community life in our area. Many of our agencies serve the general community, in addition to the Jewish community. Indeed, we seek and find common cause with peoples of all faiths.

The UJC and its partner agencies employs more than 2,000 full- and part-time employees to help the young, the old, the poor, the needy, the hungry, the homeless, and those seeking a sense of community and purpose in their lives. Our committed employees accept modest pay and benefits for helping others.

In addition to supporting our local beneficiaries financially, the UJC provides a variety of shared services to the agencies, including benefits plans (e.g. including our pension plan and also health insurance), human resource management functions, payroll services, accounting services, information technology services, and facilities management.

Specific Impacts of Excessive Pension Plan Costs

During this period of economic decline and uncertainty, our services are in greater demand than ever, and our resources (both people and assets) are in dangerously short supply. Without meaningful funding relief, the UJC and its partner agencies will be forced to permanently freeze our pension plan, and further reductions in services to the community may become necessary.

Examples of some of the reductions in services that have already been, and may become, necessary, due in part to the increases in plan funding requirements, include:

- A decrease in counseling and employment services due to staff cuts and reduced financial aid
- Budget reductions that eliminate or postpone administrative support services and needed facility maintenance projects
- Reduction in Holocaust survivor education programs
- Reduction in, or possible elimination of, support services for Holocaust survivors
- Reductions in home-based social work and advanced nursing services for at-risk seniors
- Reduction in the delivery mode for dental services for nursing home residents
- Reduction in fitness program subsidies for seniors
- Elimination of community-based adult day-care center
- Significant reductions in rent subsidies available for the poor
- Reduction in programs for the developmentally handicapped
- Reductions in scholarships and electives available for students at our Jewish Day School
- Curtailed community inter-group relations outreach programs

The UJC and its partner agencies have worked extremely hard to minimize the adverse impact on services resulting from these pension-funding increases, by reducing administrative functions, deferring maintenance and spending down reserves. But these strategies will only increase our costs in the long term.

What Has Happened to Our Plan

As part of our remuneration, UJC and its partner agencies provide a modest defined benefit pension plan, which until recently provided pensions of approximately one percent of final average pay times years of service. Before the Pension Protection Act of 2006 (the "PPA") become effective in 2008, our pension plan had been fully funded for many years, thanks in large part to careful stewardship and consistently above-average returns on investments. Although we continued to reserve cash for contingencies, we were not required to contribute to the plan because the plan was fully funded as defined by law.

Suddenly in 2008, due largely to the changes required by the PPA, our plan went from being 108% funded, with no required annual contribution, to being 97% funded and requiring a $1.3 million employer contribution, which represents an increase of four percent (4%) in payroll costs. This additional cost directly hurt our ability to deliver services, which was equivalent to losing approximately 20–25 employees. Vacant employee positions were left unfilled and our employees—already stretched too far—were stretched to the limit. Budget cuts were inevitable, and more will be needed without pension relief legislation.

For the fiscal year beginning July 1, 2009, the UJC was forced to reduce its support of local and overseas charitable organizations by 19%, because of the decline of our fundraising campaign in the face of the financial market meltdown. In addition to reductions in our external philanthropic support, our organization trimmed its own internal operating budget by approximately 11%, including reductions in force, involuntary furloughs for employees, and salary reductions for management staff.

In 2009, due to the market crash and the oppressive burdens of the PPA, the costs of our plan put our organizations in greater financial peril. For the 2008–2009 plan year, our plan assets declined 30% or $10 million, from $37.6 million to $25.7, and our plan's funding percentage further declined to 80%, which would have resulted in annual contributions increasing 266% to $3.2 million, a $2 million increase.

In the face of the dramatic cuts in budget and staff, the organization could not tolerate the higher pension funding requirements. The PPA left us and our agency partners no choice but to freeze the plan for the vast majority of the covered employees, as of July 1, 2009.

Even with the plan freeze, we have been forced to require substantial furloughs of employees, which, in turn, has reduced services (some of which are described above), made life that much harder for those we serve and our employees, and, last but not least, made it substantially harder for employees who have dedicated their lives to serving the community to have secure retirements.

Where Do We Go From Here

Unlike many companies that have frozen their pension plans with no prospect or intent to "unfreeze" them, we continue to hope that Congress will provide us with legislative relief that will allow us to unfreeze our pension plan. We recognize our responsibility to fully fund our plan—indeed, we have done so for many years. However, it will take time to recover the $13 million of plan assets lost over the past two years, which will restore our plan to full funding.

If Congress were to pass legislation giving us more time to amortize our 2008 investment losses and our unfunded liabilities, and give us more leeway to smooth assets to absorb the short-term upheavals in the markets, we would like to unfreeze our plan, and possibly consider restoring some, if not all, of the benefits that have been lost during the freeze.

