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H.R. 2830, THE PENSION PROTECTION ACT

HEARING

BEFORE THE

COMMITTEE ON EDUCATION AND THE WORKFORCE U.S. HOUSE OF REPRESENTATIVES

ONE HUNDRED NINTH CONGRESS

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H.R. 2830, THE PENSION PROTECTION ACT

Wednesday, June 15, 2005
U.S. House of Representatives
Committee on Education and the Workforce
Washington, DC

The committee met, pursuant to call, at 10:30 a.m., in room 2175, Rayburn House Office Building, Hon. John A. Boehner [chairman of the committee] presiding.

Present: Representatives Boehner, Petri, McKeon, Castle, Johnson, Souder, Norwood, Ehlers, Tiberi, Osborne, Porter, Kline, Musgrave, Inglis, McMorris, Marchant, Price, Fortuno, Boustany, Foxx, Drake, Kuhl, Miller, Kildee, Owens, Andrews, Scott, Woolsey, McCarthy, Tierney, Kind, Kucinich, Wu, Holt, Davis of California, McCollum, Davis of Illinois, Grijalva, Van Hollen, Ryan, and Bishop.

Staff Present: Stacey Dion, Professional Staff Member; Kevin Frank, Professional Staff Member; Ed Gilroy, Director of Workforce Policy; Richard Hoar, Staff Assistant; Greg Maurer, Coalitions Director; Steve Perrotta, Professional Staff Member; Molly Salmi, Deputy Director of Workforce Policy; Deborah Samantar, Committee Clerk/Intern Coordinator; Kevin Smith, Senior Communications Advisor; Jo-Marie St. Martin, General Counsel; Jody Calemine, Minority Counsel, Employer-Employee Relations; Tylease Fitzgerald, Minority Staff Assistant; Margo Hennigan, Minority Legislative Assistant/Labor; Michele Varnhagen, Minority Labor Counsel/Coordinator; and Mark Zuckerman, Minority General Counsel.

Chairman BOEHNER. A quorum being present, we are holding this hearing today to hear testimony on H.R. 2830, the Pension Protection Act of 2005.

Under committee Rule 12(b), opening statements are limited to the chairman and ranking member. Therefore, if other members have statements, they can be included in the hearing record. And with that I ask for unanimous consent for the hearing record to remain open for 14 days to allow members' statements and other extraneous material being referenced here in today's hearing to be included in the official hearing record. Without objection, so ordered.

I want to thank all of you for coming and thank all of our witnesses for their willingness to be here today.

Last week, my colleagues and I introduced the Pension Protection Act, a legislation we have been working on for nearly a year, to reform our private pension system. As I said previously, our re-

form bill won't just tinker around the edges of a defined benefit pension system. As promised, the bill we introduced, as outlined, is a comprehensive solution to address these problems.

Because of today's outdated pension rules, workers, retirees and taxpayers all stand to lose unless we act quickly on fundamental pension reform. The recent example of United Airlines demonstrates the need for reform, and we plan to act quickly over the next month.

The balance we have attempted to strike is a difficult one. How do we preserve the defined benefit pension plan for workers and ensure these plans are adequately and consistently funded without making the rules so onerous it becomes more attractive for employers to simply stop offering these benefits altogether?

Our efforts are focused not just on ensuring PBGC solvency, which alone will not solve the problem. Instead, we have a broader vision of strengthening the health of defined benefit pension plans and preserving these benefit pension plans for workers.

Our bill adopts many of the features in the administration proposal. It includes tough new funding requirements to ensure that employers properly fund their plans, it provides workers with meaningful disclosure about the status of their pension plans, and it protects taxpayers from a possible multibillion dollar bailout of the Pension Benefit Guaranty Corporation. As you would expect, there are some differences, and in some cases we solve the same problems with a slightly different approach.

While every stakeholder may not agree with each aspect of our bill, our approach has been focused on protecting the interests of workers, retirees and taxpayers; and I think our proposal accomplishes the goals that we set out without jeopardizing employers ability to offer these voluntary benefits. So it is important to note we are at the beginning of this process. And we plan to work with all interested parties, including the administration, employers, labor groups and our colleagues on the other side of the aisle as we move forward.

I would like to highlight several key aspects of the Pension Protection Act. The bill provides a permanent interest rate based on a modified yield curve. It also requires employers to meet a 100 percent funding target; and, requires additional contributions to address any funding shortfalls over 7 years, the measure also includes a key provision that restricts executive compensation arrangements for employers with underfunded pension plans.

Some have expressed concern that employers may smooth their pension assets and liabilities over too long a period of time, and I agree. That is why our bill reduces the practice of smoothing. The complete elimination of smoothing, however, could render employers' ability to protect and budget for pension contribution virtually impossible. Without some degree of predictability, the dramatic volatility we have seen will continue and employers will simply stop offering these benefits altogether.

Some employers have used credit balances to mask plan underfunding. I think our bill solves this problem not just by prohibiting the use of such balances and plans that are underfunded but also by reforming the funding rules to ensure that employers properly fund their plan.

The bill phases in increases in employer premiums paid to the Pension Benefit Guaranty Corporation; and while raising premiums alone will not solve the problem of PBGC's insolvency, an increase is both prudent and necessary.

The measure also makes all form 4010 information filed with the PBGC by underfunded plans available to the public.

The bill also goes beyond the administration disclosure plan by requiring both single- and multi-employer pension plans to notify workers and retirees about the status of their plan within 90 days after the close of the plan year.

The introduced bill does not include any industry specific relief. Our immediate focus has been overhauling a broken pension system and laws that have contributed to the problems in the airline industry and similar industries. But I would prefer to focus on comprehensive solutions in addressing this problem.

This is an important issue for some of our colleagues on this committee, particularly Mr. Price, and a former member of our committee, Mr. Isakson, our colleague in the Senate and other members; and I have a lot of respect for what they are trying to accomplish and understand the impact of this issue to many of their constituents. I want to work with them on pension reform as we move forward.

We have also included much-needed reforms to the multi-employer pension system in our proposal. Our bill includes new funding benchmarks, limits future benefit increases for severely underfunded plans, and provides new disclosure for workers and contributing employers. I am pleased that the coalition of employers and labor groups have made significant progress on this issue, and we are going to continue to work with both sides as we move forward.

We all know there is a lack of personalized investment advice readily available to workers. Our bill allows employers to provide rank-and-file workers with access to high-quality investment advice as an employee benefit, while making certain a tough fiduciary and disclosure protection ensures the advice remains solely in the workers' best interest.

This proposal has passed the House three times in the past 4 years with significant bipartisan support, and we think that it is a commonsense way to give workers access to quality investment advice.

The Pension Protection Act, as introduced, does not include finalized cash balance protections. Last week, I also introduced a standalone bill, the Pension Preservation and Portability Act, as a starting point towards discussions on efforts to resolve the legal uncertainty surrounding cash balance plans. We are working to resolve details and expect to finalize this issue before we report the bill from the committee.

It is interesting to hear the reaction to our proposal. Some of my Democrat friends are actually arguing that our bill is too tough on employers, an argument I am not sure I've ever heard from them. Some in the administration may argue we need to go a little bit further. On balance, I think that that means we have it just about right. This bill meets our objectives of putting together requirements in place to ensure worker protections are properly funded

but does so in a real-world, practical way that will help preserve these plans for workers and protect the interests of taxpayers.

I want to thank all of our witnesses for being here today.

I would like to thank the members of the committee for their assistance in drafting this bill, especially Mr. Johnson and Mr. Kline, who have worked closely with us. We have had bipartisan conversations on many aspects of this bill, and I look forward to continuing to work closely with the members of our committee on both sides and with Mr. Thomas and the members of the Ways and Means Committee as we continue to move this bill through the legislative process.

With that, I would like to yield to my friend, the ranking Democrat on our committee, Mr. Miller.

Mr. MILLER. Almost 3 years ago, in July of 2002, I wrote a letter to the Bush administration warning that urgent action was needed to reform defined benefit plans. That year the underfunding of the private pension plans jumped 425 percent from the previous year to $111 billion. Subsequently, the GAO and the PBGC repeatedly warned that action by Congress was needed. From that time that I sent the letter in 2002 urging immediate action, private pension plan underfunding has jumped another 425 percent to $450 billion.

I say all of this because—as a prime example of Congress and the President ignoring the urgent needs of the American people. Precious time has slipped away, with devastating, real consequences. What was then an urgent matter has exploded into a national retirement security crisis.

Today, United Airlines is about to dump $6.6 billion of losses onto the Pension Benefit Guaranty Corporation. The stakes for the 120,000 United Airlines employees and retirees is very high. They face deep and permanent cuts in their retirement benefits. United employees have always been repeatedly asked to give wage concessions to help United to improve its financial condition, and they have done so each and every time.

In return for operating in good faith, United and the PBGC cut a side deal to terminate these employees' plans. Right before the employees were cut out of the discussions, the PBGC itself concluded that United could afford to continue at least one of its four plans.

I will put a letter into the record later by PBGC Executive Director Bradley Belt, dated April 6 this year, that states, that the PBGC continues to believe that the interests of the participants in the pension insurance program would best be served by the continuance of the AFA plan, the flight attendant plan. How can the PBGC conclude one week that it is in everyone's interest to continue the pension plan and then move to ax it the next week? You don't have to be a student of the business pages or the business journals to see that there is open speculation that all other airlines will look at United actions to see if they can cut their own costs by dumping their workers' pension plans.

I am also very concerned—and again the speculation goes to other industries—of whether or not those who face economic difficulties or which have drastically underfunded their pension plans will follow United's examples and pass the debts on to the taxpayers and their own employees.

I am disappointed that this committee has yet to hold a hearing on the United pension plan termination. All the hard-working United employees were denied access to this hearing room. Over 2,000 pilots, flight attendants, and machinists from all over the country participated in the Democratic online hearing 2 weeks ago. They have been given no opportunity to tell their story to this committee, which will write the new pension legislation.

Collectively, these employees and retirees face over $3 billion in irreplaceable retirement savings that were promised by United. Their letters are heartbreaking, and their voices deserve to be heard by this committee.

Two of those individuals are in the audience today. Jamie Manley was a flight attendant for United, and Ellen Saracini, whose husband Victor was the pilot of the plane that was flown into the South Tower of the World Trade Center. In their letters, they outline the economic hardship that will devastate their families.

Mr. Chairman, I requested that an abbreviated portion of that hearing, this online hearing, be entered into the record today as part of my testimony.

Chairman BOEHNER. Reserving the right to object. I think all of us agree that the plight of the employees of United Airlines demonstrates the need for comprehensive pension reform. The thousands of workers and retirees of United and others companies who have lost a portion of their pension benefits deserve action now. I have reintroduced a comprehensive reform package to address this.

But I also remind my colleagues that, beginning some 2 years ago, as we were preparing and passed the Pension Funding Equity Act that was signed into law some 15 months ago, that included specific airline industry relief, relief that United and others and their employees were in fact requesting. That relief was for last calendar year and this calendar year, when we expected to have a comprehensive reform bill ready to pass this year.

I have to make clear that the so-called online hearing is not a hearing. The gentleman from California and I have had this discussion before. Our staffs have had discussions back and forth; and I need to make clear that, while people may have participated in an online chat conversation about this, I hope no one was misled into believing that this was an official hearing because, in fact, it was not.

Now, I would ask my colleague from California to, under the rules of the House, not to refer to this publicity issue as a hearing. Now, I understand, we are in some difficult partisan fights around here, but—if the gentleman wants to take people's comments, he is certainly entitled to do that, but I don't want anyone to be misled into believing that this is official testimony for an official hearing, and I would like to ask my colleague if he would amend his unanimous consent request to submit this information in a digest form. He has in fact done that, and we will be happy to take this and put it in the record. But, please, let's all play by the rules; and I don't want anyone to think that in fact this was an official hearing when in fact it wasn't.

Mr. MILLER. Mr. Chairman.

Chairman BOEHNER. Without objection, we will accept the comments.*

Mr. MILLER. I thank you for accepting this as part of the record, part of my testimony. I think this testimony is important. I only wish it were part of the official record of this and this was an official hearing. Unfortunately, that opportunity was not given to us, I thank you for accepting that testimony——

Chairman BOEHNER. Will the gentleman from California yield?

Mr. MILLER. Yes.

Chairman BOEHNER. Good. Now all of you who have been around the committee over the last 4 years know that Mr. Miller and I in fact have a very good relationship here. As a matter of fact, I think I have a very good relationship with all the members on both sides of the aisle. I want to remind my colleague from California that there has never been a request for a hearing on a United Airlines-specific situation. We have had hearings over the last several years on the problems in the airline industry in general, but there has never been a specific request to go through the United situation specifically.

Mr. MILLER. Mr. Chairman, I would be remiss if I did not accept that invitation to dance.

I request a hearing on the United Airlines. I think it is absolutely critical to understand what happened in the last weeks of the bankruptcy negotiations and the transfer of those negotiations to the PBGC and what took place there, it is critical to know whether or not alternatives that could have been explored, alternatives that are being asked for by Delta and others were a possibility. I don't know the answer to that question.

As we consider the markup of your legislation and other suggestions, I think it would be most important that we understand what transpired at that time. So I hope that we can have that hearing.

Chairman BOEHNER. I will take your request under advisement.

Mr. MILLER. Thank you, Mr. Chairman, but do it before the music stops.

The point is this, that we need an independent review of United Airlines' ability to continue its plans either as they currently were or in a modified form. And the reason why we need that is to see whether or not greater protection could have been provided for the employees that have spent 30 years, 20 years, 15 years of their lives trying to make sure that this airline continued to fly.

The employees should be full participants in the discussions about the future of their retirement. The Congress and the American taxpayers, who could be called upon to pay out billions of dollars to cover pension plans that have been underfunded and sent to the PBGC for payment, deserve accurate information.

Last week, Representative Jan Schakowsky and I introduced legislation, H.R. 2327, to impose a 6-month freeze on any company in bankruptcy trying to dump its pension obligations onto the PBGC until Congress has time to explore the alternatives to bankruptcy and to the dumping in PBGC. Employees should not wake up and find themselves divested of their life savings or retirement nest

*Submitted and placed in permanent archive file, comments before the U.S. House of Representatives, Committee on Education and the Workforce (July 19, 2006).

eggs. We need a set of rules in place before companies unload their liabilities.

The alternatives to termination, such as the conversion to multiemployer plans, or cash balance plans, or the bonding of pension plans, or the bonding of premiums, should all be considered before we dump this onto the taxpayers. The PBGC should have the flexibility to help struggling plans turn around with financial help in some circumstances. The employees should be at the table for any consideration of pension plan termination. Our 6-month moratorium bill would give us time to legislate these improvements in pension law.

Mr. Chairman, regrettably, the bill before us today has many of the flawed provisions that President Bush advocated earlier this year: heavy reliance on employee benefit cuts and billion dollar tax hikes for employers. These actions might seriously undermine the defined benefit plans of employees and employers and would fail to provide the protection that employees need for their hard-earned retirement nest egg.

The bill also fails to stop the runaway pension terminations like United airlines. Therefore, more companies will dump their unwanted pension liabilities onto the Federal Government and onto pension sponsors without meeting any significant test that they have no other choice; and that will spread the misery and disappointment to employees, who are the real victims of these unfair terminations.

This bill fails to hold corporate executives accountable for the mismanagement of the company's pension plans, while allowing the same executives to enjoy lavish retirement benefits. Last week United Chairman, Glenn Tilton admitted that he will keep all of his $4.5 million golden parachute, while employees lose 30, 40, and 70 percent of their retirement. I guess contract givebacks are only for employees, not for the executives.

Here is how one retired pilot, John Clark of Charlottesville, who was a United pilot for 36 years and will have his pension reduced by 70, responded to Tilton: "What Tilton is saying is that United guaranteed to me, why is the promise made to him understandable and one made to me go by the wayside?" We must act now to stop this unfair treatment.

This bill, finally, Mr. Chairman, also fails to help airline pilots who take a double hit when the plan is terminated because the pilots are forced to retire at age 60 when they get less than $46,000 a year of the maximum allowed by PBGC.

Mr. Chairman, in conclusion, let me say this. One of the most troubling aspects of our rush to mark up this bill is that we all now have become painfully aware, and the members of this committee and the records that have been submitted to them, that these companies are allowed to keep two sets of books for pension purposes. This bill proposes to make the secret set of books published, and I applaud you for doing that. But this information, referred to as the 4010 plan information, will give employees and investors up-to-date, accurate information about their company's pension plans. This is a good idea, and I have proposed legislation for the last year that we do this.

This committee has in its possession the 4010 summary information with some 850 seriously underfunded plans for 2003 and 2004. We can and we should release this information today for the benefit of millions of employees represented by these companies. We should also do it for the benefit of those stock analysts, those who are investing their pension plans in these very same companies through their mutual fund plans, through their IRAs, through their 401(k)s. They ought to know what the real situation is with these pension plans.

As I have said to you in a letter asking for the release of this information, the discrepancy, in some cases, is hundreds of millions of dollars and, in some cases, billions of dollars. We need to know and we need to have this transparency so those who have interest in this industry will be able to analyze this, give us the benefit of their information, their read on this.

Because, as you know, not speculation on our part but within the business journals every day the question is will or will not the remedies for pension problems hasten the dumping and the termination of pension plans by companies that are in difficult situations. The extent to which these plans are underfunded I believe is a key component to whether or not people will be able to answer that question as we write this legislation.

So I would hope that you would join me and you join President Bush and you would make that information available prior markup of this legislation, and I applaud you for making it a part of your bill. I think it is critical to the transparency of the understanding and the negotiations around this legislation.

Thank you very much for the opportunity, and I do realize that you were nice enough to give me a little bit more than 5 minutes.

Chairman BOEHNER. Will the gentleman yield?

Mr. Miller, you understand that we, you and I, came to an agreement on the request for the 4010 information from the Pension Benefit Guaranty Corporation. We came to an understanding in a bipartisan way that we would request them to turn over the information, and we agreed that we would keep that information for the purpose of our staffs and members to be used in the development of our pension proposals.

While I understand the interest in disclosing this information, I think you know as well as I know that the current 4010 information is flawed. That is why in the bill we clarify and make significant changes to the 4010 information that is collected so that it is much more useful.

The problem with this information under current law is that I think it is inherently misleading and not useful in determining whether the plans are underfunded and pose a risk to the PBGC. So the release of this information I don't think is warranted. It violates the agreement that you and I came to. When I gave you my word that I would ask for this information in a bipartisan way, I gave you my word. I think we came to an agreement and would I would prefer that we stick to that agreement.

Mr. MILLER. Mr. Chairman, if I may respond.

Chairman BOEHNER. On your time.

Mr. MILLER. Thank you.

I have honored that agreement; and I appreciate you, after we introduced the resolution of inquiry, to responding to that resolution and arranging for the members of this committee to have this information.

What I am saying is, now, after reviewing that information, we may have a difference of opinion on whether it is flawed or not flawed or to what extent it is or is not. But after reviewing that information, and seeing the magnitude of the discrepancies between those PBGC documents and the public documents, I think—I don't know how we can go forward without the public understanding that. But more importantly, the professionals in the field understanding that and the ramifications for this legislation. I believe that is why the administration has asked 2 years ago that this information be made available.

I have introduced legislation to do it, so I am not going to violate our agreement. I am asking that you and I, as parties to that agreement, consider the modification of that prior to the markup of this legislation. Because it is hard for me to see how we can go forward without that information being on the table.

You will characterize it one way. Analysts will characterize it another way. The companies will characterize it another way. But it is critical information that has been reported to the PBGC which is different from the reports in the 401(k) public statements of these very same corporations and again draws into question of whether or not—how we balance. You have a bill that requires and we are going to have a process that requires this balance, the assessments and premiums. Whether or not that pushes these companies over or not, I think you have to know the real extent of their liabilities. The companies will certainly be free to modify and tell us what their current problems are and if they believe that that information does not accurately reflect that.

Thank you very much, Mr. Chairman. Mr. Chairman, again, I thank you for the extension.

Chairman BOEHNER. Mr. Miller——

Mr. MILLER. Yes, I will yield to you.

Chairman BOEHNER.—I understand clearly your request. But I have to say very clearly for you and for others that the release of this information—in my view, would be totally irresponsible on the part of myself and the members of this committee to disclose it in the form in which it is. As I said before, this data, as this form is currently drawn up and currently used, is inherently flawed; and for us to release that—all of that data to the public would be irresponsible, in my opinion, on the part of myself and all of us.

Mr. MILLER. I would just say, after reviewing it, apparently the administration didn't think it was inherently flawed; and I don't know the PBGC has testified or suggested that it is inherently flawed. Maybe we will hear something new here in these hearings. I just think it goes to whether or not Congress has all the information. The decisions we are going to make on your legislation—and, again, I thank you for bringing it forward—are going to affect the livelihoods and the futures of millions of Americans that are a part of these plans.

And, again, it is Wall Street that is making this speculation. It is not George Miller. It is in the business journals. It is in the ana-

lysts' statements. It is in the discussions of these companies. And we are now, in one form or another, going to provide for these assessments. I think we have to know the impact of those assessments for the sake of the future of these workers and their retirements.

I think I have exhausted my time.

Chairman BOEHNER. The gentleman's time has expired.

Mr. MILLER. Thank you.

Chairman BOEHNER. Let me announce for all of you that room 2257, one floor above us, is open for overflow. We have monitors and screens there. So if you would like to have a seat upstairs, you are more than welcome to go to the overflow room.

We have two panels of witnesses today, the first of which will address single-employer defined benefit system reforms; and I want to begin by introducing our first panel.

Our first witness will be Ms. Lynn Franzoi. Ms. Franzoi is the Senior Vice President of Benefits for Fox Entertainment Group, where she is responsible for the designed administration of financing of all benefit programs for over 12,000 domestic employees and 800 foreign employees and for operation of the Child Development Center at Fox.

Ms. Franzoi has served on the National Summits on Retirement Savings in 1998 and 2002. She also serves as a member of the U.S. Chamber of Commerce Health and Employee Benefits Committee and as chairperson for the U.S. Chamber of Commerce Qualified Plan Committee. She was appointed to a 3-year term as a member of the Advisory Council on Employee Welfare and Pension Benefit Plans to the Department of Labor's Employee Benefits Security Administration in 2004.

We will then hear from Mr. Bart Pushaw. Mr. Pushaw is consulting actuary in Milliman's Dallas office. Since entering the field in 1995, he has worked primarily with Fortune 500 companies as a retirement advisor and account manager. Mr. Pushaw has lead and managed compensation and benefit post merger integration in multibillion dollar acquisitions and helped develop and execute new total retirement programs.