Our actuaries have considered the potential impact of Congressman Pomeroy's proposal on our plan. If both asset smoothing (i.e., widening the permitted deviation between the actuarial value and market value of assets from 10% to 20% of market value) and permitting 9-year amortization of 2008 losses, with interest-only payments in the first two years were enacted, it would provide much needed relief to our organizations and would help us overcome the difficult combination of drastic changes in the law and crippling losses in the markets. Any diminution of Congressman Pomeroy's proposal for pension funding relief will seriously impair our ability to deliver critical services.

Please contact Howard Rabner, our Chief Operating Officer/Chief Financial Officer, if you have further questions regarding our situation.

Thank you your help on behalf of the UJC, its partner agencies, and the more than 1.4 million people in our central New Jersey service area.

Sincerely,

Max L. Kleinman
Chief Executive Officer

Statement of YRC WORLDWIDE, INC.

YRC Worldwide, Inc. is one of the nation's largest trucking companies. We employ approximately 45,000 men and women in the United States, the majority of whom are members of the International Brotherhood of Teamsters. We provide good middle class jobs with strong wages, health care, and a pension. YRCW has approximately 700,000 customers, including the Department of Defense and FEMA. In 2008, YRCW generated $22.1 billion in total output, employment for 141,158 workers, and $2.8 billion in total tax revenues for federal, state, and local governments. The Company transported goods valued at approximately $202 billion or 1.4 percent of GDP. In addition, YRCW contributed approximately $540 million to 36 multiemployer pension plans to provide pension benefits to more than 1.2 million active and retired Teamster members.

In the hearing notice, the Chairman pointed out that many companies that sponsor defined benefit plans "may find themselves simultaneously struggling to navigate an economy during a severe downturn with decreased cash flow and less access to credit while having to make up for significant losses incurred in the pension trusts that fund their workers' pension benefits." For companies that are part of the trucking and grocery industries, the problems are even more acute.

Prior to the start of the recession, the Company had delivered record earnings and operating margins. Since the freight recession began in the second half of 2006, however, the Company has gone from producing strong earnings to significant losses. In this exceptionally difficult business environment, YRCW now faces three inter-related problems in meeting its pension obligations: The Company funds the benefits of, and effectively acts an insurer or guarantor for, hundreds of thousands of workers who never have worked for YRCW ("non-sponsored retirees"); the multiemployer plans to which we have been contributing have suffered significant investment losses; and we face a worsening demographic challenge as fewer workers support the pension obligations of more and more retirees. Given our significant pension obligations, the downturn in business volume in the current economic environment has had especially adverse consequences for the Company. In short, our contribution burden has now grown to an unsustainable level as our business continues to suffer from the global economic meltdown.

Working with the Teamsters, we are doing what we can through self-help measures to address the challenges we face. Since the beginning of the year, for example, our union and non-union employees have agreed to a 15% reduction in wages. Management has done so as well. In addition, YRCW has taken other steps to improve the company's cash flow and liquidity, including selling off excess property, consolidating back-office functions, and reducing overhead. In addition, we have temporarily terminated our participation in our largest plans for 18 months in order to preserve our cash flow. At the same time, the multiemployer plans to which the Company has contributed also have taken self-help measures to address the solvency challenges they face.

But unless Congress provides legislative relief *this year,* many of the pension plans to which YRCW has been contributing will eventually become insolvent. When that occurs, the Pension Benefit Guaranty Corporation (PBGC) will be responsible for the pension obligations of the hundreds of thousands of participants in the plans.

How did we get here? In 1980, Congress enacted two bills that, albeit seemingly unrelated, have together over time created unsustainable pension plan obligations for YRCW and other successful freight carriers. The Motor Carrier Act deregulated the trucking industry, while the Multiemployer Pension Plan Amendments Act (MPPAA) imposed an exit penalty on companies upon their withdrawal from multiemployer pension plans, including companies in the trucking industry. As a result of MPPAA, a company that withdraws from a multiemployer plan must pay its fair share of liability to fund the plan's unfunded vested benefits.

Although seemingly similar, "termination" liability and "withdrawal" liability are fundamentally different legal concepts, and have had fundamentally different impacts in the real world. Prior to the enactment of MPPAA, if a multiemployer plan had a declining base of contributing employers, the remaining employers were required to absorb a greater share of the funding costs of benefits for non-sponsored participants, *i.e.,* plan participants previously employed by former contributing employers. Similarly, if a multiemployer plan terminated because of a substantial decline in its contribution base, only the companies remaining in the plan at the time of termination were required to pay termination liability to the PBGC. This often resulted in a race to the exits by companies wishing to avoid termination liability upon the plan's termination.