He has also led asset allocation and investment policy development projects for pension and retiree medical plans as well as managed human resource due diligence efforts. Before joining Milliman, Mr. Pushaw was a partner at Ernst and Young 11 years and a partner at Mercer prior to that. Mr. Pushaw has written numerous articles and spoken before many professional actuarial groups. He is a member of the American Academy of Actuaries and an enrolled actuary under ERISA and an associate with the Society of Actuaries and fellow in the Conference of Actuaries.

We will then hear from Dr. Theresa Ghilarducci. Dr. Ghilarducci is an Associate Professor of Economics at Notre Dame, Director of the Higgins Labor Research Center. She is a Fellow in the Kellogg Institute, the Kroc Institute for International Peace Studies and Nanovic Institute for European Studies and served as trustee of the Indiana Public Employees Retirement Fund and an Advisory Board Member of the of Pension Benefit Guaranty Corporation.

Professor Ghilarducci's scholarly work is on the financial human resource aspects of pension systems, including private and public

plans and social security. Professionally she is a trustee and advisor to pension and trust funds worth over $30 billion at the Federal and State level, and has appeared before this committee on several occasions.

I want to remind the members of our panel, somebody has explained the lights to you. Keep it to 5 minutes, will be great; a little longer isn't the end of the world.

Chairman BOEHNER. And with that, Ms. Franzoi can begin.

STATEMENT OF LYNN FRANZOI, VICE PRESIDENT FOR HUMAN RESOURCES, FOX ENTERTAINMENT GROUP

Ms. FRANZOI. Thank you.

Good morning, Chairman Boehner, Ranking Member Miller and members of the committee. I would like to thank you for the opportunity to appear before you this morning to discuss an issue that I think is critical to American employees, workers and retirees.

My name is Lynn Franzoi, and I am the Senior Vice President of Benefits for Fox Entertainment Group, Inc. I am testifying today on behalf of the United States Chamber of Commerce, which represents more than three million businesses and organizations of every size, industry sector and geographical region. Fox Entertainment Group is a member of the Chamber's Employee Benefit Committee, and I serve as chairperson of the Qualified Plans Committee. The American Benefits Council Business Roundtable, Committee on Investment of Employee Benefit Assets, ERISA Industry Committee, National Association of Manufacturers and National Rural Electric Cooperative Association also join in the themes expressed in this testimony; and some of these groups will be submitting their own supplemental testimony.

I have over 30 years of experience—close to 30 years, not over—in the field of employee benefits; and, as was recently stated, I am currently serving on a 3-year term as a member of the Advisory Council.

We appreciate the hard work that Chairman Boehner, Chairman Thomas, Chairman Johnson and other members of the Committee on Education and the Workforce have contributed to the issue of pension reform which has resulted in the introduction of H.R. 2830, the Pension Protection Act of 2005. We also appreciate the committee taking the lead on pension reform and believe that the legislation moves the debate forward in a constructive manner. However, we have significant concerns with important aspects of the legislation, and that could negatively impact the defined benefit system.

My written testimony delineates in detail a number of items that we endorse in the bill as well as several areas of concern. I will use my time before you to highlight some of our more immediate concerns about the bill.

First, I must stress that employers need time to weigh the effects of H.R. 2830. Pension issues are extremely complex. As such, employers will expend significant time and effort determining the impact of all of the changes proposed in H.R. 2830.

The proposed legislation fundamentally changes the current funding regime. Analyzing these proposed rules will require employers to examine the changes from a comprehensive and systemic

viewpoint. We ask the members of the committee to view this legislation as the beginning of a discussion on pension reform. All of the business organizations I represent here today look forward to continuing to work with the committee as our members weigh the practical impact of this legislation.

Second, the business community continues to have serious concerns about the yield curve concept. The yield curve is often used for things that have a definite maturity rate, such as mortgages and loans for autos. However, pension liabilities do not have a definite maturity due date because there are many assumptions that are built into the maturity date such as expected retirement date, expected work life with the company and expected mortality. These assumptions may or may not actually turn out as expected. Thus, a yield curve does not present the certainty that it is advertised to have.

While we appreciate the efforts made to simplify the yield curve through the introduction of segments, the proposal would still engender significant complexity. The segmented rates are more complex than the current composite corporate bond interest rate, and there has yet to be any justification for this additional complexity. In addition, we are concerned that the legislation confers substantial discretion to the Treasury Department in the construction of the proposed modified yield curve which would make it virtually impossible for employers to model internally as part of their corporate planning and would be also difficult for Congress to oversee.

Third, we urge Congress to protect credit balances. While H.R. 2830 generally keeps the credit balance concept, the bill works in a manner that could force some employers to write off their existing credit balances. Without the ability to use credit balances, employers have no incentives to contribute more than the minimum required contribution. Under H.R. 2830, credit balances would be subtracted from assets for a number of purposes, including benefit restriction purposes and the determination of at-risk liability. This could result in some companies that are adequately funded and being subject to benefit restrictions and at-risk liability targets. We recommend revising the bill to provide that credit balances are not subtracted from assets for any purpose other than determining the amortization amount for underfunding.

Fourth, on the issue of hybrid plans, we commend Chairman Boehner for recognizing the importance of addressing the hybrid plan issue despite the ongoing controversy surrounding cash balance and other hybrid plans. Many employers find that these plans offer the best designs for their workers.

One way to encourage continued participation in the defined benefit system is to allow employers the flexibility of design. If employers do not have design options that meet the needs of their workforce, they will leave the defined benefit system. To this end, H.R. 2831, the Pension Preservation and Portability Act of 2005, moves the debate on hybrid plans forward; and therefore, we urge Congress to include it as part of the comprehensive pension reform.

Fifth, Congress should give very careful consideration to increasing the PBGC premiums. Not only does the bill increase the flat premium rate from $19 to $30, which is a 63 percent increase, but it also indexes both the flat premium rate and the variable rate to

wages. ERISA requires the PBGC to maintain premiums at the lowest levels possible. Including an annual automatic increase to the PBGC premium takes away from Congress' ability to regulate PBGC premiums because the amount of the premiums will change without Congress reviewing the need for such change.

We acknowledge that this is a difficult and complex public policy area because Congress must find the right balance between setting funding requirements which protect employees and the PBGC but are not so overly restrictive so as to drive employers away from this voluntary defined benefit pension system, much less from establishing new pension plans.

The business community is committed to finding a solution that at the end of the day will strengthen the defined benefit system by encouraging plan sponsors to continue to maintain their plans. We look forward to working with you, Chairman Boehner, and with Chairman Thomas and your committee to find such a solution.

Thank you, and I am happy to answer any questions that you may have.

[The statement of Ms. Franzoi follows:]

Prepared Statement of Lynn Franzoi, Senior Vice President, Benefits, Fox Entertainment Group, Inc., on Behalf of the U.S. Chamber of Commerce

Good afternoon, Chairman Boehner, Ranking Member Miller, and members of the Committee, I would like to thank you for the opportunity to appear before you this morning to discuss an issue that is critical to American employers, workers, and retirees. My name is Lynn Franzoi and I am the Senior Vice President, Benefits, for Fox Entertainment Group, Inc. Fox administers benefit programs for over 12,000 domestic employees, 800 foreign employees, 1,000 retirees and over 3,000 terminated vested participants. Fox maintains defined contribution plans, defined benefit plans, and contributes to several multiemployer plans.

I am testifying today on behalf of the United States Chamber of Commerce, the world's largest business federation, representing more than three million businesses and organizations of every size, sector, and region. Fox Entertainment Group is a member of the Chamber's Employee Benefit Committee and I serve as Chairperson of the Qualified Plans Subcommittee. American Benefits Council, Business Roundtable, Committee on Investment of Employee Benefit Assets, ERISA Industry Committee, National Association of Manufacturers, and National Rural Electric Cooperative Association also join in the themes expressed in this testimony and some of these groups will be submitting their own supplemental testimony.

While I am here today on behalf of several organizations, my testimony also reflects my years of experience in the benefits field. In addition to over 20 years in the field of employee benefits, I am currently serving a three-year term as a member of the Advisory Council of Employee Welfare and Pension Benefit Plans to the Department of Labor's Employee Benefits Security Administration. I also served on the National Summit on Retirement Savings in 1998 and 2002.

We appreciate the hard work that Chairman Boehner, Chairman Thomas, Chairman Johnson, and other members of the Committee on Education and the Workforce have contributed to the issue of pension reform which has resulted in the introduction of H.R. 2830, the Pension Protection Act of 2005 (the "Act"). We appreciate the Committee taking the lead on pension reform and believe that the legislation moves the debate forward in a constructive manner, and in many ways shores up the viability of the defined benefit plan system. However, as outlined below, we also have significant concerns with important aspects of the legislation that may be counter-productive to this goal.

Defined benefit plans allow employers to provide an important retirement benefit to workers. In a defined benefit plan, employers bear the investment risk. In the event that plan assets are insufficient to pay benefits, the employer and its affiliated companies must do so. Even when a company is liquidated in bankruptcy, plan benefits are guaranteed by the PBGC. Moreover, defined benefit plans must offer an annuity form of payment. Annuities provide a lifetime payment stream that ensures that retirees do not outlive their retirement benefit. Thus, defined benefit plans provide a fixed, guaranteed, and secure retirement benefit.

Defined benefit plans are an integral part of the national economy. There are over 30,000 single and multiemployer defined benefit plans that cover roughly 32 million workers.[1] These plans paid out over $120 billion in retirement benefits last year. Currently, there are 11.6 million retirees receiving benefits from private employer defined benefit plans. Furthermore, defined benefit plans held $1.6 trillion in assets as of 2002, thereby increasing the national pool of long-term capital.

Issues of Immediate Concern

Employers Need Time to Weigh the Effects of H.R. 2830

Pension issues are extremely complex and, therefore, employers are still determining the impact of all of the changes proposed in H.R. 2830. The current timetable for consideration of the bill may not be sufficient for a complete analysis by employers so additional issues may continue to arise throughout this process. The proposed legislation fundamentally changes the current funding regime. Therefore, analyzing the proposed rules will require employers to examine the changes from a systemic viewpoint as the entirety of the changes could have a profound impact upon an employer's plan. Moreover, as the funding situation of various companies differs from one to the other, the impact of the proposal will be different on each company. Thus, the business organizations represented today will also need time to best determine how to approach the proposed rules in the manner best for the defined benefit plan community. All of the business organizations listed look forward to continuing to work with the Committee as our members weigh the practical impact of this legislation.

Employers Will Require Transition Relief

As stated above, H.R. 2830 will implement broad changes to the current system. Therefore, in addition to time to weigh the provisions, employers will also need time to implement changes that are made into law. We are concerned that H.R. 2830 does not provide adequate transition relief. The bill replaces all of the current funding rules with an entirely new set of rules. It is essential that Congress provide an adequate phase-in period for employers to implement these changes successfully.

Among the provisions that will have a significant impact are the new rules requiring that projected lump sums be taken into account in determining liability. Under current law, projected lump sums are not (and cannot be) taken into account in determining current liability. This omission generally understates a plan's true liability because current rules for determining the minimum value of lump sum payments are extremely generous to participants at the expense of the plan as a whole. The bill begins to coordinate the payment rules with the liability rules. However, there is a generous phase-in for lump sum payment purposes but not for liability purposes. This means that many plans will experience a sharp increase in liability without time to adjust to such an increase.

Similarly, H.R. 2830 establishes a 100% funding target which is an increase from the current minimum funding requirement of 90%. For many plans, this is an effective 10% increase in liabilities that would occur immediately. Employers will need time to fund their plans to the increased level and without an appropriate transition period there could be massive disruptions to their capital spending and long-term business plans.

The Yield Curve Concept is Not Appropriate for Pension Plans

The yield curve will add unnecessary complexity to pension calculations. The yield curve is often used for things that have a definite maturity date, such as mortgages and auto loans. However, pension liabilities do not have a definite maturity date because there are many assumptions built into the maturity date such as expected retirement date, expected work life with the company, and expected mortality rate. These assumptions may or may not actually turn out as expected. Thus, the yield curve does not present the certainty that it is advertised to have. Rather, it is just another method of estimating pension liability and it is one that will be costly and burdensome for employers to adopt.

While we appreciate the efforts made to simplify the yield curve through the introduction of segments, the proposal would still engender significant complexity and we remain 4 concerned about the impact of the change. The segmented rates required under H.R. 2830 are more complex than the current composite corporate bond interest rate and there has yet to be any justification for the additional com-

[1] Pension Benefit Guarantee Corporation, Pension Insurance Data Book 2004, Spring 2005.

plexity. On the contrary, critical analysis of the yield curve concept indicates that it may be inappropriate for calculating pension liabilities.[2]

In addition, we are concerned about the construction of the proposed modified yield curve. H.R. 2830 directs the Treasury Department to develop the modified yield curve based on investment grade corporate bonds and confers substantial discretion onto the Treasury Department. This type of discretionary, non-market interest rate would be virtually impossible for employers to model internally as part of corporate planning and would also be particularly difficult for Congress to oversee. Moreover, the Treasury Department has complete discretion in determining how the different classes of bonds are to be weighted. As the bill has been drafted, Treasury could, for example, provide that only six-year bonds will be used to determine the interest rate on the five to 20-year segment. Alternatively, Treasury could provide that durations from five to 10 years will be weighted at twice the weighting of bonds from 10 to 20 years. These changes could have a significant impact on the effective interest rate. Because the interest rate has such a dramatic effect on pension funding, it would be important for Congress, and not Treasury, to determine how the interest rate for each segment is calculated.

Current Credit Balances Must be Protected and Workable Rules Provided for the Future

While H.R. 2830 generally keeps the credit balance concept, the bill works in a manner that could force some employers to write-off their existing credit balances. Without the ability to use credit balances, employers have no incentive to contribute more than the minimum required contribution. Moreover, employers should not be precluded from using the credit balances that they have already accumulated. Employers pre-funded their plans with the expectation that they would be able to credit the excess funding in future years in which they may face difficult economic times. Employers made these additional contributions relying upon rules that were in place at the time. Changing these rules on them now would be unfair and could cause employers to view the credit balance system as unreliable and, thereby, create a disincentive for advanced funding.

Under H.R. 2830, credit balances would be subtracted from assets for a number of purposes, including benefit restriction purposes and the determination of at-risk liability. This requirement could have dire consequences for some plans. For example, consider a plan that has $100 in liabilities, $90 in assets, and $40 in credit balances. Such a plan would be considered 50% funded for purposes of imposing benefit restrictions and at-risk liability determinations. As a result, the plan would have to be frozen (no new benefits for any participant), lump sums could not be paid, and liabilities would have to be calculated using the at-risk determination rules that require accelerated and burdensome funding. This is entirely inappropriate given that the plan is in fact 90% funded. We recommend revising the bill to provide that credit balances are not subtracted from assets for any purpose other than determining the amortization amount for underfunding.

Hybrid Plans are Vital to the Defined Benefit Plan System and Should be Included in Comprehensive Pension Reform

We commend Chairman Boehner for recognizing the importance of addressing the hybrid plan issue. Despite the ongoing controversy surrounding cash balance and other hybrid plans, many employers find that these plans offer the best designs for their workers. For an increasingly mobile workforce, steady accruals under a cash balance plan provide greater benefits than under a traditional pension plan where accruals are back-loaded. Moreover, workers desire cash balance plans because of the similarities to 401(k) plans. One way to encourage continued participation in the defined benefit system is to allow employers the flexibility of design. If employers do not have design options that meet the needs of their workforce, they will leave the defined benefit system.

Without statutory guidance, there will continue to be litigation that only serves to confuse the issue even further. Such lawsuits against plan sponsors put hybrid

[2] For example, one critic has reported that yield curves offer only a "Band Aid" approach that could conceivably make liability estimation models more reliable, but that yield curve data that is not carefully constructed will make estimates less, not more, reliable. (Don Mango, Structural Dependence and Stochastic Processes, American Re-Insurance 2001 Casualty Actuarial Society DFA Seminar, available at www.casact.org/coneduc/dfa/2001/handouts/mango1.ppt [hereinafter Mango]. For a similar criticism of the use of yield curves in certain liability models, see Peter Blum, Michel Dacorogna & Paul Embrechts, Putting the Power of Modern Applied Stochastics into DFA, 2001 Casualty Actuarial Society DFA Seminar, available at www.casact.org/coneduc/dfa/2001/handouts/blum1.ppt.) This critic has also suggested that even the most well constructed yield curve data sets will only address a symptom of an otherwise internally inconsistent model.

plans at risk and threaten the retirement security of workers who benefit under these plans. For reasons described more fully below, we believe that H.R. 2831, the Pension Preservation and Portability Act of 2005, moves the debate on hybrid plans forward and, therefore, urge Congress to include it as part of comprehensive pension reforms, such as in H.R. 2830.

Additional Issues

As stated above, employers will need time to thoroughly review the impact of H.R. 2830. Nonetheless, in the remainder of this testimony, we would like to share with you some of our initial thoughts and reactions to certain provisions in the legislation.

Pension Reform Must Contribute to the Viability of the Defined Benefit Plan System

For the protection of workers and the defined benefit system, the funding rules should ensure that pension benefits are appropriately funded. As such, funding requirements should track investment practices and choices as much as possible and allow employers freedom in making funding choices. It is very important that funding rules not impose unrealistic requirements or burdens that would create an administrative and financial drain on plans or overburden employers that are already struggling to better fund their plans.

It is extremely important that employers be encouraged to maintain their participation in the defined benefit plan system. There are elements of H.R. 2830 that achieve this goal. For example, the increase in the maximum deductible contribution to 150% of current liability and maintaining the concept of credit balances are both extremely important in encouraging additional contributions to pension plans during good economic times. In addition, we appreciate the recognition that the benchmark for the interest rate assumption should be based upon corporate bond rates and not the 30-year Treasury rate and that smoothing over multiple years is essential to reflecting actual investment trends and maintaining predictability.

• *The Increased Maximum Deduction Limit Will Encourage Greater Contributions*

H.R. 2830 increases the deductible limit to 150% of current liability for single-employer plans and 140% of current liability for multiemployer plans. Increasing the maximum deductible contribution limit is long overdue. Employers should be able to contribute more to their plans in good times and not be forced to increase contributions during bad economic times. Some employers with plans that are now experiencing funding deficiencies would have liked to have increased contributions when they had cash on hand. However, they were limited by the maximum deductibility rules. Not only would their additional contributions have been nondeductible, but they would have had to pay a significant excise tax on the contributions. This cap on contributions works against companies and plan participants by requiring contributions when companies are financially strapped and prohibiting contributions when companies are prosperous. Thus, companies cannot insulate themselves and their plan participants against cyclical changes in the economy. Therefore, we fully support the increases to the maximum deductible contributions for defined benefit plans.

• *The 30-year Treasury Bond Interest Rate is an Inappropriate Benchmark*

There has been considerable debate over the proper replacement for the 30-year Treasury bond interest rate assumption. We believe that the interest rate assumption should be a reliable indicator of long-term expected returns on long-term investments for permanent defined benefit plans and should not be subject to significant short-term fluctuation. The Chamber believes that a composite corporate bond rate is the appropriate replacement for the 30-year Treasury rate and addresses these concerns. We are pleased that H.R. 2830 recognizes that the interest rate should be based upon a corporate bond rate and not linked to a government debt instrument.

• *Smoothing of the Asset and Liability Calculations are Necessary to Provide Predictability*

Plan sponsors generally project their funding requirements over several years and would like to have certainty about their funding requirements over that period of time. Over a short time period, market rates remain fairly volatile and, thus, funding assumptions based on a short time period are unpredictable. We appreciate that H.R. 2830 will use a long-term weighted average. However, it will decrease the average period for asset 7 calculations from five years for assets and four years for liabilities to three years for both. Since it is a shorter time period than what is currently in place, there are concerns about its practical effect. As our members analyze this

change, we will determine the impact of this decrease and whether it is a viable change.

Permanent Funding Reform for Multiemployer Pension Plans is Critical

Multiemployer plans must deal with many of the same funding issues as single-employer plans, but also have other concerns that are specific to their structure. In addition to the current economic situation, multiemployer plans are contending with a long-term issue of declining participation by workers and employers. Thus, as the pool of retirees is increasing, the pool of contributing workers is decreasing. This is causing significant burdens upon employers who continue to participate in these plans. In addition, as bankrupt employers withdraw from multiemployer plans, the remaining U.S. employers are left to pay liabilities for people who never worked for them, which puts U.S. employers at a competitive disadvantage to foreign competition in the same industries which are not burdened by such assessments. Obviously, this is an unfair drain of resources on these employers and their workers.

The Pension Funding Equity Act of 2004 granted temporary funding relief to certain multiemployer plans. Such a temporary provision that provided only limited relief does not offer a lasting solution. Particularly for multiemployer plans in crisis, there needs to be permanent and fundamental funding reform.

There are several challenges facing participating employers in multiemployer plans. Some large multiemployer plans are facing unprecedented shortfalls that are likely to result in funding deficiencies that will require substantial catch-up contributions by remaining employers and create excise tax liability. In addition, some of these same plans are experiencing shifting demographics in which retired participants outnumber active participants and life expectancy assumptions are proving to be inaccurate. The funding deficiency problems could result in significant financial outlays by remaining employers and, in extreme cases, could push an employer into bankruptcy.

To address these issues, H.R. 2830 will ensure that multiemployer plan sponsors and trustees have the flexibility to implement measures that will ensure the continuation of their plans by creating various "zones" that depend upon the funding status of the plan. Within each zone, there are requirements that must be met and tools that allow the trustees to improve the funding of these plans. One important tool that was not included in the legislation is allowing plans in critical status to reduce accrued benefits. We understand that this is a drastic measure but it is necessary to remedy the severe underfunding some of these plans are experiencing. Many in the business community and labor organizations support inclusion of this provision as a necessary tool to save these plans. Therefore, we encourage Congress to allow multiemployer plans that are in critical status the option to reduce accrued benefits.

H.R. 2831 Would Resolve Key Issues in the Hybrid Plan Debate

We would like to thank Chairman Boehner for introducing separate legislation that addresses the cash balance and hybrid plan situation. Cash balance and hybrid plans are the fastest growing type of defined benefit plan and, thus, critical to the viability of the system. Therefore, assuring the validity of these plans is extremely important. We urge Congress to include this legislation with the other pension reforms in H.R. 2830.

The Chamber has argued that formulaic tests may not adequately determine age discrimination in hybrid plans and, therefore, a broader test should be used. Calculating benefits in terms of an age-65 annuity is not required under ERISA and is not an accurate method for determining age discrimination in cash balance and hybrid plans. Rather, age discrimination in such plans should be tested by looking at the pay and interest credits received on an annual basis or by looking at the change in an individual's account balance from year to year.

H.R. 2831 meets these criteria. By establishing a broad test for age discrimination, it will provide realistic criteria for hybrid plans that will protect all workers and allow employers to continue to offer benefits through these types of plans. Moreover, the retroactive effective date provides much needed clarification for existing hybrid plans.

In addition, H.R. 2831 resolves the whipsaw effect issue. The whipsaw effect prevents plan sponsors from providing a more generous benefit because it may result in an unintended windfall for participants who decide to take their benefit in the form of a lump sum. Rather than penalizing plan sponsors for attempting to increase benefits, the law should support such efforts while also ensuring that participants receive the proper benefit. Allowing employers to use a market rate to determine the present value of the accrued benefit will ensure that all workers receive the benefit to which they are entitled.

Transition Options for Hybrid Plans Must Remain Flexible—Mandates are Not a Viable Solution

We are pleased that H.R. 2831 does not impose a mandate on benefit options. Plan sponsors have been converting traditional defined benefit plans to cash balance and hybrid plans for over 20 years. In that time, plan sponsors have used many different transition methods to successfully convert their plans. Limiting transition options will only hurt the workers participating in hybrid plans. Mandating specific safe harbors for conversion may encourage some employers to terminate their defined benefit plan rather than convert it to a hybrid plan. Also, for those plans that have already converted, mandating retroactive safe harbors would require certain employers to terminate their plans. Mandatory choice or any other mandatory benefit imposition is inconsistent with the voluntary nature of ERISA and should not be part of any legislative resolution for hybrid plans.

H.R. 2830 Removes Obstacles to Providing Investment Advice

H.R. 2830 modernizes 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 9 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.

H.R. 2830 clarifies existing law to allow employers to 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.

Careful Consideration Should be Given to Increases in the PBGC Premiums

We believe that the existence of the PBGC as a viable insurance institution is of paramount importance to the defined benefit plan system. However, funding reform that drives healthy companies and plans out of the system is at odds to the goal of protecting the PBGC. Therefore, reforms such as increasing PBGC premiums should be reviewed carefully. We are concerned that the flat-rate premium increase from $19 to $30 under H.R. 2830 will drive some employers out of the system and the additional increases on top of that will be even more detrimental.

• *PBGC Premiums Should Not Be Automatically Indexed*

Under H.R. 2830, the amount of the flat-rate premium and the variable rate premium will be indexed to wages. ERISA section 4002 states that the PBGC must maintain premiums "at the lowest level consistent with carrying out its obligations under this title." Therefore, increases in premiums should be made only as determined to be necessary by Congress. Including an annual automatic increase to the PBGC premiums takes away Congress's ability to regulate PGBC premiums because the amount of the premiums will change without Congress reviewing the need for such change. We recommend that the premiums not be indexed and that Congress maintain its responsibility in regulating the premiums.

Certain Benefit Restrictions are Unduly Burdensome

• *Shut Down Benefits Should Not be Prohibited*

H.R. 2830 prohibits single-employer plans from providing shut down benefits or benefits based upon unpredictable contingent events. This restriction severely interferes with an employer's ability to provide benefits that are appropriate for its workforce and business situation. Eliminating the ability of employers to provide a certain type of benefit is unduly restrictive. There have been several alternatives put forth to deal with the issue of shut down and contingent event benefits and we urge Congress to consider these alternatives.

• *Lump Sums Should Not be Restricted at the Levels Provided for in H.R. 2830*

H.R. 2830 will prohibit plans that are less than 80% funded from paying out benefits in a lump sum. Currently, plans are only similarly restricted if they have a liquidity shortfall.[3] Clearly there is a significant difference between a plan having a liquidity problem and being less than 80% funded. If this limitation must be included in pension reform, we recommend that it be included at a much lower fund-

[3] A plan has a liquidity shortfall when it does not have enough liquid assets to cover three times the amount of benefit disbursements made in the previous year.

ing level (i.e., 60%). Another alternative is to allow employers that are less than 80% funded to eliminate the lump sum benefit as an option to improve its funded status. It is unduly restrictive to participants to require employers to eliminate this option at such a high level of funding.

• *Restrictions on Benefit Accruals and Deferred Compensation are Overly Intrusive*

The Act will require severely underfunded plans to cease benefit accruals and prohibit advanced funding of deferred compensation. These restrictions interfere with employment contracts and management-labor relations and, therefore, are inappropriate. The ceasing of benefit accruals effectively freezes the plan. Even if the employer is able to improve its funded status, the workers will have lost the benefits that would have accrued during that period. This provision obviously intrudes into the labor-management relationship in a detrimental way. Similarly, restricting the funding of deferred compensation impedes upon an employer's contractual relationships with its workers. Deferred compensation arrangements are entered into for various reasons that may have nothing to do with retirement options. Thus, linking these items together again intrudes upon an employer's ability to manage its workforce. Consequently, these restrictions should not be included in the Act.

ERISA Section 4010 Information Should Not be Disclosed

The value of disclosing ERISA Section 4010 filing information is not readily apparent. It is not a measure of business stability or plan viability—rather, it is an arbitrary measure of funding. Moreover, H.R. 2830 requires that funding information for all plans in the controlled group be made available to participants and beneficiaries and not just those that are underfunded. Including this information will be confusing to participants who are participating in only one plan and may not even be aware of other plans in the controlled group. In addition, the information should not have to be provided to all participants in plans that are not underfunded. A worker receiving information about a plan in which he does not participate may become confused about the status of his or her own plan.

In addition, the Section 4010 filing requirement is currently flawed in that it uses a fixed dollar threshold of $50 million of underfunding. For large pension plans with billions of dollars in assets, $50 million of underfunding is a miniscule amount of relative underfunding. Furthermore, in the current low interest rate environment, most every medium to large employer plan has a good chance of being required to make this filing even if it is nearly fully funded. Publicizing this information would perpetuate and magnify these anomalies.

Conclusion

We acknowledge that this is a difficult, complex public policy area because the Congress must find the right balance between setting funding requirements which protect employees and the PBGC, but are not so overly strict—in search of "perfect" funding requirements—so as to drive employers away from continuing with defined benefit pension plans, much less establishing new ones. Further, overly strict requirements will divert resources away from other useful purposes such as higher wages and capital investments.

The Pension Protection Act of 2005 advances the discussion of pension reform. It includes a number of beneficial provisions that will encourage employers to maintain and strengthen their plans. However, there are also provisions that are counter-productive to that goal. We are committed to finding a solution that, at the end of the day, will strengthen the defined benefit plan system by encouraging plan sponsors to continue to maintain their plans. We look forward to continuing to work with Chairman Boehner and Chairman Thomas and their Committees to find such a solution.

Thank you and I am happy to answer any questions that you might have.

Chairman BOEHNER. Mr. Pushaw.

STATEMENT OF BART PUSHAW, ACTUARY, MILLIMAN, INC.

Mr. PUSHAW. Thank you, Chairman Boehner, Mr. Miller, members of the committee. Good morning. I am honored to be before you today. Thank you for inviting me.

I would like to begin by commending the committee members on this bill. The Pension Protection Act significantly updates ERISA, which has been incredibly successful for over 30 years. Those who

were responsible for it should be proud of their achievement and not sorry to see these parts changed.

Today, I am speaking as an experienced, practicing retirement actuary enrolled under ERISA. I have been and continue to be proud to be a part of one of our most important institutional pillars of financial security.

The funded position of many pension plans is recovering. The old rules indeed have worked in allowing sponsoring companies a brief but sufficient time to begin to recover from a recession before being required to contribute funds to plans, though weaknesses remain.

This bill, as I mentioned, updates ERISA and greatly simplifies relevant provisions and fixes some of these weaknesses.

The yield curve is not a widely familiar concept, and it has only recently begun to enter into use by the pension industry. Thirty years after ERISA was enacted, pension plans now have a wide range of maturity, from new plans with hordes of new hires at young ages, to plans which have retired population liabilities on their balance sheets which dwarf that of the plan sponsor. These vastly differing plan profiles have, in the past, all been treated identically for valuation purposes, grossly and materially erring relative to market value. Erroneous, inaccurate valuations mean no money to pay benefits.

Using yield curves is the right answer. The market, arguably, incorporates more information about expectations in the yield curve than any other single measure. Capable plan managers and actuaries will be able to extract this forward-looking information to enhance financial forecasts, better supporting prudent plan management, leading to higher levels of benefit security for participants and thus strengthening the financial security of millions.

Providing accurate estimates of future plan costs to corporate financial managers is important, because it is those same managers who will abandon a defined benefit pension plan when that plan impedes them in managing the financial affairs of the sponsor, in spite of their many valuable features. This bill enables rather than impedes good management. Accuracy promotes strengthened benefit security.

The modified yield curve approach in this bill is a good simplification to ease administrative implementation by small plans but rigorous enough to develop market-based valuations for the largest of plans, reflective of their plan's liability profiles and, hence, emerging cash flow needs.

These cash flow needs include paying benefit distributions as lump sum payments. This bill brings a huge improvement with regard to lump sums. A financial disconnect occurred when plans were mandated to pay lump sums under artificial conditions, having no bearing to the intent of the plan sponsor nor with the way the plan had been funded. This bill removes that disconnect and enables the plan to properly fund paying lump sums to those who choose them.

Due to the formidable risks associated with lump sums, I do not advocate them for the general population. However, lump sums do have a valuable and important role in financial planning when part of a comprehensive, well-designed personal financial plan. It is in this latter regard that I believe a limited exemption allowing lump

sums to the small number of participants at or near normal retirement age should be granted, not limiting them in accordance with plan funded status since the run-on-the-bank issue is now defused due to the proposed plan/lump sum interest rate and mortality rate harmony.

These bona fide retirees, at the end of their working career, cannot without pain suffer such sudden changes to their financial condition. Nor should they be asked to do so. In tandem with this positive change in determining lump sums, it should be noted it would indeed be in PBGC's own financial interests that lump sums be paid out rather than become an entry on their books with an even larger assigned value.

The benefit limitations, the amendment ban and benefit accrual freeze are entirely appropriate and makes common sense a required dictum again. Significant benefit enhancements promised while sponsors face financial demise buy nothing. The end game of funding these back room deals with taxpayer dollars needs to end, and I commend the committee for proposing to take this action.

Use of credit balances is corrective. First intent reflected prepayments against long horizon schedules. These accumulations lose relevance, resulting in use antithetical to benefit security. More flexibility in using and accumulating these balances, giving appropriate credit to contributing sponsors and adjusting them for plan asset performance all support the primacy of strengthening benefit security while maximizing value to the sponsor.

Since the inception of the earliest pension plans at around the turn of the last century, Americans have lived ever longer lives, and this improvement in mortality is expected to continue. Reflecting this expectation with regular updates of the underlying mortality tables is crucial.

Time calls for another update, and the most recent mortality table published by the Society of Actuaries is the proposed table in the bill. This table, under proper projection of mortality improvement, incorporates this increased longevity, which results in a more accurate estimate of expected plan payouts and liabilities. Again, tying together the table the plan uses to estimate and fund payouts to the actual payouts themselves is sound actuarial finance,ameliorates distortions and adds back credibility to defined benefit plan as a strong tool for use in retirement plan strategy.

This bill brings a new ability and a new flexibility to defined benefit plans which will allow prudent, well-managed companies the ability to continue or return to relying on the defined benefit plan as core of their retirement benefit strategy, differentiating themselves competitively in a positive manner to a labor force eager to gain and retain financial security in an era of increased personal assumption of financial risk.

I humbly thank you for your patience and the opportunity to present my opinions to the committee.

Chairman BOEHNER. Thank you.

[The statement of Mr. Pushaw follows:]

Prepared Statement of Bart Pushaw, Actuary, Milliman, Inc.*

The Pension Protection Act significantly updates ERISA, which has been incredibly successful for over 30 years—those who were responsible for it should be proud of their achievement and not sorry to see these parts changed. I have been and continue to be proud to be a part of one of our most important institutional pillars of financial security.

The funded position of pension plans is recovering—the old rules have indeed worked in allowing, through techniques of smoothing, sponsoring companies a brief but sufficient time to recover from a recession before being required to contribute funds to plans. But weaknesses remain.

This bill, as mentioned, updates ERISA and also, in my belief, greatly simplifies relevant provisions and fixes some of those weaknesses. The updates primarily include use of the corporate spot rate yield curve and the mortality table. The fixes relate to the determination of lump sums and benefit limitations. The simplification of the funding rules is significant.

Inherent in the old rules was the business environment of the day. Contrasting against that, today's corporate finance officer manages in a faster pace, faster changing world, as we all know. Competitive forces, of a global fashion, have shortened planning horizons and leaned down corporate balance sheets. This leaning-down means it can't support plans fixated on the long horizons underlying current funding rules any longer. This bill finally re-focuses pension plan financial drivers to a 'Security-Now' approach.

The focus of measuring has also changed—Book Values are out, Market Values are required. This bill successfully accomplishes this change with pension liabilities. In the past, individual actuarial discretion had driven the liability value of a plan, with professional latitude wide enough to lead to valuations virtually always significantly different than what can be considered market valuations.

The yield curve is not a widely familiar concept, and it has only recently begun to enter into use by the pension industry. Thirty years after ERISA was enacted, pension plans now come in a wide range of maturity—ranging from new plans with hordes of new hires at young ages, to plans which have retired population liabilities on their balance sheets which dwarf that of the plan sponsor. These vastly differing plan profiles have, in the past, all been treated identically for valuation purposes, grossly and materially erring relative to market value. Erroneous, inaccurate valuations mean either no money to pay benefits or no money for corporate development and investment.

Using yield curves is the right answer. The market incorporates more information about expectations in the yield curve than probably any other single measure. Capable plan managers and actuaries will be able to extract this forward looking information to enhance financial forecasts, better supporting prudent plan management, leading to higher levels of benefit security for participants and thus strengthening the financial security of millions.

Providing accurate estimates of future plan costs to corporate financial managers is important because it is those same managers who will abandon a defined benefit pension plan when the plan impedes them in managing the financial affairs of the sponsor, in spite of their value-added features. This Bill enables rather than impedes good management. Accuracy promotes strengthened benefit security.

The modified yield curve approach in this Bill is a good simplification to ease administrative implementation by small plans but rigorous enough to develop market-based valuations for the largest of plans, reflective of their plan's liability profiles and hence emerging cash flow needs.

These cash flow needs include paying benefit distributions as lump sums. This Bill brings a huge improvement with regard to lump sum payments. A financial disconnect occurred when plans were forced to pay lump sums under artificial conditions; having no bearing to the intent of the plan sponsor nor with the way the plan had been funded. This Bill removes that disconnect and enables the plan to properly fund and pay lump sums to those who choose them.

Much concern of pension financial integrity has been laid on the door of the lump sum payout. While this is not the most prudent choice of benefit selection for many, it still has its place. Additionally, lump sums carry something of a bad reputation as 'they keep draining trusts but can't be funded.'

The proper application of the yield curve to determine both a plan's Current, or Target, Liability interest rate and the Lump Sum cash out rate remedies these ails.

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*The following comments express my own opinions and position, and do not reflect those of Milliman, the American Academy of Actuaries or any other organization.

This occurs because the lump sum exactly equals the liability. Pension plans might have been better off if the PBGC interest rate was never mandated.

When we say we want to use the yield curve to determine the liability of a plan, we mean the following. Project annuity benefit payments the plan expects to pay for a person until they die. This gives you a stream of payments expected in each year from now to well into the future. Do this for each person; some payments will begin right away while others don't start until sometime in the future. Then, add them all up. This gives you the stream of expected payments for the entire plan, for each year, out 85 years or so.

Next, find a spot rate yield curve representing the high quality corporate bond market. This is a series of interest rates, one for each year out into the future.

Then, to develop the liability of the plan, discount each year's benefit payment by applying the corresponding year's rate. Add all these discounted benefit payments together and you end up with the plan liability.

Here's a simplified numerical example.

In this example, the relative dollar amounts and payout periods are irrelevant to the results. The yield curve used here is the actual December 31, 2004 curve as published by Citigroup and posted on the Society of Actuaries' website.

Let's say we have a plan with two participants: Mary and Bob. Mary will retire today and receive $100 annually for ten years. Bob is younger, will retire 10 years from now and receive the same $100 a year for ten years. We show the plan benefits along with the current yield curve as follows:

Year	Rate (%)	Mary's benefit	Bob's benefit	Total plan benefits	Discounted benefits
1	3.09	$100		$100	$97
2	3.40	100		100	94
3	3.64	100		100	90
4	3.90	100		100	86
5	4.12	100		100	82
6	4.33	100		100	78
7	4.52	100		100	73
8	4.65	100		100	70
9	4.80	100		100	66
10	4.94	100		100	62
11	5.09		$100	100	58
12	5.26		100	100	54
13	5.44		100	100	50
14	5.58		100	100	47
15	5.69		100	100	44
16	5.76		100	100	41
17	5.83		100	100	38
18	5.89		100	100	36
19	5.94		100	100	33
20	5.98		100	100	31
Total		$1,000	$1,000	$2,000	$1,230

The plan expects to pay out $2,000 over the next 20 years and the liability today is $1,230. The plan is economically indifferent as to whether it pays out $1,230 today or $2,000 over 20 years. We can compute an effective rate which is the single interest rate equivalent to the series of rates forming the yield curve. The effective discount rate for the plan is 5.15% in our example. That is, if you use 5.15% each year for the entire plan, the liability would be the same $1,230 as above. Let's also say the plan has assets of $1,230.

What happens to the plan when a lump sum is paid out to Mary using a lower interest rate to calculate her lump sum? Is Bob, the remaining participants or PBGC, left less well off after the Mary takes her lump sum?

The answer is NO. Let's see why not.

First, let's use a lower interest rate, say 4.30%, to determine Mary's lump sum. We go through the same discounting process on her benefits as follows:

Year	Rate (%)	Annuity benefit	Discounted benefit
1	4.30	$100	$96
2	4.30	100	92
3	4.30	100	88
4	4.30	100	84
5	4.30	100	81

Year	Rate (%)	Annuity benefit	Discounted benefit
6	4.30	100	78
7	4.30	100	74
8	4.30	100	71
9	4.30	100	68
10	4.30	100	66
Total		$1,000	$798

This says Mary gets paid a lump sum of $798. Now, let's take another look at the plan's liabilities, person by person.

To do this, let's separately discount each participant's benefits using our yield curve.

Year	Mary's discounted benefits	Bob's discounted benefits
1	$97	$0
2	94	0
3	90	0
4	86	0
5	82	0
6	78	0
7	73	0
8	70	0
9	66	0
10	62	0
11	0	58
12	0	54
13	0	50
14	0	47
15	0	44
16	0	41
17	0	38
18	0	36
19	0	33
20	0	31
Total	$798	$432

Notice that the sum of Mary's liability of $798 and Bob's liability of $432 equals the plan's liability of $1,230. You will also notice that the lump sum we paid to Mary using a lower interest rate is exactly equal to the liability the plan expected to pay her using a different rate, a rate for the plan as a whole. And after Mary is paid, the plan still has the $432 it holds for Bob.

Now, what if Bob wants a lump sum, too, and he wants it now? We can pay Bob his lump sum in the same way we did for Mary, and Bob would get exactly $432. In the end, after everyone is paid their benefit, the plan equitably pays out exactly as was expected, $1,320.

What was the effective lump sum interest rate used to determine Bob's lump sum amount? It was 5.63%.

What's the trick? Where did the lump sum interest rates come from and is this result a coincident or an actuarial anomaly?

There is no trick at all. The rate used to determine the lump sum for Mary was arrived at using the same yield curve for her benefits as was used for the plan as a whole. Because the spot rates corresponding to her benefit payouts are lower than the spot rates that occur in later years, Mary's lump sum rate (ie, her effective rate) is also than the plan's effective rate.

Is this coincidence? No, it is the logical result of using an internally consistent methodology, applying the very same yield curve equally to both the plan and the individual.

Result: When done correctly, the lump sum rate for a retiree is lower than the rate used for the entire plan. In this case, 85 basis points less.

What would have happened if we had used the plan's rate of 5.15% to calculate Mary's lump sum? Mary would have been paid $767, or $31 less. This would have resulted in a windfall for the plan at Mary's expense.

Result: Using the same yield curve equally is correct while using the same interest rate is not; the lump sum is equal to the liability.

For the general population I do not advocate lump sums, due to the formidable risks associated with them. However, lump sums do have a valuable and important role in financial planning when part of a comprehensive, well designed personal financial plan. It is in this latter regard that I believe a limited exemption allowing lump sums to the small number of participants at or near normal retirement age should be granted—not limiting them in accordance with plan funded status, since the 'run on the bank' issue is now happily defused due to the proposed plan/lump sum interest rate and mortality harmony.

Some of the examples of the importance lump sums are:

1. Lump sums allow a retiring employee to collect their deferred compensation entirely, as compared to an annuity, where in the case of premature death, even one day after retirement, the entire benefit is forfeited.

2. Pension plans are considered a deferral of current wages. These wages are entirely earned in the year they are earned. Requiring annuitization means unfairly subjecting previously earned wages to forfeiture.

3. Lump sums allow a retiring employee to sever economic ties to the company, plan and industry and reduce their exposure to industry risk by collecting and self-directing their lump sum in a manner they deem most appropriate for them.

4. An employee's lifetime earnings are subjected to market forces specific to the industry and company she works in. Often, this employment risk is converted into imprudent investment risk by a company requiring undiversified ownership of company stock via its defined contribution retirement plans. Laws which have historically allowed employees to diversify away this company risk are currently being strengthened. This same risk diversification ought to be allowed in a defined benefit plan as well.

5. Collecting a lump sum allows a retiring employee better management over their entire portfolio of assets.

6. Financial advisors promote the view of total wealth management to optimize investment choices. Each individual investor owns different assets in different proportions and has different needs and goals. These needs and goals often require an asset allocation approach which allocates pension funds other than in a level annual annuity. Unlike a portfolio of §401(k) fund investments, pension plan investments only facilitate self-direction when paid out in a lump sum.

7. Collecting a lump sum allows the retiring employee to choose the appropriate time and extent of annuitization that's right for them.

8. Academic studies (e.g., the Pension Research Council at the Wharton School of Business, University of Pennsylvania) have indicated that the optimal age for a retiree to annuitize some part of their personal wealth is at an age which is significantly after the plan's normal retirement age.

9. A lump sum option facilitates retiree estate planning.

10. Some retirees prefer their earned benefit be available for use in either bequeaths to heirs, providing liquid assets upon their deaths or other worthwhile uses chosen by the individual. Without a lump sum option, the death of the retiree leads to the partial or complete forfeiture of unpaid benefits denying the retiree their choice in how to use compensation they earned during employment.