By substituting "withdrawal liability" for "termination liability" in MPPAA, Congress sought to provide some measure of protection for companies remaining in multiemployer plans. The rationale for the change was that, if a company had to pay a fee upon withdrawal, remaining employers would be less exposed and less inclined to race to exit the plan. But the legislation had a perverse effect instead: by imposing an exit penalty upon withdrawing companies, MPPAA acted as a deterrent to new companies entering into multiemployer agreements. The impact was particularly dramatic in a contracting industry such as the freight carrier industry.

As a result of the interplay of the two statutes, of the thousands of carriers in business in 1979, only a few are left to principally fund multiemployer pension plans today. This has created a crippling financial obligation that could lead to massive job losses and health care and pension benefits losses for hundreds of thousands of active and retired workers. To put the impact of the legislation in perspective, we have appended to our statement a list of the top 50 LTL carriers that were in business in 1979 and the handful left in business today, two of which are now part of YRCW and two of which have dropped out of the top 50.

In short, as an unintended consequence of the 1980 legislation, YRCW now supports hundreds of thousands of workers who never worked for YRCW. In fact, we have contributed more than $3 billion towards their benefits. Employer bankruptcies and recent investment losses are crippling the multiemployer plans to which YRCW has been contributing. As a result, YRCW's contribution burden has become unsustainable and many pension funds are headed for insolvency.

Many plans have been forced to implement both benefit reductions and contribution increases as a result of the collapse in equities and the requirements of the Pension Protection Act. Many plans are "mature" plans in which retirees receiving benefits heavily outnumber participating active employees and where contributions already fall well short of paying benefits, requiring significant investment earnings each year to maintain their funding level. By themselves, these circumstances likely will require every multiemployer plan to make some kind of draconian adjustment for 2009 and beyond. Plans that are fully funded or nearly fully funded will likely be required to reduce the level of benefits they provide. Plans that are operating under an amortization extension, funding improvement plan or rehabilitation plan likely will be required to further reduce benefits or increase contributions or both for 2009 and beyond.

The failure of a major employer, such as YRCW, will exacerbate these problems. When a contributing employer fails, the plan loses the contributions attributable to the employer both for the current year and for the purposes of its actuarial calculations. Only a small percentage of withdrawal liability—the amount the defunct contributors owe for prior year benefits—is ever recovered in bankruptcy. The plan suffers an immediate reduction in actives and often a substantial and immediate increase in retirees, increasing its annual benefit payments and making it more dependent on investment income. Required adjustments become correspondingly greater. Contributions will need to be higher. Cuts will need to be deeper.

In a multiemployer plan, when one employer fails, the benefit obligations are shifted to the surviving employers, who must bear the burden not only for current participants but also for the new non-sponsored retirees. For members of the Teamsters, the remaining employers include not just industrial employers but also participating local unions and affiliated health and welfare and pension plans. At a minimum, these remaining employers will bear the added burden of the vested benefits of the failed employer's employees. Depending on required adjustments, their employees may suffer reduced future accruals, and the employers will likely be required to pay even higher contributions. If the failure creates an immediate funding deficiency, the remaining employers, even if they have an existing collective bargaining agreement, will likely be required to pay an excise tax on top of the increased contributions.

Higher contributions and reduced benefits may prompt other employers to leave the plan, further reducing the number of active members and the contribution base, increasing the number of retirees and terminated vested members, and making the plan even more dependent on future investment returns and more unstable. In some situations, higher contributions will likely force remaining employers into bankruptcy, resulting in even more lost jobs. In the worst case, the failure of the primary plan will have a domino effect, leading to the failure of other plans in which these employers contribute and even more job losses.

Having made roughly $3 billion in contributions to fund the pension benefits of retirees not affiliated with YRCW, the Company can no longer afford to continue to serve in its role as an involuntary surrogate for the PBGC. Self-help measures will not be enough. For the sake of our Teamster employees and retirees, we need help from the Congress this year to address the challenges facing the company and the multiemployer plans to which we have long provided support.

Proposed Legislative Solution

We very much appreciate the efforts by Representative Pomeroy and other Members to address the challenges faced by multiemployer plans and companies such as YRCW. In drafting legislation this year, we urge the Ways and Means Committee to—

- Update the "partitioning rules" of current law so that the PBGC would assume the pension obligations for non-sponsored retirees while the plans continue to support the participants of current employers;
- Provide a "fresh start" for multiemployer pension plans suffering from recent investment losses; and
- Provide tax relief to offset the financial burden that employers like YRCW have borne by acting as a surrogate PBGC in funding the pension obligations of non-sponsored retirees.

Thank you for your consideration.

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