11. A lump sum allows more varied use of portions of their total retirement nest egg at their own discretion.

12. Anecdotally, we know many newly retired individuals look forward to celebrating the end of their working lifetimes and new retirement. Oftentimes, they want to pay off their mortgages, take a well-earned trip(s) or contribute to their grandchildren's college funds. Most individuals covered in pension plans without lump sum access have the vast bulk of their retirement funds locked in annuities via the plan (and Social Security). At least part of this retirement wealth ought to be accessible to them via lump sums if they desire to celebrate their achievement in any of these or numerous other ways.

These bonafide retirees, at the end of their working career, can not without pain suffer such sudden changes to their financial condition, nor should they be asked to do so. In tandem with this positive change in determining lump sums, it should be noted, it would indeed be in the PBGC's own financial interest that lump sums be paid out rather than become an entry on their books at an even larger assigned value.

When a pension plan is funded on a correct actuarial basis, a lump sum payment does not cause undue hardship or otherwise denigrate the plan's funded status. On the other hand, under current rules, lump sums cost more than annuities and, sometimes, can not be funded.

Lump sums can be made to be a cost neutral benefit, as they were prior to PBGC-mandated interest rates, by the prudent selection of an interest rate. The yield curve approach to determining the plan interest rate combined with an equivalent application of that yield curve to retiring participants will result in a lump sum which is cost neutral with no 'leakage' whatsoever.

The benefit limitations, the amendment ban and benefit accrual freeze are entirely appropriate and makes common sense a required dictum again. Significant benefit-enhancements promised while sponsors face financial demise buy nothing. Vaporous agreements by leadership faithfully relied upon by the rank and file adds to shattered trusts. The end-game of funding these back room deals with taxpayer dollars needs to end. And I commend the Committee for proposing to take this action.

Since the inception of the earliest pension plans at around the turn of the last century, Americans have lived ever longer lives and this improvement in mortality is expected to continue. Reflecting this expectation with regular updates of the underlying mortality tables is crucial.

Time calls for another update and the most recent mortality table published by the Society of Actuaries is the proposed table in the Bill. This table, under proper projection of mortality improvement, incorporates this increased longevity which allows for a more accurate estimate of expected plan payouts and liabilities. Again, tying together the table the plan uses to estimate and fund payouts to the actual payouts themselves is sound actuarial finance, ameliorates distortions and adds back credibility to the defined benefit plan as a strong tool for use in retirement plan strategy.

The transition elements of the Bill are substantial. The changes brought about by the provisions during the phase-in periods are not dramatic, but easy. Plan sponsors will in general greet the new law with enthusiasm, drawn by the certainty brought by finally having an interest rate methodology in place as well as the internal cohesiveness and financial soundness in its approach.

This Bill brings a new ability and new flexibility to defined benefit plans which will allow prudent, well-managed companies the ability to continue or return to relying on the defined benefit plan as the core of their retirement benefit strategy, differentiating themselves competitively in a positive manner to a labor force eager to gain and retain financial security in an era of increased personal assumption of financial risk.

I humbly thank you for the opportunity to present my opinions to the Committee.

Chairman BOEHNER. Dr. Ghilarducci.

STATEMENT OF THERESA GHILARDUCCI, PROFESSOR OF ECONOMICS, UNIVERSITY OF NOTRE DAME

Ms. GHILARDUCCI. Hello. I am also honored by the invitation; and I hope that my research and my observations will help your deliberations.

I evaluate all pension reform by answers to four questions.

The first one is, did this bill encourage better funding? Believe it or not, most pension funds are well funded and behave properly. I painstakingly developed a data set of 670 firms of over 18 years and linked them with firm profitability data and other kinds of data. I found that the vast majority of firms contribute more when their funds earns high returns and they contribute less when their funds aren't doing so well. And that is good news. It is what ERISA intended.

The bad news is that the limit on the funding ratios didn't matter very much. So that, though it is reasonable to raise the funded ration to 150 percent, I don't have high hopes it will significantly improve the plan funding. Most plans were not limited by that lower ratio. But prohibiting the use of credit balances for underfunded plans that this bill proposes may discourage well-funded plans from accumulating them, making bad times worse for good DB sponsors. We need to encourage pro cyclical accumulations.

Now freezing benefit accruals at plans that are 60 percent funded does make sense, but I have serious problems with the limits on benefits increasing for plans that are funded at 80 percent.

One of the reasons that the PBGC stopped publishing the "iffy fifty" list which publicized underfunded plans that many plans weren't iffy at all, even if they were below the 90 percent funding ratio. But some were iffy, so I do support making those 4010 forms public. It is absolutely crucial.

Now classifying companies by their funding ratios and not their ability to pay could let profitable companies purposely underfund the plan so they would have an excuse to renege on benefits. That would supersede the intended ERISA, and it would supersede any notions of fairness because workers paid for their promised benefits through, indirectly or directly, by taking less compensation in wages or other places. Real pension protections stops, it does not encourage, this reneging.

Now everyone knows, I guess on this panel as well, that prohibiting lump sums could improve plan funding. Findings from behavioral economics and common sense show that they don't result in real pensions and they bleed pension funds dry. But this plan—actually, this bill actually encourages lump sum payouts because they make them cheaper.

The second question I ask, is this bill fair to workers and retirees?

Well, the lump sum provisions aren't fair. The bill raises the valuation rates to reflect what only high-income investors can attain. It lowers the lump sum by 27 percent in retirees who invest in only safe money market funds.

Further, the bill lessens protection and shifts most of the costs of funding failures to workers who had no role in the decisions that caused the failures. Shut-down benefits make plant closings humane. But it is very important for all of us to realize that workers pay for those shut-down benefits through lower wages, deferred wages. Even more unfair is that this bill denies shut-down benefits to workers but doesn't touch manager severance pay and executive buyouts. Eliminating shut-down benefits often just makes the deal more profitable to another buyer. I saw that happen in my area with the steel companies.

This bill isn't fair because it also allows workers' accrued benefits to be cut when the fund hits that arbitrary 80 percent of funding ratio, though manager and salary benefits are only cut when they reach a lower ratio.

Now, the United Airlines' decision was unfair. The PBGC bypassed the labor management negotiations, which could have saved benefits, and cut their own deals to terminate the plan. This bill does not encourage that from happening again.

Third question, does this bill encourage firms to stay in the DB system?

I fear not. Besides being unfair and not improving the funding, and it could chase companies from the DB system. The premium cost hikes are over and above what is needed.

The advice portions tacked on the bill bias the bill towards 401(k) plans and that is especially glaring because there is no provision in this bill for the cash balance provisions.

DBs are important to the economy and will be as the labor force gets older. They reduce training costs, and they reduce turnover costs. Older women workers are much less likely to retire at 65 if they have a DB plan. We need those older workers.

But this bill could raise the costs of uncertainty. The yield curve, as already been mentioned, causes increasing uncertainty. PBGC defaults and a surprise hike in premiums also cause uncertainty. They may overwhelm these benefits I just mentioned and employers would leave the system.

Does the bill help distressed companies maintain their plans?

It doesn't do much to not prevent companies from trying to figure out ways to not terminate it. In fact, without provisions to slow down those terminations, it could lead to a race to the bottom.

In sum, how could you all protect real pensions?

We need meaningful rules to structure cash balance plans.

We need to raise premiums in a nonpunitive fashion and think out a way for PBGC to have a reassurance plan. That is the fatal flaw in the PBGC. It was only meant to take care of situations where a company went bankrupt, not whole industries going through restructuring and failure.

We should help troubled companies stay in the system. You did that with the airline bill.

You should slow down terminations.

And I say just prohibit lump sum payouts. They are not fair.

Thank you.

[The statement of Ms. Ghilarducci follows:]

Statement of Dr. Teresa Ghilarducci, Professor of Economics, University of Notre Dame

I appreciate the invitation, Chairman Boehner and Ranking Member Miller, and members of the Committee, to testify on the pension reform bill. I hope my research and observations will help your deliberations.

I evaluate pension reform by answers to four questions.[1]

1. Does this bill encourage better funding?

My research observes the same 670 pension sponsors for 18 years (no agency or researcher has this data set) and, after controlling for most factors[2] determining pension contributions per participant, I conclude the vast majority of companies responsibly fund their plans despite popular conceptions. Firms contribute more to their funds when the funds are doing well and the funding ratio did not inhibit funding. That's good news. That is what ERISA intended. The bad news is that pension funding falls when health insurance costs rise and when firms introduce a 401(k).[3]

In sum, existing funding rules work well for the vast majority of the funds. Raising the funded ratio to 150 percent (for qualified contributions) is reasonable; but don't have high hopes it will significantly improve plan funding—most firms were not limited by the lower ratio.

Prohibiting the use of credit balances for underfunded plans may have the unintended consequence of discouraging DB plans and making bad times worse for DB sponsors who sincerely want to preserve their plans. We need to encourage accumulations in good times. I doubt that the prohibition would have prevented United's pension plan default.

Freezing benefit accruals at 60% makes sense, but I have problems with the limits on benefits for 80% funded plans. One of the reasons the PBGC stopped publishing the "iffy fifty" is that the many plans weren't iffy at all even if they had below 90% funding ratios.[4]

Classifying companies by their funding ratios and not their ability to pay could let profitable companies purposefully underfund the plan as an excuse to renege on benefits that workers paid for by deferring compensation.

Prohibiting lump sums could improve plan funding. Findings from behavioral economics and common sense show they don't result in real pensions and they bleed funds dry. Lump sums came about to please management and sponsors seeing their

cost may still be chary of being the first to revoke them. Congress can help them by banning them.

2. Is the bill fair to workers and retirees by protecting benefits?

If lump sums are kept this bill is unfair. Under current law, worker lump sums are valued using 30 year treasury rates (now at 5%). The bill raises the rate to investment grade corporate bonds (6%) which individuals generally do not have access to and lowers the lump sum by 27%.[5]

The whole idea of ERISA and pension protection was to ensure that promises made and indirectly paid for by workers weren't reneged on. But this bill steps away from protecting accrued benefits by shifting most of the cost of funding failures to workers. Shut down benefits make plant closings humane; but they are mostly eliminated in this bill- even though workers gave up wages for them. Even more unfair manager severance pay and buyouts aren't. Eliminating shut down benefits often just makes a deal more profitable to another buyer.

The bill further moves away from pension protection by allowing workers accrued benefits to be cut when the fund hits a 80% funding ratios, though manager and salary plans only have to be below 60%.

The PBGC's decision in the UAL case is an example of moving away from ERISA's intent. The agency bypassed union/company negotiations[6]—which could have saved benefits—and cut their own deal and involuntarily terminated the plan cutting benefits. The decision shifted all the costs of the company's problems on the oldest and most loyal workers caused by factors out of their control.[7]

A fair move would have been the PBGC and Congress segregating the airline pension liabilities and paying them off with a temporary airline ticket tax. The rationale is that low-cost, start-up carriers and the passengers are benefiting from the legacy left by older workers and firms so they should pay some of the legacy costs.[8]

3. Does the bill encourage firms to stay in the DB system?

I fear not. First, the bill's premium cost hikes are not only high relative to expected losses from healthy plans but worse; companies could expect even more hikes because the PBGC suffers from the serious flaw of having no real plan reinsurance other than stiffing the healthy sponsors and taxpayers of last resort. For example, a user-fee revenue stream could reinsure the PBGC for the airline industry problems. (Future DB sponsors need the confidence Congress could provide by reinsuring the PBGC for a catastrophe like an industry collapse the agency was never structured to deal with: Studebaker failed but the U.S. car industry was doing well.)

Two, the advice portions tacked on the bill may have unintended consequences of raising hopes that advice and education improve 401(k)s. Believe me its depressing to educators that research shows workers who attend investment advice seminars are LESS likely to change their contributions or allocations than those who didn't.[9] Also by emphasizing investment advice in this bill implies workers' ignorance alone causes 401(k)s' limitations as a pension system.[10]

Third, the bill's bias towards 401(k)s is especially glaring since the bill has no protection for firms wanting to provide the future of DB plans—cash balance plans.

(I am mostly disappointed in the bill for not encouraging the PBGC for not living up to the law[11] that mandates the PBGC seek ways to strengthen the defined benefit system.)

DBs are important to the economy. Firms, especially as the workforce ages, will want DB plans; they engender worker loyalty and reduce turnover and training costs.[12] Older women workers are much less likely to retire at 65 if they are in a DB plan.[13] DB participation is up slightly in retail and professional services.

The last question for a pension reform bill is:

4. Does the bill help companies that are in bankruptcy and/or distressed?

The bill will not prevent firms in bankruptcy from dumping liabilities easily. Terminations produce lemming-like behavior and a race to the bottom.[14] The bill should also put procedures in place that slow down terminations and make them subject to negotiations between workers and firms.

Pension reform should also help employers find ways to stay in the system and survive short-term difficulties. The bill does not recognize that companies often need to have underfunded plans for some time, e.g. in a recession. Also penalizing companies in bad times[15] could make DB pension plans more vulnerable and less attractive.

In sum, how Congress can help protect real pensions?

1. We need meaningful and encouraging rules for structuring cash balance plans—I trust you are working hard on that.

2. Raise premiums in a non-punitive fashion and provide assurances to high performance DB sponsors that the PBGC has a thought-out reinsurance plan, not panicked premium increases.

3. Implement funding rules that freeze benefit accruals for funds with below 60% funding, but don't make 80% a blanket trigger. Shutdown benefits are crucial to fair restructuring and owners should have to reveal these costs better—your disclosure requirements will help.

4. Help troubled companies stay in the system, rather than putting more pressure on their funding when they are least able to pay.

5. Slow down terminations to prevent race to the bottom in an industry.

6. Prohibit lump sums from qualified plans.

7. Worker representation would be an efficient and effective way to enforce the commendable disclosure requirements.

ENDNOTES

1. Does the reform encourage better and stable funding; is the reform fair to workers, retirees, executives, shareholders, customers, and tax payers; does the bill encourage the formation of "real" pensions; a modest stream of lifetime income; and do the proposals help firms adjust to business cycles and industrial trauma?

2. Firm profitability, normal cost, age of plan, cost of capital, and other determinants of funding contributions, 401(k) share of total pension contributions. See http://www.nd.edu/?tghilard/ Choose recent papers: "Did ERISA Fail Us Because Firms' Pension Funding Practices Are Perverse?"

3. Firms did not engage in perverse behavior—reducing funding when times are good only to find a short fall and more funding requirements when times are bad. The airline industry sponsors are exceptional they decreased DB funding even when the rest of the economy was doing well.)

4. Because the company sponsors were viable in the medium term and publishing their names unduly worried workers and investors.

5. It is reasonable that this bill allows the rate to vary by age—so older folks would presume to have lower and safer returns. But raising the interest rate substantially lowers the lump sum:

What the lump sum would be	If the interest rate is	To pay this amount for 25 years
$99,999.98	at 3%	$5,742.79
$73,412.08	at 6%	$5,742.79
$52,127.50	at 10%	$5,742.79

Also insurance companies discriminate reduce annuities for women, because on average they live longer. Women lose 30%. (The justification for raising the rate is that the Treasury rate is "artificially" low. This is a very curious and confusing judgment. Rates are set by markets, which are seen to be less artificial. What is artificial about the current market rate—it is still the best judgment of what a risk free long-term rate is.)

6. Held under Section 1113 of the Bankruptcy Code.

7. What is happening in airlines happened in railroads in the early 1900s. The first private defined pension plans were established by railroads in 1865, they were the airlines of their day. In 1919, the maturing defined benefit railroad pension plans were threatening to default for two familiar reasons. Workers were beginning to retire in large numbers and small start-up companies, that paid low wages and provided no benefits, invaded the legacy railroad's routes by slashing haul rates. The nation could have chosen to allow what the PBGC and Untied Airlines agreed to happen, let pensions default and have the workers pay for the industrial restructuring. But the American decision-makers viewed that solution as unfair and the government mandated a multiemployer pension plan, the Railroad Retirement fund that all railroads pay into. The rationale was that the low-cost, start-up companies were taking advantage of the infrastructure the mature, legacy railroads and their workers created and needed to pay for the legacy benefits they were enjoying. To this day railroad workers have a strong defined benefit plan portable anywhere in the industry regardless of the death and birth of individual railroad companies.

8. The agency segregates liabilities occasionally with idiosyncratic bankruptcies like TWA. Congress and Sec. of Labor Elizabeth Dole created a similar tax for coal to pay of miner's health liabilities. Another creative solution is to put all airline employees into an airline retirement fund like the railroad workers. Delta and the airlines will keep their DB plans, not forced to follow United and crash their plans. Once airlines are out of the PBGC and into a multiemployer plan for the industry, the rest of the defined benefit system will be in better shape.

9. See Steve Venti's excellent overview of 401(k) investment behavior. http:// www.dartmouth.edu/?bventi/Papers/venti—savings—12-04.pdf

10. Instead of adding another layer of for-profit vendors why not a worker representative on the board of trustees adds for both DB and DC plans. Through their representative they would have a genuine link and awareness of ongoing pension funding issues. A worker representative would further transparency goals. This bill sensibly requires more complete and timely Form 5500s. Pension plans must notify participants of the funded status of their plan within 90 days and plans must provide summary reports within 15 days of the Form 5500 filing deadline. The act will also implement the investment advice proposal that passed the House in the 107th and 108th Congress, which allows employers to provide workers with a qualified investment adviser and include fiduciary, and disclosure safeguards.

11. The Employee Retirement Income Security Act: (Title 29 Chapter 18, Subchapter 111 USC Sec. 1302) gives three duties to the Pension Benefit Guaranty Corporation. The first is "(1) to

encourage the continuation and maintenance of voluntary private pension plans for the benefit of their participants.

12. It would be wrong to take away the lesson from the United Airlines bankruptcy and pension default that the idea of pension insurance is deeply flawed or that defined benefit pension plans are extinct and of no further use to employers. Companies sponsor defined benefit plans for vital economic reasons—they help retain valuable employees, they provide long service workers with a certain pension source that combined with Social Security and some home equity and health insurance can carry a middle class worker into a middle class retirement.

13. www.nd.edu/tghilard choose recent papers and click on "The Distribution of Retirement Leisure"

14. Shareholders and managers faced with competitors who can shift costs to the PBGC are encouraged to mimic.

15. Higher premiums, faster and higher funding requirements, and limited credit balance use.

Chairman BOEHNER. Well, I am glad to see everybody is on the same page in full agreement.

I just have a question. It is kind of interesting that the business community thinks we have gone too far, and the professor thinks we haven't gone far enough. The administration thinks that we have weakened their provisions, yet my phones haven't stop ringing from businesses who think that it is just too hard to do.

Let me explain just explain to everyone that we have a very difficult job to do. We know that the defined benefit pension system is in a crisis. We know that we have to do something about it. And the administration's approach was really focused in on saving the PBGC. But I think there is a lot more we need to do than just saving the PBGC. That clearly is one of our goals. But trying to keep employers in the defined benefit system is critically important to those workers who are entitled to those benefits. Requiring companies to actually meet the commitments they are making to those employers are—in fact, are important goals as well. So the vision we have with this proposal is much broader than the administration's and I think touches all of the goals that we need if we are truly going to reform the defined benefit system.

Now the modified yield curve understandably is of some concern because it requires plans to fund liabilities as they come due, an inconvenient requirement if you don't want to pay for what you promised. Now I don't think anyone can argue against what we have here with a straight face. In fact, some of the testimony we have seen says that the companies can't tell when their liabilities are coming due. So if accuracy of the modified yield curve is a concern, can somebody explain to me why one rate—one rate as we used to have under the law—is more accurate than a modified yield curve?

Ms. Franzoi, I will let you tackle that.

Ms. FRANZOI. Okay. I think with the single rate, that it is based on the corporate bond rate, it is realistic to what is happening out there, what returns are earning. And when you look at this modified yield curve, which is extremely complex, it is a snapshot picture. What I see today in my plan, is not going to be what it looks like 3 months from now. It varies dramatically, depending on your company, depending on your turnover, depending on the age of your employees.

Chairman BOEHNER. Well, the demographics of your plan participants could not change dramatically within 3 months, I wouldn't think.

Ms. FRANZOI. It could within 6 months if you are in a company that has high turnover, if you are a company that is in a lot of ac-

quisitions and divestitures, which really is happening a lot in our businesses out there.

So when I look at plans that I have worked with over the years, I have seen dramatic changes over like a 3- or 4-year period of time and sometimes in a very short period of time.

So this would dramatically impact many employers to go to this——

Chairman BOEHNER. But how would a single rate, let's use what has been in law—the 30-year Treasury bond, how would that rate—how could it be more accurate to use a rate like that than what we have outlined in the bill where you have got three different rates based on the maturity or the demographics of your employees whether they are going to retire in 0 to 5 years, 5 to 20 years or over 20 years? And by blending the interest rates applicable to those three areas you get a much more accurate picture of what your liabilities are.

Now, Mr. Pushaw, you are the expert here, much more so than I. So I will let you respond.

Mr. PUSHAW. Thank you, Mr. Chairman.

The choice of interest rate to use to value those liabilities is fairly irrelevant when you try and match up with the demographics. What I mean by that, your people are going to do what your people are going to do. Your demographics—your people are going to retire when they retire; they are going to die when they die. The choice of the interest rate does not impact that.

So it comes down to, when are those cash flows going to come due? And surprisingly perhaps, that corporate bond rate is probably right, is probably the perfect rate for 5 percent, 7 percent of the plans out there coincidentally.

But there are other extremes of when those cash flow needs come due, for example, in the legacy industries where there are lots of retirees, and there are lots of deferred vested employees and there are lots of older workers that have huge benefit liabilities coming due. That is what will be captured by a modified yield curve approach.

It cannot be captured by the use of a single rate. A single rate cannot fit all. The yield curve with the flexibility built into it with this approach is intended to be modified to better suit the wide range of plans we have in America today, sir.

Chairman BOEHNER. Ms. Franzoi, you made reference to and raised concerns about the PBGC premium increase, and I wanted to ask you whether you prefer what we have in our bill, which phases this in over 3 years for employers who are funded at 80 percent or above in their plans and only gives 3 years to those who are below 80 percent—they have to get their premiums up to $30. Or would you prefer the administration's approach, and that is to have it all go into effect next year?

Ms. FRANZOI. Well, if you are asking me if I prefer the phased-in versus the immediate, I would support the phased-in over the immediate.

Chairman BOEHNER. That is what I thought.

Now, you also raised concern about the fact that we index these premiums to a wage indicator, and I think I have to respond that PBGC premiums have not increased since 1991. Why? Because

Congress did not act. I think, looking back clearly, it was irresponsible for the Congress not to have put an index in place so that those premiums would, in fact, increase regularly. And given the condition of the PBGC, I don't think we have any choice but not only to increase these premiums, but in fact to index them.

But having said that, I want to make it clear to everyone that we do not believe—and it is clear that the premium increase alone will not solve the problems at the PBGC—that a lot of the policy issues that we have in this bill will, in fact, require employers to better fund their plans, thereby reducing the risk—the long-term risk to the PBGC.

I have overused my time. Let me recognize my colleague from California, Mr. Miller.

Mr. MILLER. Thank you, Mr. Chairman.

Dr. Ghilarducci, you supported the idea that the 4010 information should be made available. I would just like to recount a couple of efforts in the past, what we have suffered from this.

In 2002, the Bethlehem Steel Corporation reported that its plan was 85 percent funded on a current liability basis. But when it was terminated, of course, it was a $3 billion loss to the PBGC, or to the fund.

LTV reported that its fund on a current basis was 80 percent funded, and when termination came along it, in fact, was less than 52 percent. And USAirways reported that it was 94 percent funded on a current liability basis, and when termination came, it turned out it was only 35 percent funded.

So the government had this information, but employees, pensioners, investors did not have this information. And there is a world of difference between—as it turned out there was a world of difference between the claim of current liabilities being 94 percent funded and at termination of, 35 percent funded. So I appreciate and I hope that this committee will continue to look at the question of whether or not the public, the employees, investors and others are entitled to this information.

I want to go to another point that you raised in your e-testimony, when I was hearing what you were saying on that online discussion. And that is whether or not PBGC to some extent, even though its mandate is to protect defined benefit plans, appears to be putting in a one-size-fits-all. We now see Delta and Northwest and a couple of other airlines saying, We want to modify; we would like to have a chance to stretch out and hold on to these assets for our employees, our retirees.

Can you elaborate on other proposals that have been made here? I know that you mentioned in your testimony that Secretary Dole created such a fund for, what was it, the mine workers, right?

Ms. GHILARDUCCI. Yes, the PBGC does have a lot of leeway to negotiate with companies, work with them early. If the public knew about the termination liability and the probability of termination, that would aid the PBGC in working out a deal to maintain benefits. That would be—that would match what the PBGC is supposed to do under the law, which is to try to maintain the defined benefit system.

We have had defined benefit plans since 1865 in the railroad companies. Those legacy railroads developed defined benefit plans,

and in 1910 those workers were older and they were retiring and those DB plans, just like now, were very expensive. At the same time, new low-cost start-ups—these were railroads, not airlines, but it should sound familiar because it is exactly the same kinds of situation—were taking advantage of the establishment of railroad travel and commerce in the United States.

They were using their lines, but did not have unions or any pensioners. They got the benefits of all of those legacy workers and railroads, but they paid none of the costs. The Congress and the employers and workers developed the railroad retirement plan funded by all people taking advantage and using the railroad system. They pay a tax on railroad.

Move forward to Elizabeth Dole working out a coal tax to pay for miners' retiree health. These are the kinds of things that PBGC could have done. It could have segregated out the airline industry liabilities and found another revenue stream to pay for it. The PBGC did that with the TWA bailout, and Carl Icahn had to fund that plan specially. So there are precedents for having creative solutions, and this PBGC did not try.

Mr. MILLER. The concern in terms of much of the anecdotal evidence we receive and what has been reported in the public press is that somehow the opportunity to complete those negotiations was short-circuited in the United negotiations.

Ms. GHILARDUCCI. Yes, I think the PBGC panicked. There were a lot of people saying, Terminate those plans, bypass the negotiations, do not let them work it out. And a lot of people were saying, Give us time. The PBGC could have given them time and those benefits could have been preserved to minimize the losses.

Mr. MILLER. We have seen—since the advent of the PBGC, the private sector has created an enormous array of financial facilities to make care of really huge liabilities—in some cases, national liabilities; in some cases, corporate liabilities, event liabilities—and they have been able to work out these kinds of facilities. And I just wonder to what extent in this legislation we should make that available because, again, different companies will have different scenarios.

Different events will cause short-term/long-term restructuring events, but the PBGC ought to have that available. They ought to be to go to the reinsurance industry and say, How do we work this out? We want to make this decision a different way or we have different interests. We see our long-term interests being different, and yet I am worried because of the liabilities of PBGC that currently exist, the fear of taking on additional ones.

The taxpayer exposure gets you into sort of one-size-inside-the-box thinking. We will take these, grab a billion and a half from United and hope things work out, when you have an array of financial instruments and risk-sharing instruments that have been created that we couldn't even contemplate 10 years ago.

You are shaking your head.

Mr. PUSHAW. The issue of PBGC is an interesting one. It seems distasteful to have PBGC only act as a repository to mistakes. It seems, among the comments that I have just heard, that their role seems better suited to employees in an advocacy role, not in an insurer role. And I certainly do support your comments, Mr. Miller,

about there is a large private insurance market out there that probably has a lot more experience and a lot more success in hedging those kinds of liabilities than the PBGC has shown us in the past 10 years. So the privatization perhaps of the insurance aspect would be interesting.

However, also some of the numbers that we hear from PBGC, I am quite reluctant to put much faith in them. It seems odd that they can put their own assignment of value on these liabilities, that happens to be different from anybody else's—I daresay likely different from the private insurance market.

Mr. MILLER. I know that we are running over, but one of the discrepancies is the termination liability and the current liability.

Mr. PUSHAW. One of the many problems you have with actuaries is that we have so many different measures of the same single obligation. But you know what, the PBGC liability is by far the largest assignment of value that you will see anywhere else.

One of the things I think this bill does is, it collapses some of these different measures into a single measure that in my opinion is more accurate, more of a market value liability. And that, I think, is the one—maybe even the at-risk liability with its little load in there is the one that PBGC ought to be using for their own books.

And then this other aspect of including deficits on their books before the events have even occurred seems to rhyme a little bit too closely for my pleasure with some of the other accounting issues that we are seeing in the headlines for the past couple of years. Why book a loss before the event even takes place?

So the measure of the liability and the accounting methodology does not seem to jibe with the rest of the accounting industry.

Mr. MILLER. That and other issues will be answered in these hearings.

Mr. JOHNSON [presiding]. Thank you, Mr. Miller.

Do you each agree that pension plans should be adequately prefunded? I think you do. And two of you argued that shutdown benefits ought not to be eliminated, but these benefits are not prefunded, and I don't know how you can stand on both sides of that issue.

Shutdown benefits are just like severance payments and ought not to be paid from underfunded pension plans. Would you like to comment? Go ahead.

Ms. GHILARDUCCI. Shutdown benefits are implicitly funded. It is a possibility that could occur in the industry. They have caused problems before and have caused plans to be very underfunded; but they have been paid in many other places, and it makes the plant closure which often happens on a surprise basis much more humane.

So there have got to be other ways to not eliminate them outright, and also to recognize that if a plan is 90 percent funded, it does not mean it is in danger, 80 percent funded, it does not mean it is in danger.

When ERISA was passed and defined benefits were constructed, the choice was not between no defined benefit plans and 100 percent fully funded defined benefit plans. It was no defined benefit

plans and partially defined benefit plans. So we are going—in this system going to tolerate underfunding.

But when the company is ongoing and there are no new DB plans being formed, that is when it becomes a problem. It is not just the funding issue that is the problem.

Mr. JOHNSON. Anyone else care to comment?

Okay. I am not sure I agree with what you say. Mr. Pushaw, while the administration's proposal eliminates credit balances completely, the Pension Protection Act retains the use of credit balances, but they can't be used to offset real contributions if a plan is less than 80 percent.

What are some of the problems with the current use of credit balances and do you believe the bill adequately addresses some of those problems?

Mr. PUSHAW. Thank you, sir. Yes, I do believe the bill addresses them properly. One of the issues with credit balances is that they stale and they lose relevance. A credit balance can be due to a contribution made in excess of a minimum requirement, and that contribution could have been made 30 years ago, it could have been made 20 years ago. And that credit balance will grow under current law with 8 percent, 9 percent, 7 percent growth year in, year out, decade after decade perhaps, and really have nothing to do with the operations of the plan.

And then, I think, what we are seeing a little bit today is that when a corporation—although these credit balances do afford great flexibilities, when you are on that slippery slope of declining funded status, that is not the time to reach into your pocket for Monopoly money. It is a time to reach in for cash.

Mr. JOHNSON. Thank you.

Ms. Franzoi, you argued against freezing benefits when plans hit 60 percent funding. If neither labor nor management can't or won't control costs in plans, don't you think Congress has to act before the plans go to the PBGC?

Ms. FRANZOI. I think that freezing benefits is really detrimental to the employees who have been working for those benefits. And I really do not see what purpose freezing those benefits serves.

Mr. JOHNSON. Well, it keeps the company from going bankrupt on their pension plans, that is what. And you know and I know that a lot of plans are in trouble, and we have got to resolve that, and you can't make the government pay for all of those plans. That is not our responsibility. PBGC was not formed to do that. It was a protection; you know that.

Ms. FRANZOI. I know that. But I think that the estimate of what the underfunding out there—as Mr. Pushaw said earlier—is not a reasonable estimate of the underfunding. And from the plans I have seen and the plans I have worked with as a plan sponsor, our goal is to keep them well funded; and they have been well funded.

Mr. JOHNSON. Thank you. Appreciate your comments.

My time has about expired, so I recognize Mr. Kildee for whatever comments you have.

Mr. KILDEE. Thank you, Mr. Chairman.

You mentioned, Ms. Franzoi, 29 years you have been involved in this, and about the same time I have been involved. I came to Congress 29 years ago, so we share at least the length of time and ex-

perience. I am sure you have greater depth. As a matter of fact, when in the early days of ERISA, I have to say that there were only about three people in Washington who understood it at that time. That was John Erlenborn a member of this committee, a Republican member; Phyllis Borsi, who used to work for the committee; and my neighbor, Don Myers, who I would walk across the street and pick up some ideas from him. That number has growth, obviously, but I remember those days.

Let me make this statement and ask this question: There is a fear out there in my district and around the country that since United Airlines dumped its $6.6 billion into the PBGC, there is a fear, really growing fear that this may broaden out.

I have attended in the last 2 weeks labor meetings in Saginaw, Bay City, and Flint, Michigan, and while they are still worried about possible changes in Social Security, they are becoming deeply concerned now about the safety of their pension plans. They really face now—many of them face what they feel is a double whammy—Social Security uncertainty and now the pension plans.

Let me ask you this: What are the more timid parts of this bill, 2830, or the more bold parts?

Or maybe put it in another way: What are the greater deficiencies and the greater strengths? We will start with you, Ms. Ghilarducci.

Ms. GHILARDUCCI. The biggest weakness in this bill is that it does not recognize that the way to strengthen the defined benefit system is to get new plans in with younger workers. It does not address everything that is needed to make DB plans more attractive. Inherently, they are. Employers will need them as the workforce ages, but there is nothing in the bill that expands the universe of DB plans.

Some of the best aspects of the bill are the disclosure requirements. It is ridiculous that it takes so long to get information from the form 5500, and the 4010s do have important information in them.

Mr. KILDEE. Mr. Pushaw?

Mr. PUSHAW. Thank you, sir.

I think one of the key improvements here with this bill is the change of focus in the rules—in the funding rules themselves. ERISA instituted a funding methodology that looked 30 years down the road, looked very long term. And we focused our eyes when we were developing these minimum funding requirements on the peak of that summit so far away.

As long as we are following that path to the future, it did not really matter under the rules what happened today.

And what this bill does is, it refocuses us from where ERISA did, which back in 1974, that was the sign of the times with the economics/capital markets/business environment back then—much more stable than it is at least today.

This bill takes our focus from the long-term, short-term bedeviled, and refocuses us on the short term, what people have earned today. Security now; not, you know, we will be okay in 10 or 20 years when our investments earn 8 or 9 or 10 or 11 percent.

So the shift in focus from long term to short term, and funding at 100 percent rather than what the current DRC rules have—

where 80 percent is okay, 90 percent is better, but we do not care about anything better than that necessarily—I think it is an improvement; followed by the other aspect of what we would refer to as the market valuation of the liabilities using the modified yield curve approach as opposed to leaving it to the discretion of the individual actuary on the plan, what they think that liability might be valued at, which is typically again a long term, what our portfolio of assets might earn over the next 30 years.

Mr. KILDEE. Ms. Franzoi?

Ms. FRANZOI. Well, I think this bill is a first—a good first attempt. I think in many respects it does not do enough to encourage employers to continue to maintain their plans, and while I agree with disclosure, I have an inherent problem with the 4010. It is based on a $50 million deficit, which when that went into place in the early to mid-90s when they did away with the top 50 plans, that might have been a significant number; but I can certainly look at my pension plan and how great our assets have increased.

And you could have a plan, a company that has multiple plans, a large controlled group, and each plan could have $5 or $10 million of underfunding, and they are required to file that 4010. So that could really create concern, unnecessary concern, in employees for a plan that is well-funded.

But if you look at the overall controlled group, it is not that I have a problem with the disclosure, but it needs to be meaningful and it cannot create fear. And I think with the $50 million index, well, really, it is detrimental to plan participants.

Mr. KILDEE. Thank you.

Mr. JOHNSON. Do the other two of you agree with that statement she just made? You do?

Ms. GHILARDUCCI. I just think that information that might be confusing has to be explained. And if it does not have an explanation, there is something wrong. So I think that is trivial.

I just worry about this bill causing the DB system to end.

Mr. PUSHAW. One of the aspects in the administration's proposal tied some funding requirements to the credit rating of the sponsoring organization.

Now, I agree that should be done away with here. I think it ought to be a focus, on the other hand, of PBGC; and maybe their variable rate premiums should be tied to the credit rating of the organization.

Likewise, the second 4010 calculations might be tied to the credit rating of the organization, because that is when the rubber starts hitting the road. And on top of that, I agree with Ms. Franzoi that $50 million for an organization that has pension plans in the multibillions, the volatility just because of normal operation of a defined benefit plan can swing 50 million plus or minus—that can happen in months—that dollar amount might be looked at to change, but also the way that PBGC approaches their business likely should change.

Mr. JOHNSON. I think we do agree on the full disclosure. That is one of the landmarks.

Mr. Kline, you are recognized for 5 minutes.

Mr. KLINE. Thank you, Mr. Chairman. I want to thank the witnesses for being here. It is nice to have some real experts in the room.

We have been working on this pretty hard in the committee, and I think we have brought forward a pretty good bill, which will be changed somewhat as we go forward, but the complexity of this, I find interesting. Because when I talk to my colleagues, we share information about what we are working on, and I mention that we are spending a lot of time on the pension reform, there is a common thread. People look at me, their eyes glaze and they say, This is really complex.

And it is complex. So we appreciate your being here today.

I have got a whole bunch of questions. I want to get at a couple of them. We have seen right here today, as the chairman indicated earlier, that we really are not always on the same page in our understanding of what is going on here. For example, Professor Ghilarducci was very, very clear in saying that lump sum payments are bad and ought to be eliminated. But I noticed in your testimony, Mr. Pushaw, that you had some redeeming qualities for those lump sum payments.

I think that the professor's concerns were principally that it takes cash away from the longer-term benefits. Could you, Mr. Pushaw, again sort of reput into digest form the redeeming qualities of those lump sum payments?

Mr. PUSHAW. Yes, sir. In addition to the comments that are in my written statement, financial planning, when you near retirement, it really does take on a much more important role and a sudden change to that financial picture by a freeze on lump sums seems detrimental to those, whose fault is not theirs, that that funding status slipped like that. There are probably a half-dozen or so redeeming qualities of lump sums, at least, which include things like estate planning, which include things like, you know, My parents did not live past 65, I am not going to live past 65; why in the world would I take a life annuity when I am only going to get a couple of payments out of it? Issues like that where lump sums make more sense.

One of the issues that has been well publicized and has gotten a lot of attention in the past couple of years in this town are the negative aspects with lump sums. I believe some of that negativity is due, in fact, to the PBGC. It was their action back in the 1980s, mid-80s, that actually they stepped in and started telling pension plans, pension plan sponsors, that, No, we do not want you to pay a lump sum that is $100,000 for this retiree; we want you to pay $130,000 to this retiree because that is what we think the right value is.

So it is that disconnect—and that is the disconnect I mentioned in my verbal statement, sir—that when you have an outside influence all of the sudden dictating what the value of the benefit should be, compared to what the plan sponsor, what the plan document, what the employees even expect, there are going to be some bad things that happen.

So when you have an annuity option and a lump sum option, the annuity option might have an actuarial value of $100,000. But the lump sum that you are being forced to pay out at an elevated, sub-

sidized level of $130,000, that is how I think the picture is formed that lump sums are a drain on assets, because the plan is only holding 100, yet they are forced to pay out 130. That does not make any sense.

So one of the aspects of the bill that I think is very favorable is actually linking back the valuation of what the plan expects to pay in that lump sum based on mortality tables and modified yield curve and using a very similar, if not the same, mortality table and modified yield curve approach to determine lump sums. That way, if the plan is only holding $100,000, the lump sum and the annuity will all be the same value. It will be $100,000.

So you cannot forget that, yes, we might pay out a lot of money in lump sums, but also you are discharging your liability as well on an equal basis. If a plan happens to be $100 underfunded today and tomorrow I take a lump sum under these rules, the next day it will be $100,000; it is not going to exacerbate the situation.

Mr. KLINE. Thank you. I see I am out of time, but the professor deserves the remaining 30 seconds.

Ms. GHILARDUCCI. Let me be clear. Lump sums, in my view, don't have any place in a defined benefit system. People accumulate lump summability in 401(k)s. The defined benefit plan is the only place where people, with Social Security, can get a modest income for the rest of their lives.

This bill would actually reduce the lump sump because it raises the interest rate, and only people with a lot of income who are very sophisticated can get that interest rate. The rest us take that lower amount, put it in a money market and we are in a worse way than we would be if we took an annuity.

Mr. KLINE. Thank you, Mr. Chairman.

Mr. JOHNSON. Thank you, Mr. Kline.

The gentleman from New Jersey, Mr. Andrews.

Mr. ANDREWS. Thank you, Mr. Chairman. Good morning. I would like to thank the witnesses for their outstanding testimony. For some of you, it is a return engagement. We are glad that you are here.

I have a strong bias on this matter and that is toward defined benefit plans. I know they are good for the participants. I think they are very good for employers, because they provide a strong incentive for employees to stay with an employer; and I know that they are good for the economy, because they provide a very important source of income for retirees above and beyond Social Security.

Unfortunately, my bias flies in the face of the statistical trends. The number of plans is shrinking. The number of new plans being created is virtually nonexistent. And I look at this bill through the prism of what can we do to reverse that trend.

My instinct is that there are two things that we need to provide at the very least. The first is a greater degree of certainty for employers' decision making about what the ground rules will be for decisions that they must make in continuing or starting a defined benefit plan.

And the second is the degree of flexibility that we give the employer to deal with changing market conditions and changing competitive demands on the employer.

I wanted to ask Ms. Franzoi the question about the modified yield curve. I think you and I agree that despite yeoman efforts by the chairman to improve upon the administration's proposal, the modified yield curve proposal still raises some concerns about its complexity and ambiguity.

What should we do instead, in your opinion, to do the interest rate fix? What should we do instead of the modified yield curve, assuming that we wanted to do something beside the modified yield curve?

Ms. FRANZOI. Thank you.

I think the temporary fix we have right now, tying it to the corporate bond rate, is something that seems to be working; and I would support that—we would support that over this modified yield curve.

The modified yield curve, it really is very, very complex. I am not sure how you even start explaining that, how you calculate it. And as one other member of the committee said, people's eyes glaze over when you start talking about retirement plans. I think this is an area of so much complexity, we need to simplify plans.

Mr. ANDREWS. My concern is not the eyes-glazing-over problem; it is the eyes-slamming-shut problem. If there is too much complexity, a decision-maker might say, Let's not do this at all, because we do not know what obligations we may have.

Professor Ghilarducci—this goes to flexibility—I was interested in your summary about how to encourage and protect what you call "real pensions," and the first point of your summary is, we need meaningful rules for structuring cash balance plans.

I am one of those who believes that cash balance plans can sometimes be unfair. But they are not inherently unfair, and I believe that the law should specifically and expressly authorize cash balance plans. If we were to do so, give me your opinion on the meaningful and encouraging rules that you think we ought to adopt that would protect pensioners, but make these plans viable.

Ms. GHILARDUCCI. Good cash balance plans do not have a wearaway. They protect the benefits of older workers. They are fairly well-known. There is a list of them. The GAO report has good ones.

I want to emphasize that when I was at the PBGC, late 1990s, early 2000, we said around the table, the only hope for the defined benefit system are cash balance plans. The PBGC could have put out a model cash balance plan, could have promoted a cash balance plan among vendors; and this PBGC did not move on that.

Mr. ANDREWS. The final point I would make: I would encourage members of the committee and the panel to think about ways that the cost of the PBGC revenue problem be spread more equitably to those who created it.

My sense is that 80 percent of the PBGC's problem is attributable to permanent, deleterious conditions in two, maybe three industries—airlines, steel, maybe automotive manufacturing—and I don't think that those problems are the fault of the plans in those sectors. I don't think they are the result of cyclical changes in those sectors. I think they are the result of 9/11 in the case of the airline industry to a great extent, and I think they are the result of trade dynamics with steel.

If that is the case, then I would hope we could work together with the Ways and Means Committee and others to find a way that those that are written, well-managed, well-funded plans do not have to come to the rescue of those who are unlucky enough to be in an industry that I just described.

I see my time is up, and I thank the witnesses.

Chairman BOEHNER [presiding]. The Chair recognizes the gentleman from Texas, Mr. Marchant.

Mr. MARCHANT. Thank you, Mr. Chairman.

As far as your testimony about you do not think that it is fair, the premium structure that has been proposed in the bill is not fair, how would you make it fair?

Ms. GHILARDUCCI. There is an excellent paper done by economists at Watson Wyatt. They pointed out that raising the premiums so quickly—even a 3-year phase-in is still quick from 19 to 30—really penalizes healthy companies who probably will never have to make themselves available to that insurance. It increases their contribution to the system 340 percent of expected losses, whereas the troubled firms only have to pay like 100 percent, a little bit less than 100 percent.

So it is just an odd structure, and it is an odd—huge increase. It looks as if it is punitive, punitive to these companies because Congress did not raise their index long ago.

Mr. MARCHANT. And you also testified that you thought that we should maintain the defined benefit plans for companies. And if you were a CEO now, going into a brand-new company, could you imagine watching these hearings and reading what you are in the paper and going to your board and saying I think the thing we need to do is do a defined benefit plan?

Ms. GHILARDUCCI. I would be really worried, and if this bill passes, I wouldn't adopt a defined benefit plan.

I would hope that you do not go there. That you actually in these hearings help CEOs be certain that the defined benefit plan won't be costly or uncertain, because they know there are benefits to it.

Most CEOs want older workers to stay on board. We are coming into an era where we are going to have labor shortages. You have to do more here to encourage cash balance plans and to not penalize plans for having a DB plan. We have to encourage them to have credit balances. Maybe they shouldn't be stale.

But we have to tell executives if they have a DB plan, they can fund in good times and draw on it when their plans are underfunded. This bill does not allow them to draw on those credit balances as much as it does now when times are bad; and that belies the purpose of those things.

Mr. MARCHANT. Mr. Chairman, I am going to give the balance of my time to Mr. Price, when it is his time to come to speak, if it is all right with the Chair.

Chairman BOEHNER. I am not sure how we do that.

Mr. SCOTT. Unanimous consent that his time be given to Mr. Price.

Chairman BOEHNER. All right. The gentleman asks unanimous consent for his additional time to be given to Mr. Price when it is his turn. Without objection, it will be made in order.

Mr. PRICE. I thank the gentleman.

Chairman BOEHNER. The Chair recognizes the gentleman from Virginia, Mr. Scott.

Mr. SCOTT. Thank you, Mr. Chairman.

Mr. Chairman, I want to get to, I guess, more basic questions about how these things are funded to begin with, because if we are allowing these pension funds to get into stocks, into equities, there are naturally some ups and downs. Equities go through cycles like 1929; 1987 was the day they lost 25 percent of their market share. From 1993 to 2000, the Dow doubled twice; and 2001 to 2005, it has been pretty much where it started off.

If you had gone into some kind of yield curve or some other prediction from 1993 to 2000, you could be almost 100 percent too high. And 2001 and 2005, at least a third, 40 percent or more, underfunded. That is just the nature of equities.

The risk—the employee in these defined benefit plans is not supposed to be taking any risk in the market. That is the whole point of a defined benefit. And we do not want them to get a back-door defined contribution situation where they do take some risk by allowing the plans to get woefully underfunded.

I guess my question is, since we are talking about annuities, what solvency requirements are imposed on insurance companies that have promised to pay annuities and how is that different from what we are requiring for the pension plans?

Mr. PUSHAW. I am not an expert by far, sir, on the insurance laws that are governed by State regulation, State by State. However, the familiarity I do have with that is that the insurance industry offers a number of different investment vehicles that fall into the annuity category, and they range from a guaranteed annuity all the way to a variable annuity.

A variable annuity——

Mr. SCOTT. It is like a defined contribution plan where the employee or the recipient takes a risk in the market, and a guaranteed annuity is a defined benefit plan where you are looking for a defined benefit. If the market does well, the insurance company does well. And if the market goes down, that is the insurance company's problem.

Mr. PUSHAW. And your comment is about how those assets are invested at the insurance company. The variable annuities, there are segregated accounts, separate accounts at the insurance company if the individual chooses and does play the market and does that to gain the upside in the equity market, and there is some downside protection guaranteed by the insurance company.

The guaranteed annuity, your defined benefit example, sir, is one where the assets are invested—required to be invested in the general fund of the insurance company, and that means bond investments strictly.

Mr. SCOTT. Well, why should the pension funds be any different in terms of what is required for solvency than what is required of insurance companies?

Mr. PUSHAW. I believe it is a matter of risk preference by the sponsoring organization. They believe if the liabilities, for example, are very long-term liabilities, then there is an opportunity if they can withstand—with their balance sheet and their revenue stream and their business, if they can withstand the year-to-year volatility,

they often will take those chances and invest heavily, as we have seen, in the equity marketplace.

Mr. SCOTT. Yes, but the problem is they are taking chances, but they are also bringing the employee, because if they go bankrupt, the employee does not get the promised benefit. Whereas if you had required better funding, the employee wouldn't be at risk; they would expect a guaranteed benefit.

And if you let them kind of go the ups and downs—let me ask another question: How often should you reevaluate the value of the principal to tell whether or not there is enough there?

Mr. PUSHAW. Sir, in part, and I will turn it over to the professor—in part, that is what this bill does accomplish, because right now under the ERISA rules the liability is determined reflecting that additional risk and the expectation of long-term, increased returns because of their allocation to equities.

So I might be—I might have a liability, a long-term liability of $100. But if I restate that, likely I would be doing it with the modified yield curve, then that liability would be higher than it would—actually, my belief is it would encourage employers to reduce their risk because the liability is being valued as an insurance under the solvency type of basis.

Mr. SCOTT. And you can actually buy an insured vehicle—product at that rate; you can actually buy an insured product that an insurance company would guarantee, in addition, to the company, the payment.

Mr. PUSHAW. Notwithstanding some State taxes and profit margins and risk margins that increase the cost to the plan sponsor, generally speaking. Actually, back in the 1960s and 1970s, that is, where the pension industry was, is that the plan was an annuity insurance contract; and each year, every benefit increase, then the insurance company would reach in and buy another little piece of a guaranteed annuity.

Chairman BOEHNER. Professor?

Ms. GHILARDUCCI. If you wanted a liability fully funded at all times, you would have very few pensions. If you invested your lump sum or bought your annuity at a bond rate, as you are suggesting, it would make it safe, but it would make it a very small benefit.

We were right, as pension funds, to go away from that and look more long term and take more risks, because the company would go on—not forever, but the failures would be idiosyncratic.

I have to emphasize to everybody who might hear these hearings and contemplate the security of their funds, the vast majority of pension funds are well funded, that ERISA works for a vast majority of them. We are here today because two industries, steel and airline, have catastrophic risk. And that is what I would like this bill to actually address, how PBGC could be reinsured.

Chairman BOEHNER. The Chair recognizes the gentleman from Georgia, Mr. Price, for 7 minutes.

Mr. PRICE. Thank you, Mr. Chairman. I appreciate that. A little creative yielding, I guess.

I want to thank the chairman for this hearing and for your bill. I commend you for your action and I have heard a couple of folks say that we need to slow down. I am here to tell you that we need to move with all due speed.

We are in, I think, a crisis situation as it relates to a couple of industries, and I would like to focus a little bit on the legacy airline carriers in the airline industry, because I think there is where the problem is most clear.

I have introduced, as the chairman mentioned, a bill H.R. 2106, which is a mirror bill of Senator Isakson in the Senate, that focuses on the airline carriers and allows them to adopt new funding rules for their DB system and allows them to spread out over 25 years their unfunded accrued liability and to pay it down using stable, long-term assumptions and gives them, I think, much greater flexibility.

It does not exempt them from their obligations, which would occur should they go to the PBGC, and obviously that puts great hardship potentially on the taxpayer. It does not provide for any form of subsidy from the Federal Government, and taxpayers, as I mentioned, are limited by limiting the liability of the PBGC through the bill itself.

The airlines have lost $33 billion, $33 billion since 2000, and the PBGC, as has been mentioned by many folks, has assumed 9.6 billion in unfunded pension liabilities from the two legacy carriers that have gone under in the past 2 years. The pension funds of other carriers are underfunded to the tune of $31 billion. We are in a situation where we need to act with all new dispatch.

Last week, before the Senate Committee on Finance, the president of Northwest Airlines, Douglas Steenland, made the following comment: Defined benefit plans are one of the last vestiges of the airline regulation era. Northwest has concluded that defined benefit plans simply do not work for an industry that is as competitive and vulnerable to forces ranging from terrorism to international oil prices, that are largely beyond its control, as is the airline industry.

And I would ask you, Mr. Pushaw, if you would comment on the state of the airline industry and the viability of DB plans within that industry.

Mr. PUSHAW. Thank you, sir.

A comment was made earlier about the number of plan terminations that we have seen over the years. Since 1986, plan terminations have numbered a little over 100,000. Those are startling numbers. They grab your attention. They say, Oh, there is a dinosaur on the way out.

But when you look behind the numbers and you look at what is going on, my belief is that the vast majority of those plan terminations, in any case, were plan terminations of plans in industries and companies that never had any business starting a defined benefit plan.

Mr. PRICE. How about the airline industry?

Mr. PUSHAW. The airline industry is due to its cyclical nature, if nothing else, and ever-increasing competitiveness as it has emerged from regulation. If I was the CEO of a start-up airline today, I probably would not on day one establish a defined benefit plan, even though I think cash balance plans, in particular, are very worthwhile.

On the other hand, as in any start-up organization, if you follow a company on this graph, how it is a start-up and high growth and then maturity, any start-up company would not have one. It might

well be that airlines now are in a stage of decline, but I think it is only a limited decline to what we have always thought about with airlines in the legacy sense. The airline industry is changing and it is due for more change.

The Catch-22 you all find yourself in is, how quickly do we act to support the current level of obligation those airline corporations have to their retirees and current employees on promises they have been making for a long time and how far do we push them for solutions to the solvency issue, getting PBGC to be an advocate there?

And how far can you push them or how far can you give them a little bit more rope to react to it themselves?

I am afraid I don't know the answer to that, sir.

Mr. PRICE. Do you believe that industry-specific bills or measures to address the airline industry are appropriate at this time in view of the legacy airline carriers' difficulties?

Mr. PUSHAW. It seems to make a lot of sense that if there are one or two bad apples—and I do not mean to say "bad" in terms of malfeasance or anything like that—but if there are one or two bad apples in the barrel, and the best of the apples, as both of my panelists have mentioned, are really doing very, very well, then perhaps it does make sense to deal very surgically and in a very limited way with those industries that you have mentioned.

Mr. PRICE. Thank you.

Thank you, Mr. Chairman.

Chairman BOEHNER. The Chair recognizes the gentlewoman from New York, Mrs. McCarthy.

Mrs. MCCARTHY. Thank you, Mr. Chairman.

A number of the questions that I was going to ask have actually been answered. But I think where I want to go is with a lot of the businesses we are finding that they like predictability; and you need predictability to be able to figure out how many employees you have, what time basically are they going to be retiring and are they going to have the funds at this particular time. And what I also understand is that one of the questions that was answered is that a majority of our companies actually have enough money in their funds. It has basically been the Tax Code that has hurt a number of the companies; when they were earning a lot of money, they were not allowed to put a lot of money back in. When times are bad, obviously they do not have the money to put it into it.

So I guess what I am looking for, with the plan that we are looking at through this committee, is that the best plan to have the predictability down the road for basically our corporations?

Ms. GHILARDUCCI. I will be short. I know that everybody wants to say something.

I think that the way that you are treating the current shortfall and the PBGC by hiking premiums a huge amount actually would make a company think, oh, when another industry goes down and the PBGC wants money, they are going to come back to me. They will stiff the healthy companies.

I want to say that the industry approach is the only thing that makes sense. We should segregate out the airline industry's liabilities and pay for it. Pay it down with a $1 or $2 ticket tax, a temporary tax on JetBlue, Southwest, on all of the airline industry like we did with the miners.

But I am answering your question. A move like that from Congress would signal to corporations that we have a defined benefit plan and an insurance plan that takes care of idiosyncratic bankruptcies. We are not going to make you take the losses of industry collapses. And that would be a very good signal of predictability that you could send to employers.

Mrs. MCCARTHY. What do you think about, as far as what we are planning on doing here, actually forcing some companies not to make any decisions on—maybe not do anything on their pension plans or going into the 401(k) plans versus really a defined benefit?

Ms. GHILARDUCCI. I am sorry, could you repeat that? You think this bill actually encourages 401(k) plans?

Mrs. MCCARTHY. I am asking you.

Ms. GHILARDUCCI. Yes, that is what my written testimony appealed to by really asking the credit balances to be foreshortened. To actually show that the premiums can go up a huge amount, to have a modified yield curve that may not be explicable and therefore is unpredictable, the only place an employer could be encouraged to go is a 401(k), and those are not real pension plans. They shift all the risk of accumulation onto the employees.

So if that is what you want to do, do not call it pension protection; it is eliminating these kinds of plans.

Mrs. MCCARTHY. I agree with you, especially with the 401. We are just hearing everything up here about, let's go 401. It is great for us to save into the 401(k) plans or Thrift Savings or anything, but it is not definite.

Thank you. I yield back the balance of my time.

Chairman BOEHNER. The Chair recognizes the gentleman from New York, Mr. Kuhl.

Mr. KUHL. Thank you, Mr. Chairman. And thank you for scheduling this event so that we could have the benefit of the testimony. And thank you, members of the panel, for your contributions today.

I am curious, I have enjoyed the questions and the answers that you have been giving, and I was noticing in your opening statements that two of you, I think out of the three of you, indicated that if this bill were to pass, in fact it would be a disincentive for employers to continue with defined benefit plans. I am curious, because I haven't heard anybody ask the question, what would you do—I understand the benefits of a defined benefit plan and why employers—you have talked about older workers and retaining them and that sort of thing. But I am curious as to what you would do, if it is such a good plan to encourage employers—recognizing in fact that there are significant liabilities out there that certainly we as a body have to recognize and want to protect the people who are enrolling in these plan—what would you do, or what would you suggest we include in this bill, to encourage employers to not only continue defined benefit plans, but actually think about using them as they are opening new businesses?

Ms. GHILARDUCCI. This bill should have cash balance language in it. If it is a comprehensive bill and if you do not want to give the impression that you are encouraging 401(k) over DB, you have to have the cash balance provision in there. I also think that in this bill you should segregate out the liabilities from the airline indus-

try and find another revenue stream to pay for it. This bill should hike premiums, but on a much less startling basis.

This bill should have encouragements for credit balances to be accrued. They are not there; the credit balances are discouraged. This bill should discourage lump sum payouts and not encourage them like this bill does.

So the points you hit in this bill are the right ones to look at, but they are working in the opposite direction.

Ms. FRANZOI. I also think that this bill, as we said earlier, is a good start in going forward on it. But it needs to be something that gets rid of complexity and simplifies it for employers and helps businesses to have predictability as they are going forward with the funding.

Once again, you get into the yield curve which, as I said earlier, I think is like a snapshot picture. You cannot compare it to auto loans and home mortgages, which are fixed things. This is almost like a fictional picture of what the plan looks like, and if employers do not have predictability and they are going to see this up and down movement with their funding, it is going to distract them from wanting to continue a plan or to put a plan in if they do not have one.

Mr. KUHL. Thank you.

Mr. Pushaw, would you care to make a contribution?

Mr. PUSHAW. I agree with the professor, for example, in at least addressing, whether it is in this bill or a separate stand-alone bill, the cash balance attributes. They really are, when you talk about simplification, cash balance plans, albeit in the past from time to time they have been introduced at companies in the wrong way, they have been misused. But as any tool, they can be used for good as well as bad, and they have been misused. And we have seen the headlines of those cases where they have been misused, but that does not mean the cash balance plans are bad.

Getting the cash balance plans, giving them a solid foundation, is probably, I would think, my first priority. Dealing with those airlines and steel industries probably is the second priority.

Mr. KUHL. I yield back the balance of my time, Mr. Chairman.

Chairman BOEHNER. The Chair recognizes the gentleman from Massachusetts, Mr. Tierney.

Mr. TIERNEY. Thank you, Mr. Chairman.

I thank all the witnesses today for your testimony and your answers to this.

Let me start with two questions I want to try to get to. One is the PBGC, at least with respect to the airline, steel—those industries that are a problem like that ought to have some reinsurance mechanism, and several of you have mentioned segregating out the airlines and dealing with that separately from this problem.

Is this something we should do structurally as we do this bill, to not have us make each one be drawn out when it happens, but deal with it as it goes along?

Ms. GHILARDUCCI. I actually do not think it should be done structurally. Collapses of industries do not happen all the time. But to do it on an ad hoc basis like we would, it would send a signal that this is the way that PBGC is going to handle it.

Mr. PUSHAW. We have mentioned before, the old lists that PBGC used to collect and publish, the "Iffy 50," the 50 most poorly funded plans in the Nation that was replaced with the section 4010 filings. My comments earlier, I think are appropriate in that I would rather see PBGC structurally turned into an advocate, so that these early warning system devices like the "Iffy 50" or the 4010 are then acted upon early; that they are given enough authority to go into these sponsoring organizations and say, What are you going to do now?

We have heard in the industry quite a bit about PBGC saying that, if you have been, or every plan that has terminated and dumped liabilities on our doorstep have been in junk bond status at least 10 years.

I think that is even inherent in some of the administration proposal language. If that is such a well known, documented fact, then getting PBGC to the doorstep of that organization to do something about it in year one or year two with a combination of the indicators of underfunding and junk status, that is the time to act.

Chairman BOEHNER. We feel they don't have that authority right now.

Mr. TIERNEY. We don't believe they have that authority right now.

Mr. PUSHAW. I do not believe that they have that authority if they did not act on it sufficiently.

Ms. GHILARDUCCI. PBGC has an award winning early warning system where they have all the data necessary and they act on it by basically jawboning. Especially if a company has an underfunded plan and looks like it is going to be taken over they kind of jawbone and get it over early. I am surprised they are not here asking for more authority to intervene earlier. I don't know why they are not doing that.

Mr. TIERNEY. Thank you. On a separate issue that we have talked a lot about, the cash balance plans, and I think Mr. Pushaw said it best, they have it bad now because of the way they were implemented in certain instances, and generally I see people shy away almost when you start saying that. Could one or more of you just explain for me in broad terms what a good cash balance start-up would look like that people might feel comfortable with?

Mr. PUSHAW. Sir, if I can digress a little bit from your point of your question, it is the issues that I think we have all seen with cash balance isn't necessarily the end product. It is not necessarily that, you know, this particular cash balance plan credits like a 401(k) does, maybe 6 percent of pay into my account each year, and some of these ongoing details. The issues seem to be typical of a change from a final pay, final pay based to defined benefit plan, and I make that distinction because it is in the last 10 years of your career on any of that kind of plan that your benefit value skyrockets. Any time we change those plans, whether we are changing benefit structure, whether we are modifying some earlier retirement provisions, or even going to cash balance, even without going to cash balance, any time you change those that group of people are the ones that get hurt.

So there is almost always some grandfathering, some protections, some transition for those folks that are so far down the defined

benefit path in their career that switching to a 401(k), a savings share plan, or, in essence, a cash balance plan, will be hurt severely. So it is in those transitions when things change that we need to be particularly careful to address limiting how those things change, who would change, who it affects, how you communicate that to the employees because, in fact, some of these transitions from traditional defined benefit plans to cash balance plans were not communicated to the employees.

Mr. TIERNEY. Thank you, sir.

Ms. GHILARDUCCI. But that only refers to change in their traditional plans to cash balance. I think you were asking about an initial cash balance plan. They would be liked by young workers and old workers. They would be preferable to a 401(k) because your employer would set aside money for you in an account and guarantee a return. That is why they are insured by the PBGC and they are defined. But you can't get at it to buy a new house or anything else that you do. And one of the problems is that they are cashed out when people leave the firm, and that has got to be actually firmed up.

But if cash balance plans were sold by vendors and they were, they had a better reputation, I think many employers would implement them and maybe perhaps just have a 401(k) as a supplement.

Mr. TIERNEY. And you think they would be as strong as the current DB plans in terms of at the end of a person's career?

Ms. GHILARDUCCI. No, they wouldn't be as strong. They wouldn't have the skyrocketing acceleration, and you might not get the personal benefit from it as your employer. What you want is your older workers to stay on the job. The DB system is doing that very well, and we are going to need that as we go into the future as the workforce ages. So already I have conceded that cash balance plan is our hope, but maybe some other companies will think that traditional defined benefit plans where they were confronted by these older workers will implement them. Having a clear flight path for cash balance plan doesn't mean that traditional plans won't be attractive.

Chairman BOEHNER. The gentleman's time has expired.

Mr. TIERNEY. Thank you.

Chairman BOEHNER. Chair recognizes the gentlelady from Washington, Ms. McMorris.

Ms. MCMORRIS. Thank you, Mr. Chairman, and I, too, want to thank each of you for being here today and sharing your perspectives. It has been very helpful. I had a question for Ms. Franzoi. For the past few years, we have all heard that the current funding rules are simply not working. And if you read the newspaper or watch the news, there is more than enough examples to choose from. In your testimony, you state that restrictions on benefit accruals for greatly underfunded plans are overly intrusive and that the current credit balance system should remain virtually intact. How can you essentially defend status quo rules which have contributed significantly to the current state of our pension system?

Ms. FRANZOI. I don't think that you could say that having the credit balances or allowing plans to increase their benefit have so substantially contributed to where we are at today. There are many other factors in there that have gone to this, and I think as the

professor has testified and what I have seen in my experience, there are a lot of really healthy plans out there. And they developed those credit balances with one idea, and now to turn around and change it, really puts them at a disadvantage. I think businesses look at these plans as an attraction and a retention tool.

It is important to business to offer that to their employees, and most of us have been, I think, responsible plan sponsors. And our goal is to keep those plans well funded. So this is sort of a quick reaction to something that is happening in the airline industry. But I don't think that is indicative of what all of us have done or how we financed our plans or how we have set up our asset allocations to fund these plans and make them viable.

Ms. MCMORRIS. Thank you.

Chairman BOEHNER. Any other questions for witnesses? If not, we want to thank our first panel for their contributions to our efforts, and we want to invite the second panel to come forward.

And just for everyone's information we do expect to have a series of at least five votes occur around 1 o'clock today. So we will go as far as we can and then make some decisions about how we proceed. So again thank you. The committee will stand in recess for 5 minutes.

[Recess].

Chairman BOEHNER. I want to welcome our second panel today who are here to discuss the multi employer reforms in our bill. The first witness will be Mr. Timothy Lynch. Mr. Lynch holds the position as President and CEO of Motor Freight Carriers Association. He joined MFCA in October of 1997. MFCA is a National Trade Association representing the business interests of unionized general freight motor carriers. It is also the bargaining agent for those truck companies who are signatories of the Teamsters national master freight agreement. Prior to joining MFCA, Mr. Lynch was Vice President, Legislative Affairs of the American Trucking Association, where he was responsible for directing ATA's legislative program on Capitol Hill operations. From February of 1982 until December of 1992, Mr. Lynch was Vice President for Government Affairs at Roadway Services, Incorporated.

We will then hear from Mr. Andy Scoggin, and Mr. Scoggin is Vice President of Labor Relations for Albertsons, Inc. and has been with Albertsons since 1993. Prior to that time, Mr. Scoggin was an attorney for a San Francisco Bay Area law firm, and he has served on the board of trustees on a number of Taft-Hartley trust funds over the last decade. He currently serves as a management trustee on the Western Conference Trust Pension Fund, one of the largest private sector Taft-Hartley pension trust funds in the United States.

Mr. Scoggin is a member of the International Foundation of Employee Benefit Plans. He also serves on the Pension Legislation Task Force of the Food and Marketing Institute and is a member of the International Foundation of Employee Benefit Plans.

And then lastly, we will hear from Judith Mazo. Ms. Mazo is the Senior Vice President and Director of Research for the Segal Company with responsibility for directing research and providing guidance on public policy, legislative and regulatory issues. And before joining the Segal Company, Ms. Mazo was engaged in a private law

practice here in Washington specializing in ERISA and serving as a special counsel to the PBGC and as a consultant to the Pension Task Force on the Committee on Education and Labor of the U.S. House of Representatives. She was the senior attorney for the PBGC and executive assistant to its general counsel from 1975 to 1979.

So I want to thank the three of you for coming here today and, Mr. Lynch, you can begin.

STATEMENT OF TIMOTHY LYNCH, PRESIDENT AND CEO, MOTOR FREIGHT CARRIERS ASSOCIATION

Mr. LYNCH. Mr. Chairman and members of the committee, good morning, or good afternoon. I want to begin by first thanking Chairman Boehner for holding this hearing on H.R. 2830. I also want to thank all the members of the committee and their staff and certainly the members and staff of the Employer Employee Relation Subcommittee for all of their hard work in developing a legislative proposal that is the subject of today's hearing.

While I cannot speak to all of the provisions of H.R. 2830, I can say that with respect to title II, the Funding Rules For Multiemployer Defined Benefit Plans, the sponsors of H.R. 2830 have done something at times unique in Washington. You have addressed a problem before it becomes a crisis. You are doing that by providing the tools for labor, management and plan trustees to deal with a problem without resorting to additional government regulation. Additionally, you are dealing with a problem before it grows so large that the only recourse is to government intervention through the PBGC. In our view, that is no small accomplishment, and we pledge to work with you to ensure enactment in law.

I am here today as a representative of the Trade Association of Trucking Industry Employers who, by virtue of their collective bargaining agreement, are major participants in a number of multiemployer pension plans. In addition, I was a participant in discussions that began last October with other industry and labor representatives that ultimately resulted in a coalition, the Multiemployer Pension Plan Coalition, that developed a legislative proposal addressing many of the problems facing multiemployer pension plans.

Because H.R. 2830 contains many of the recommendations of the Coalition, I believe it represents or presents an excellent opportunity for legislative action. The Coalition proposal is the only proposal that has the full support of contributing employers, organized labor, and those responsible for the governance and administration of multiemployer plans; in other words, all of the parties most directly affected by the MEPA statute.

I would like to focus my comments today on two provisions of H.R. 2830, funding rules for multiemployer plans and endangered status and those in critical status. Both of these provisions are similar to recommendations that the Coalition proposed but they contain significant differences that I would like to highlight.

The Coalition proposal envisioned an early warning system for plans that were at risk but not necessarily heading for severe financial difficulties. Plans in this category would be required to develop a benefit security plan to improve the funding ratio. That approach can probably be described as a soft benchmark. H.R. 2830

establishes a hard benchmark with very stringent and time definite standards as part of the funding improvement plan. Plans at the higher end of the endangered category, for example, those with a funding ratio of between 75 and 79 percent, undoubtedly will be able to meet the one-third improvement benchmark.

Unfortunately plans at the lower end; for example, those with a funding ratio between 66 and 69 percent, will have a virtually impossible task. The level of benefit modifications coupled with additional employer contributions needed to meet that benchmark over the 10-year time frame will be very detrimental, in our view, to both contributing employers and plan participants. We would request that the committee give consideration to alternative approaches, maintaining the benchmarks, but not ones that create an insurmountable and unreasonable financial burden on contributing employers.

With respect to the funding rules for multiemployer plans in critical status, this provision is similar to the approach suggested by the Coalition's category for plans with severe funding problems or what has been referred to as the red zone. Under the Coalition proposal, the most difficult and controversial remedies, additional employer contributions in the form of a mandatory surcharge and benefit modifications, are reserved for those plans that face the severest funding problems. This is in part designed as a strong incentive to plan trustees to do all they can to solve the plan's problem before entering the red zone category.

I believe it is to the credit of those in the Coalition and the interests that they represent that they recognize the risk and concern attendant to both additional contributions and benefit modifications. Any significant increases in employer contributions run the very real risk of jeopardizing the very large pool of small employers typically involved in multiemployer plans.

Conversely, any significant modifications in the benefit plan raise important issues of labor management relations, employee trust, and fundamental fairness to retirees. I say this somewhat gingerly, but I can assure the members of this committee that you will have no more spirited debate over this issue than we had in the Coalition.

But we understand that you cannot solve the problems facing a severely underfunded plan without both components. I would urge the committee to include both concepts as requirements for plans in the critical status category.

Mr. Chairman, I want to close by once again praising the efforts of this committee in addressing the problems facing multiemployer plans. We will do everything we can to ensure final passage of a balanced and fair approach, and we believe that H.R. 2830 starts us well on our way toward that goal. Thank you.

Chairman BOEHNER. Thank you, Mr. Lynch.

[The statement of Mr. Lynch follows:]

Prepared Statement of Timothy P. Lynch, President and CEO, Motor Freight Carriers Association

Mr. Chairman and Members of the Committee on Education and the Workforce, good morning. My name is Timothy Lynch and I am the President and CEO of the Motor Freight Carriers Association (MFCA). I want to begin by thanking Chairman John Boehner for holding this hearing on H.R. 2830, the Pension Protection Act of

2005. I also want to thank all of the members of the Committee, their staffs and certainly the staff of the Employer-Employee Relations Subcommittee for all of their hard work in developing the legislative proposal that is the subject of today's hearing.

While I cannot speak to all of the provisions of H.R. 2830, I can say that with respect to Title II—Funding Rules for Multiemployer Defined Benefit Plans—the sponsors of H.R. 2830 have done something at times unique in Washington. You have addressed a problem before it becomes a crisis. You are doing that by providing the tools for labor, management and plan trustees to deal with a problem without resorting to additional government regulation. Additionally, you are dealing with a problem before it grows so large that the only recourse is to government intervention through the Pension Benefit Guarantee Corporation. In our view, that is no small accomplishment and we pledge to work with you to ensure enactment into law.

I am here today as a representative of an association of trucking industry employers who by virtue of their collective bargaining agreement are major participants in a number of multiemployer pension plans. In addition, I was a participant in discussions that began last October with other industry and labor representatives that ultimately resulted in a coalition—the Multiemployer Pension Plan Coalition—that developed a legislative proposal addressing many of the problems facing multiemployer pension plans.

MFCA is a national trade association representing the interests of unionized, general freight truck companies. MFCA member companies employ approximately 60,000 Teamsters in three basic work functions: local pick-up and delivery drivers, over-the-road drivers and dockworkers. All MFCA member companies operate under the terms and conditions of the Teamsters' National Master Freight Agreement, one of three national Teamster contracts in the transportation industry.

MFCA member companies are key stakeholders in multiemployer pension funds. They are concerned about the current framework for multiemployer pension plans and strongly believe that if not properly addressed, the problems will increase and possibly jeopardize the ability of contributing employers to finance the pension plans. The end result could put at risk the pension benefits of their employees and retirees.

Development of Coalition Proposal

Last October, we began participating in a small working group of trucking company and union representatives to try to develop recommendations that would be acceptable to multiemployer plans, unions and contributing employers. The objective was to develop a legislative proposal that would alleviate the short-term consequences of funding deficits and promote long-term funding reform for multiemployer plans. As a representative of contributing employers, I entered those discussions with a clear mission to protect the economic interests of my membership. My union counterparts entered with a similar mission to protect the interests of their membership.

Early on in those discussions, we agreed on several fundamental issues that ultimately formed the basis for our recommendations.

- Because of the diversity of multiemployer plans, a one-size-fits-all approach would not be productive. Instead remedial programs would be targeted to those plans facing the greatest financial problems.
- Multiemployer plans function as a quasi-PBGC, with contributing employers assuming plan liabilities and shielding the federal agency from that responsibility until plan bankruptcy. Unfortunately, plan trustees don't have all the tools available to the PBGC to address funding problems.
- Furthermore, most of the tools available to address funding problems become available too late in the process and are often viewed as "last-resort" remedies by federal agencies.
- All parties to the plans deserve more timely and meaningful disclosure of information about the status of the plans.
- The need to establish an early warning system for "at risk" plans and a separate category for "severely underfunded" plans.
- The burden to fix the problem of severely underfunded plans should not be borne disproportionately by any one party to the plans. To do otherwise would, in fact, jeopardize the continued viability of the plan and its defined benefits.

This process ultimately was expanded to include employer and union representatives from other industries. The result is a coalition proposal that has the support of a wide range of business and labor organization interests.

Recommendations for Legislative Action

From the perspective of the contributing employers, the key elements of the coalition proposal are as follows.

Funding Rules

Under the proposal, multiemployer plans will be required to have strong funding discipline by accelerating the amortization periods, implementing funding targets for severely underfunded plans and involving the bargaining parties in establishing funding that will improve plan performance over a fixed period of time. In addition, the proposal limits the ability for plan benefit enhancements unless the plan reaches certain funding levels.

Funding Volatility

By virtue of their collective bargaining agreements, contributing employers must make consistent payments regardless what gains are achieved in the financial markets. (This is in contrast to single employer plans that may avoid contribution payments in lieu of above-average market returns.) However, the volatility of these plans occurs in the form of funding deficiencies. The coalition proposal addresses this situation by allowing the plans to use existing extension and deferral methods to permit time for the bargaining process to address the underfunding over a rational period of time.

Earlier Warning System

The coalition proposal establishes a "yellow zone" or early warning system. The goal of the yellow zone concept is to make sure plans are cautious in the ability to have affordable benefit levels. Additionally, plans in the yellow zone must improve their funded status in a responsible manner, one that does not put extreme pressure on the benefits provided or eliminate the ability for employers to operate in a highly competitive marketplace. The coalition proposal strikes a reasonable balance through creation of a bright line standard for an improving funded status but not one that creates an insurmountable and unreasonable financial burden on contributing employers. While it is important that yellow zone plans develop a program for funding improvement, the burden to do so should be commensurate with the ability to recover over a rational period of time.

Plans With Severe Funding Problems

Under the coalition proposal, plans facing severe funding problems are in a "red zone" or essentially reorganization status. When a plan is in reorganization status, extraordinary measures will be necessary to address the funding difficulties. It is here that the concept of shared responsibility for balancing plan assets and liabilities fully comes into play. Reorganization contemplates a combination of contribution increases—above those required under the collective bargaining agreement—and benefit reductions—though benefits at normal retirement age are fully protected—to achieve balance.

Transparency and Disclosure

The Pension Funding Stability Act of 2004 greatly improved the transparency of multiemployer plans. The coalition proposal expands those disclosures and places additional disclosure requirements for plans that are severely underfunded in the red zone.

Withdrawal Liability

The coalition proposal attempts to strengthen and clarify withdrawal liability rules to protect the remaining contributing employers from assuming a disproportionate and unfair burden from non-sponsored participants.

Pension Protection Act of 2005—Title II Multiemployer Plans

How then do we view Title II of H.R. 2830? We believe that H.R. 2830 addresses, in part, all of the issues that we suggested were in need of reform. Several provisions of the legislation represent a significant—and innovative—approach to solving the funding problems facing multiemployer pension plans. We believe that H.R. 2830 meets the overall objective of alleviating the short-term consequences of funding deficits while promoting long-term funding reform for multiemployer pension plans.

Early Warning System

H.R. 2830 contains the suggested early warning system for plans viewed as "at risk" through the establishment of a category called, "endangered plans." While we are in agreement with this approach toward financially ailing plans, we have one very important—and critical—issue that needs to be addressed in order to gain our full support.

The coalition proposal contained what can be described as "soft" benchmarks for plans in the endangered category while H.R. 2830 establishes very stringent and time-definite standards. Our rationale for a softer schedule takes into consideration that plans in this category will vary in the ability to improve their funding status over a defined time line. While plans at the higher end of the category (e.g., 75-79%) undoubtedly will be able to meet the 33 1/3% improvement benchmark, plans at the lower end (e.g., 66-70%) will have a virtually impossible task. The level of benefit modifications coupled with additional employer contributions needed to meet this benchmark will be detrimental to both contributing employers and plan participants.

We would request that the Committee give consideration to alternative approaches to the treatment of plans in the endangered category and we would be willing to provide suggestions to accomplish that goal. While we certainly agree that the patient needs help, we cannot support an approach that potentially harms—if not kills—the patient.

Plans With Severe Funding Problems

H.R. 2830 establishes a second category of plans—"critical"—that is designed to address plans with the severest funding problems. Under the coalition proposal, the most difficult and controversial remedies—additional employer contributions and benefit modifications—are reserved for those plans that face the most difficulties. The members of the coalition recognize—and don't take lightly—the impact of additional employer contributions and benefit modifications. Any significant increases in employer contributions run the very real risk of jeopardizing the large pool of small employers typically involved in multiemployer plans. Conversely, any significant modifications in the benefit plan raise important issues of labor/management relations, employee trust and fundamental fairness with retirees.

However, all members of the coalition recognize that we cannot solve the problems facing "critical" plans without those two tools. Consequently, I would urge in the strongest terms possible that the Committee give consideration to including language that puts meaningful remedies back into the "critical" category of plans.

Funding Rules

H.R. 2830 will require plans to have strong funding discipline by accelerating the amortization periods, implementing funding targets for severely under funded plans and involving the bargaining parties in establishing funding that will improve plan performance over a fixed period of time. In addition, H.R. 2830 will limit the ability for plan benefit enhancements unless the plan reaches certain funding levels. While the legislation proposes a 15 year amortization schedule for increases and decreases, we would ask that further consideration be given to a 10 year schedule. We believe a 10 year schedule will provide stronger funding discipline.

Funding Volatility

H.R. 2830 attempts to provide additional tools to plan trustees to address the problems of a short-term funding deficiency and funding volatility. The coalition proposal addressed this issue by allowing the plans to use existing extension and deferral methods to permit time for the bargaining process to address the under funding over a rational period of time. We would urge the Committee to consider a more expansive list of tools for plan trustees to utilize in addressing funding volatility.

Additionally, one of the objectives of the coalition was to preclude funding deficiencies—and the attendant penalties—from occurring during the collective bargaining agreement cycle. In the case of the excise tax penalty, this provides no benefit to plan funding and represents a punitive assessment against contributing employers. We would hope that the Committee shares that view.

Transparency and Disclosure

H.R. 2830, coupled with the earlier requirements under the Pension Funding Stability Act, provide additional information to plan participants, contributing employers, and employee organizations that should improve the dissemination of important plan information.

Withdrawal Liability

H.R. 2830 strengthens and clarifies the withdrawal liability rules to protect contributing employers from assuming a disproportionate and unfair burden from nonsponsored participants.

Mr. Chairman, thank you for giving me the opportunity to present the views of the Motor Freight Carriers Association. I look forward to working with the members and staff of this Committee on the Pension Protection Act of 2005. I would be happy to answer any questions you may have.

Chairman BOEHNER. Mr. Scoggin.

STATEMENT OF ANDY SCOGGIN, VICE PRESIDENT FOR LABOR RELATIONS, ALBERTSONS, INC.

Mr. SCOGGIN. Thank you, Mr. Chairman, members of the committee. Thank you for allowing me to testify today. I am testifying on behalf of Food Marketing Institute and its pension legislation task force. FMI represents 26,000 retail food stores across the country, many of which participate in multiemployer plans.

As you mentioned in your outline, Mr. Chairman, my experience is not as an actuary but as a trustee and a collective bargainer addressing these issues at the table. I am pleased to appear before the committee today to express our views on H.R. 2830, the Pension Protection Act. Multiemployer pension plans provide benefits to almost 10 million workers and retirees in the United States.

However, the past 10 years have exposed areas in existing law governing multiemployer pension plans that are inconsistent with the goal of stable and long-term decision making. We believe that responsible multiemployer plans can continue to maintain strong and viable funds and the minority of multiemployer plans which are facing greater risks can resolve their issues if given the necessary tools and legislative guidance.

Further, we believe that the best decisions will be made when both labor and management have a full say in the outcome and are provided with the necessary tools to accomplish that goal. I will focus on four problem areas of current law. First, current laws and rules that govern Taft-Hartley pension plans trap trustees in a narrow corridor between full funding and funding deficiencies. Much like the early computer game Pong, the trustees are batted back and forth between two arbitrary walls that don't encourage long-term decision making.

Second, there are no clear guidelines for multiemployer trustees to make longer term funding decisions. Multiemployer plans are not required to look out over a number of years to detect potential deficiencies in the future and to adopt plans with achievable benchmarks to avoid those deficiencies before they approach.

Third, access to short-term funding relief after a market downturn is good policy. It allows plans time to regain their momentum without taking short-term extraordinary and in some cases damaging action to head off a looming deficiency. Provisions such as section 304 of ERISA allow for such relief. Unfortunately, this relief has been hard for trustees to obtain, and there are no clear guidelines for trustees or bargaining parties today to determine when such relief will be granted.

Finally, despite important changes in recent legislation access to key information, what we call transparency, is still not sufficiently able to participants and to contributing employers.

But the multiemployer pension provisions in H.R. 2830 incorporate four principles that we believe are essential to accomplishing fundamental reform. One, greater transparency and greater flexibility for all plans; two, an early warning system for what the proposed legislation terms endangered and critical plans; three, immediate steps to stabilize these plans and, perhaps most importantly, objective, quantifiable benchmarks that measure the plan's

funding improvement, and they provide reasonable targets for the trustees and the bargaining parties.

H.R. 2830 recognizes the unique nature of multiemployer plans and we appreciate that. All parties, the contributing employers, the unions and the trustees, will be encouraged to act responsibly on behalf of employees by taking a longer term view and by correcting any funding problems on the horizon before they reach a crisis stage. H.R. 2830 provides these solutions in a manner that will maintain the collective bargaining rights of all parties.

In summary, we in the retail food industry strongly support efforts to reform our Nation's pension funding laws. We are asking Congress to give us the tools to manage these plans more effectively so that we can continue to provide solid benefits for our millions of employees and retirees well into the future without ever becoming a burden on the Federal Government.

Again Chairman Boehner, members of the committee, I thank you for the opportunity to testify in this important topic and I would be happy to answer questions.

[The statement of Mr. Scoggin follows:]

Prepared Statement of Andrew J. Scoggin, Vice President of Labor Relations, Albertsons, on Behalf of the Food Marketing Institute

Chairman Boehner and Members of the Committee, thank you for allowing me to testify today. My name is Andrew Scoggin, Vice President of Labor Relations for Albertsons, Inc. Albertsons is the second largest food and drug retailer in the United States, operating more than 2,500 stores in 37 states and employing over 240,000 associates nationwide. Albertsons operates under the banners of Albertsons, Acme, Shaw's, Jewel-Osco, Sav-on Drugs, Osco Drug, and Star Markets, as well as Super Saver and Bristol Farms, which are operated independently. We serve more than 28 million customers each week in our stores.

During the past decade, I have also served on the Boards of Trustees of a number of Taft Hartley multiemployer Trust Funds and I currently serve as a management trustee on the Board of Trustees of the Western Conference of Teamsters pension fund, one of the largest private sector Taft-Hartley pension trust funds in the United States with a current fund balance of $28 billion.

I am testifying today on behalf of the Food Marketing Institute (FMI), of which Albertsons is a member. FMI represents 26,000 retail food stores across the country and has worked with its members for a number of years to achieve comprehensive pension reform.

Industry-wide, supermarkets employ approximately 3.5 million Americans, providing employees with good wages and excellent benefits. Employment in the industry is a proven path to success for the American worker. The industry provides a variety of retirement plans among the wide range of benefits it offers. The industry's defined benefit pension plans include both single-employer plans (those sponsored by an individual company and common in the steel, automotive, and airline industries) and multi-employer plans, in which many companies join together to fund and operate the plans (common in the grocery and construction industries).

I am pleased to appear before the Committee today to express our views on H.R. 2830, The Pension Protection Act.

Multiemployer Plan Regulation

Multiemployer plans are governed, in part, by the Employee Retirement Income Security Act (ERISA), like their single-employer plan counterparts. Unlike single-employer plans, however, multiemployer plans are also governed by the Taft-Hartley Act, which mandates that their Boards of Trustees have equal representation by Union and Management Trustees. They are also governed by the Multiemployer Pension Plan Amendments Act of 1980, which amended ERISA and provided special rules for multiemployer pension plans.

Multiemployer Plan Impact

Multiemployer pension plans are an important part of the nation's private sector retirement system, providing pension benefits for approximately 9.7 million workers and retirees in the United States. In 1980, Congress recognized some of the funding

and operational differences between single-employer pension plans and multiemployer pension plans. As a result, Congress amended ERISA and established separate and distinct rules for multiemployer plans under the Multiemployer Pension Plan Amendments Act of 1980.

Shortfall of Current Law

The past 10 years have exposed areas in which existing law governing multiemployer pension plans are not consistent with a goal of stable, long-term decision making. We believe that responsible Trustees can continue to maintain strong and viable plans, and the minority of plans which are facing greater difficulties can resolve their issues if given the necessary tools and legislative guidance. Further, we subscribe to the view that the best decisions will be made when both management and labor have a full say in the outcome and are provided with the necessary tools to accomplish that goal.

I will focus on four primary areas of current law that do not contribute to responsible, long-term administration of multiemployer pension plans.

First, the funding ceiling is too low. As the law is currently written, any employer contributions made to a plan once the plan is "fully funded" are no longer deductible. Thus, the law discourages trustees from allowing a plan, during good times, to reach full funding. Why not? Because if the trustees come too close to a projected "full funding" status, given the imprecise nature of actuarial projections the trustees could find themselves advising the contributing employers that their contributions will no longer be deductible. In that environment, trustees are not encouraged to make long term, responsible decisions. This is, unfortunately, counterproductive. During periods of strong investment return, such as occurred in the 1990s, funds should be encouraged to build up a strong surplus to provide them with a cushion for the difficult times. Instead, trustees are forced to decide whether to increase retirement benefits, sometimes to unreasonably high levels, or to suspend contributions. Both of these approaches put funds in a much worse position when the market turns down, as it inevitably will.

Second, there are no clear legislative guidelines provided for multiemployer plan trustees to make longer term funding decisions. Unless required by a collective bargaining agreement, in practice, funds often do not "look out" over a specified number of years to detect potential deficiencies and to adopt a plan to avoid those deficiencies. Trustees aren't required to address potential deficiencies until they are confronted by them. Although some funds have implemented long term funding policies, it is still not a common practice in many multiemployer funds.

Third, access to short term funding relief granted by legislation after a market downturn is good policy because it allows trust funds time to regain momentum without taking short-term, extraordinary, and in some cases, damaging action to head off a looming deficiency. There are provisions in existence today, such as Section 412(e) of the Internal Revenue Code, that allow for such relief. Unfortunately, relief under 412(e) has been hard to obtain, and there are no clear guidelines for trustees or bargaining parties to determine when such relief will be granted. This creates uncertainty in collective bargaining and in the minds of trustees who must make significant decisions that hinge on whether such relief will be granted.

Finally, FMI member employers represent great diversity in terms of size and geography. In many instances, those employers are not represented on the Boards of Trustees of the funds to which they contribute. This puts them in a position of limited access to information about the health and funded status of the plans. Despite important changes in recent legislation, transparency to key information is still not sufficiently available to participants and contributing employers.

Need for Change

We applaud the sponsors of H.R. 2830 for recognizing that Congress must address multiemployer pensions as part of comprehensive pension reform legislation. Although H.R. 2830 doesn't address every proposal in FMI's proposed legislation, we believe that it provides a reasonable and rational framework for multiemployer pension plans to work through the problems now facing all pension plans (both single and multiemployer). The reforms in H.R. 2830 are not a government bail out. Instead, the proposed legislation will provide the tools which will allow multiemployer plans to solve our own pension problems without direct government intervention and without putting additional financial pressure on the Pension Benefit Guaranty Corporation. We believe, if Congress acts now, multiemployer plans can solve their own problems so that they do not become a burden on the federal government or the taxpayer.

FMI Task Force

FMI has been working for the past year to develop recommendations for comprehensive pension reform. In addition, our industry has worked with other employer groups as well as representatives of the trucking industry, the International Brotherhood of Teamsters, the Central States Teamsters Pension Fund, and other union representatives to address multiemployer pensions funding reform.

HR 2830—The Pension Protection Act

The multiemployer pension provisions in HR 2830 incorporate four fundamental principles which FMI and its member companies believe are essential to accomplishing fundamental reform: (i) greater transparency and greater flexibility for all plans; (ii) an early warning system for what the proposed legislation terms "endangered" and "critical" plans; (iii) immediate steps to stabilize these plans, and (iv) perhaps most importantly, objective, quantifiable benchmarks that measure the plan's funding improvement and provide reasonable targets for the Trustees and the bargaining parties. We have focused our comments on those provisions related to plans in what is referred to in the legislation as the "endangered" category—generally speaking those plans whose funding ratios are between 65 and 80 percent.

Funding Reforms for "Endangered" Plans

The requirements of current law permit, and even encourage, plans to take a short-term, "snapshot" approach to determine funding requirements and benefit formulas at the expense of long-term projections. H.R. 2830 requires multiemployer plan actuaries and trustees to take a longer-term look at a plan's funding status. As you can imagine, it can take a considerable amount of time to make changes to multibillion dollar pension funds and early intervention, and action, is the key to reform. Under this legislation, trustees will be required to look at the plan's current funding level, as well as seven years into the future, to project a plan's funding outlook. As a result, potential future funding problems are recognized early, when there is still time to correct them in a responsible manner.

Under H.R. 2830, once an "endangered" plan is identified as such, the plan's Board of Trustees will be required to prepare a Funding Improvement Plan that stabilizes the plan during the interim period. The Funding Improvement Plan further requires that the Trustees adopt a schedule that will satisfy the benchmarks and allow the collective bargaining parties to adopt contribution levels that are appropriate for the benefits provided by the plan. The schedule would allow for employer contribution increases, reductions in future employee benefit accruals, or a combination of both.

We believe that creating this mechanism will accurately address the unique nature of multiemployer plans, in which collective bargaining agreements fix contribution rates for several years into the future and where, under current ERISA law, Trustees are prohibited from retroactively reducing the benefit levels for plan participants. As a result, all parties (contributing employers, unions, and Trustees) will have the ability to act responsibly on behalf of employees by providing an accurate measure of expected liabilities over a longer time-frame and by providing a schedule to correct any funding problems on the horizon before they reach a crisis stage. We believe that H.R. 2830 provides these solutions in a manner that will also maintain the collective bargaining rights of all the parties.

Greater Flexibility and Transparency for Multiemployer Plans

H.R. 2830 encourages employers to build strong surpluses in trust accounts and provides greater flexibility to manage short term periods of reduced investment returns by increasing the maximum allowable deductibility of contributions. These proposals are critical to allowing plans sponsors to make long term, responsible decisions and open up the funding corridor to allow trustees more room to avoid crises.

FMI is also concerned about the lack of transparency in multiemployer plans. Without current and accurate financial information, contributing employers and plan participants cannot work with plan Trustees to address underfunding issues. The 2004 Pension Equity Act took a step in the right direction by requiring enhanced disclosure for multiemployer plans, but didn't go far enough toward getting timely information to affected parties. H.R. 2830 improves on the reforms initiated by this committee in the last Congress.

In summary, though H.R. 2830 does not address every issue contained in FMI's proposals, we in the retail food industry strongly support efforts to reform our nation's pension funding laws. Those of us who contribute to and participate in multiemployer pension plans are asking Congress to recognize the ways in which these plans differ from single-employer pension plans, and to enact changes to existing laws that will give us the tools to manage these plans more effectively, so that we

can continue to provide great retirement benefits for our millions of employees and retirees well into the future without ever becoming a burden on the federal government.

Again, Chairman Boehner and members of this Committee, I thank you for the opportunity to testify on this important topic. I'd be happy to answer any of your questions.

Chairman BOEHNER. Thank you. Ms. Mazo.

STATEMENT OF JUDITH F. MAZO, SENIOR VICE PRESIDENT AND DIRECTOR OF RESEARCH, THE SEGAL COMPANY

Ms. MAZO. Mr. Chairman, members of the committee, I appreciate the opportunity to testify here today. I am here also like Mr. Lynch as representing part of the Coalition that has put together its consensus proposal. I am here for the National Coordinating Committee for Multiemployer Plans, and I say with pride and trepidation, I have been on their working committee for 25 years.

And I hope, given the exchanges and what you are saying today, to welcome the supermarket industry into our coalition and in the near future because the three of us really share your goals, and share one another's goals, and we differ to some extent on some of the details along the way. But we really are in agreement both in congratulating you. I thought Tim Lynch's point was very well taken at recognizing a problem before it is an absolute crisis, but also congratulating you and your staff at doing the very hard work at understanding the distinct nature of multiemployer plans and, in fact, coming up with special rules for them rather than try to shoehorn our plans into a mold that may or may not work for single employer plans, but wouldn't necessarily recognize the realities of our industry.

With that said, as I said we agree, we think that there is work to do both with the staff and among ourselves, we agree with the idea of having clear steps, milestones along the way to prevent plans from deteriorating to a crisis situation. We are working with the Food Marketing Institute to try to come up with agreement on what the appropriate technical measurements would be that would be comfortable for all. As Mr. Lynch said, it is an extremely delicate balance to get everyone in the room agreed to exactly how far one is free to go and not to go.

I just want to summarize our philosophy on the multiemployer plan funding reform rules, and that is basically, we think that it is important to tighten the rules for plans, for multiemployer plans in general, the funding rules, to avoid preventable problems, to make sure that plans do, trustees do, look out into the future, plan appropriately, and take future costs into account. Along those lines, we applaud what your bill does, which is to bring the government along in that regard and raise the deduction limit because we estimate that some close to 75 percent of multiemployer plans were forced to increase benefits beyond what their trustees necessarily believed was appropriate.

During the 1990s, to protect the employers from punitive excise taxes and loss of tax deductions simply for living up to their bargaining agreement, the plans were doing well in those days. The employers were paying what they owed, and the automatic deduction limits that were going to cut off the employers who were living

up to their promises forced trustees to increase benefits and to dig the hole that they are now trying to climb out of.

So we strongly applaud that reform; we believe strongly in tightening the rules and clarifying the rules so plans won't get into danger and, as both of my colleagues have emphasized, coming up with appropriate tools so that when a plan does run into problems that the parties can't control because of the markets, because of demographics, et cetera, they can right the ship before it founders. I went on Google yesterday to find who said, I had this deep memory from history class in my mind, give us the tools and we will finish the job.

And the first person was Winston Churchill in 1940. The most recent person was the President of Tanzania. I think we all sort of share that objective as well. So thank you.

[The statement of Ms. Mazo follows:]

Prepared Statement of Judith F. Mazo, Senior Vice President and Director of Research, the Segal Company

Mr. Chairman and Members of the Committee, I am pleased to be here today to discuss the provisions of H.R. 2830 that are aimed at reforming and strengthening the funding rules that govern multiemployer defined benefit pension plans. The Segal Company is an international employee benefits, compensation and human resources consulting firm that serves close to 30% of the nation's multiemployer pension plans. Our clients provide a secure retirement income for more than half of the workers covered by multiemployer plans.

I appear here on behalf of a broad coalition of plans, employers, employer associations and labor organizations that sponsor multiemployer plans. The Coalition has put forth a carefully negotiated, balanced proposal for multiemployer pension plan reform, which has evolved through the efforts of many of the system's largest stakeholders. It is important to note that they represent the overwhelming majority of employers and virtually all of the unions in the construction, trucking, entertainment, service and food industries, as well as the membership of the National Coordinating Committee for Multiemployer Plans (NCCMP), which directly represents over 600 jointly-managed multiemployer pension, health, training and other trust funds and their sponsoring organizations across the economy.

I am pleased to see that you will also be hearing today from Mr. Timothy Lynch, President of the Motor Freight Carriers Association, which is part of our Coalition. We are also hoping to welcome the supermarket industry, today represented by Mr. Scroggin, to the group, as our shared goals for multiemployer pension reform are much stronger than our current differences over the details of how to reach them.

The NCCMP is a non-profit, non-partisan advocacy organization formed in 1974 to protect the interests of plans and their participants following the passage of ERISA and the increasingly complex legislative and regulatory environment that has evolved since then. The Segal Company has been the technical advisor to the NCCMP since its formation; I have been a member of its Working Committee for 25 years.

Initially, I want to congratulate Chairman Boehner and his staff for the care that you have taken to address the special issues facing multiemployer plans as distinct from the single-employer issues and problems. We appreciate the considerable effort that you have made to understand the special characteristics of multiemployer plans, the industries that support them and the labor-relations contexts in which they function, and to shape legislation appropriate for the multiemployer community rather than attempting to shoehorn multiemployer plans into the very-different single-employer requirements. We look forward to working together to refine the multiemployer provisions to be sure they achieve your goal and ours—stronger plans that do an even better job of meeting the needs of their participants, their employers and the industries that foster and sustain them.

Background

There are nearly 1600 multiemployer defined benefit pension plans in the country today. They provide benefits to active and retired workers and their dependents and survivors in virtually every area of the economy. Because of their attractive portability features, multiemployer plans are most prevalent in industries, like construction, which are characterized by mobile workforces. According to the latest informa-

tion from the Pension Benefit Guaranty Corporation, multiemployer plans cover approximately 9.7 million participants, or about one in every four Americans who still have the protection of a guaranteed income provided by a defined benefit plan. With few exceptions, these are mature plans that were created through the collective bargaining process 40, 50 or even 60 years ago and have provided secure retirement income to many times the current number of participants since their inception. Although some mistakenly refer to them as "union plans," the law has required that these plans be jointly managed with equal representation by labor and management on their governing boards since the passage of the Labor Management Relations (Taft-Hartley) Act in 1947.

This active participation by both management and labor representatives (many of whom are also participants in the plans) provides a clear distinction between single employer and multiemployer plans. Multiemployer plans are regulated not only under the tax and employee benefits laws and regulations and the watchful eyes of the Department of Labor, the Internal Revenue Service and the Pension Benefit Guaranty Corporation, with which all private-sector benefit plans must comply. In addition, they are subject to a second overlay of regulation, the federal labor-relations laws. Most important among these laws and regulations, the Taft-Hartley Act requires that the union and management fiduciaries who serve on these joint boards operate these plans for the "sole and exclusive benefit" of plan participants. This, of course, echoes and reinforces the capstone of ERISA, which imposes fiduciary obligations on plan fiduciaries that put at risk the personal assets of those who fail to meet their obligations.

It is estimated that over 65,000 employers contribute to multiemployer pension plans. The vast majority of these are small employers. For example, in the construction industry, which makes up more than 50% of all multiemployer plans (but just over one-third of the participants), it is estimated that as many as 90% of all such employers employ fewer than 20 employees. By sponsoring these industry plans, employers are able to ensure that their employees have access to comprehensive health and pension benefits and, through the jointly managed training and apprenticeship plans, the employers have access to a readily available pool of highly skilled labor, none of which would be feasible for individual employers to provide.

Funding for multiemployer plans comes from the negotiated wage package agreed to in collective bargaining. For example, if the parties agree to an increase in the wage package of $1.00 per hour over three years, the $1.00 may be allocated as 40 cents to the health benefit plan, 20 cents to pensions, 5 cents to the training fund and the remaining 35 cents taken in increased wages. Although for tax purposes the contributions that employers make to employee benefit plans are considered to be employer contributions, the funding comes from monies that would otherwise be paid to the employees as wages, health coverage or the like. Through collective bargaining the employees explicitly agree to take less in pay in order to fund the pension, so many of them feel as though they are making the contributions.

For the overwhelming majority of contributing employers, their regular involvement with the plans is limited to remitting their monthly payments to the trust funds as required pursuant to their collective bargaining agreements. For these small companies, the funds are the perfect substitute for making a large financial commitment to human resources functions, providing administrative services and meeting today's complex compliance requirements while providing economies of scale that would otherwise make such benefit plans unaffordable for small business. In effect, the employers have outsourced their employee benefits operations to the multiemployer plans and their labor-management boards of trustees.

Since the passage of the Multiemployer Pension Plans Amendments Act of 1980, participants of multiemployer plans have been covered by the benefit guarantee provisions of the PBGC. Unlike single employer plans, however, the PBGC is more like a reinsurer of last resort for multiemployer plans. Instead of having PBGC pick up the pieces when an employer goes out of business, all of the employers who contribute to these plans self-insure against the risk of failure by one another. Under the multiemployer rules, employers who no longer contribute, or cease to have an obligation to contribute to the plan, must pay their proportionate share of any unfunded vested benefits that exist at the time of their departure. This obligation, known as withdrawal liability, recognizes the shared obligations of employers in maintaining an industry-wide skilled labor pool in which employees may move among contributing employers dozens of times during their careers.

This system of shared risk has protected both the participants and the PBGC, as evidenced by the fact that it has had to intervene in fewer than 35 multiemployer cases over the past 25 years. The reduced risk to the PBGC is also reflected in a much lower premium for multiemployer plans—$2.60 per participant per year, versus $19 per participant per year plus a variable premium for single employer

plans. The PBGC guarantees a much lower benefit for multiemployer plans. The guarantee formula is expressed as an accrual rate, with the maximum at $35.75 per month per year of service. This works out to $12,870 per year for a participant with 30 years of service, compared with a maximum guaranteed annual benefit for single employer plans of roughly $45,000, for someone who retires at age 65. As of the last fiscal year, PBGC's multiemployer guaranty program showed a small deficit—about $236 million—which was in fact an improvement over the prior year. So the multiemployer program, which covers more than 20% of the people with PBGC-guaranteed pensions, has a projected deficit equal to about 1% of that projected for the single employer program.

The multiemployer system of pooled risk and mutual employer financial guarantees has been both one of the greatest strengths and major weaknesses of the multiemployer system. In the early 1980s, the presence, or even the threat of withdrawal liability produced a chilling effect on the growth of multiemployer plans that has persisted in several industries despite the fact that most have had no unfunded benefits for most of that time. On the other hand, for many, the threat of unfunded liabilities provided an incentive to plan fiduciaries to adopt and follow conservative funding and investment policies that, in combination with a robust economy, led the plans to become fully funded.

Nevertheless, rather than being able to build a buffer against future economic downturns, this success led plans to experience problems at the top of the funding spectrum. In the late 1980s and throughout the 1990s, plans began to hit the full funding limits of the tax code. Under these provisions, employers that contribute to plans in excess of these limits were precluded from receiving current deductions for their contributions to the plans. Compounding the situation, employers who continued to make their contributions also faced an excise tax for doing so, despite the fact that the collective bargaining agreements to which they were signatory obligated them to continue to make them. Although in rare instances the bargaining parties negotiated "contribution holidays," timing considerations and the fact that in most cases the plan fiduciaries and bargaining parties were different people meant that plan trustees had no choice other than to increase plan costs by improving benefits to bring plan costs up to the level of plan income to protect the deductibility of employer contributions. Further, once adopted, the actions taken to improve the plan of benefits in order to protect the employers cannot be rescinded under the anti-cutback provisions of ERISA. We estimate that over 75% of multiemployer defined benefit pension plans were forced to make benefit improvements as a result of the maximum deductible limits, even when the trustees were skeptical about being able to cover the costs in the long term. Overall, multiemployer plans were very well funded as the plans approached the end of the millennium, with the average funded position for all multiemployer plans at 97% (see The Segal Company Survey of the Funded Position of Multiemployer Plans—2000).

In the three years that followed, however, these same plans, like all investors, suffered significant losses as the markets plunged into a deep and prolonged contraction. For the first time since the ERISA funding rules were adopted in 1974—in fact, for the first time since before the beginning of World War II—the markets experienced three consecutive year of negative performance. Not only were plans unable to meet their long term assumed rates of return on their investments, like just about all investors the plans saw their principal decline. For many of these mature multiemployer plans that depend on investment income for as much as 80% of their total income, the loss of significant portions of the assets caused a rapid depletion of what for most had been significant credit balances in their funding standard accounts. The most recent Segal Company multiemployer funding report shows a significant decline from the 97% in 2000, although the average funded position is still relatively healthy at 83%. Nevertheless, these investment losses have left a number of plans at all levels of funding facing credit balances approaching zero, meaning these plans face a funding deficiency in the near future (see The Segal Company Survey of the Funded Position of Multiemployer Plans—2004, attached). According to the most recent estimates, as many as 15% of all plans are projected to have a funding deficiency by the year 2008 and an additional 13% face the same fate by 2012 (assuming benefit levels and contribution rates remain unchanged).

The implications of a funding deficiency for contributing employers, the plans and their participants are potentially devastating. Once a plan's credit balance drops below zero, contributing employers may have to be charged additional amounts to make up the shortage so that the plan can meet its minimum funding requirements. This is above the amounts they have promised to pay in their collective bargaining agreements. In addition, they are required to pay an excise tax by the IRS equal to 5% of that assessment. It the full shortfall is not made up in a timely fashion, the excise tax may be increased to 100% of the shortage.

For many of the contributing employers, especially those in industries like construction that operate through competitive bidding and traditionally have small profit margins, they have bid their work throughout the year based on their fixed labor costs (including the negotiated pension contributions). For them, receiving an assessment for what could be multiples of the total contributed for the year, could be enough to drive them into bankruptcy. In this instance, the concept of pooled risk among contributing employers means that the shortage amounts as well as the excise taxes owed by the bankrupt employers would be redistributed among the remaining employers, invariably pulling some at the next tier into a similar fate. As more and more employers fail, those companies that are more financially secure begin to worry about being the "last man standing." The result is that they will also seek ways to abandon the plan before all of their assets are at risk. When all of the employers withdraw, the assets of the plan will be distributed in the form of benefit payments until the assets on hand are sufficiently depleted to qualify for assistance from the PBGC. At that point, participants' benefits will be reduced to the maximum guaranteed levels, as noted above, which are likely to represent only a fraction of the amount to which they would otherwise be entitled.

A Balanced, Negotiated Industry-Wide Response

Trustees of most plans faced with the prospects of an impending funding deficiency have already taken action to address the problem to the extent possible. For the most part, that has involved reducing future accrual rates or ancillary benefits that have not yet been earned, as the current anti-cutback rules prohibit reducing benefits that have already accrued, including all associated features such as early retirement subsidies and the like. In many cases, this has involved substantial reductions (e.g. 40% by the Western Conference of Teamsters, 50% by the Sheet Metal Workers National Pension Plan and the Central States Teamsters Pension Plan, and 75% in the case of the Plumbers and Pipefitters National Pension Plan). But financial impact of adjusting only future benefits is limited, especially for mature plans that have relatively small numbers of active workers earning new benefits. These actions on their own may be insufficient to avoid a funding deficiency. Moreover, it can be counterproductive to take too much away from the active workers, because they are the ones who must agree to increase funding for the pension plan.

Additionally, the modest recovery of the investment markets experienced in 2004 is only marginally helpful. For example, a $1 billion fund in 2000 that suffered a 20% decline in assets through 2003 would have to realize an annualized rated of return of 15% every year for the remainder of the decade to get to the financial position by 2010 it would have had it achieved a steady rate of 7.5% for the full ten year period. Other relief, including funding amortization extensions under IRC Section 412(e) or the use of the Shortfall Funding Method, have been effectively precluded as options by the IRS. Consequently, the only alternative available requires a legislative solution.

When the Pension Funding Equity Act of 2004 failed to give multiemployer plans short-term relief to help them over the current crisis, various groups began to evaluate alternatives. The objective was to find ways to strengthen plan funding to avoid or minimize risks that the trustees and the parties can control, and to provide additional tools to the plan fiduciaries and bargaining parties for plans that face imminent funding crises so that they can bring their liabilities and resources into balance. A broad cross section of groups that deal with many varieties of multiemployer plans from many different perspectives entered into extensive negotiations to develop a set of specifications for reform that all could agree on. The resulting specifications for reform reflect a carefully conceived compromise between employer and labor groups, undoubtedly quite different from what either group would have designed independently, but reflective of a desire by all parties to preserve the plans as valuable sources of retirement income security on a cost-effective basis. The result was the current coalition proposal, a copy of which is attached as an addendum to this testimony. Here is a summary of that proposal:

Summary of Coalition Proposal

The proposed specifications for multiemployer reform include three major components, supplemented with several clarifying and remedial changes intended to make the system work more effectively for plans, their participants and their contributing employers.

The first component is applicable to all multiemployer plans and has two major provisions geared to strengthening funding requirements for plan amendments that increase or decrease plan costs (specifically unfunded actuarial accrued liabilities) related to past service and to require that new benefits designed to be paid out over a short period, like 13th checks, be amortized over that payout period.

The other major provision would allow plans to build a "cushion" against future contractions in investments, and to save for the lean years when times are good, by increasing the maximum deductible limit to 140% of the current limits and repealing the combined limit on deductions for multiemployer defined benefit and defined contribution plans.

The second component of the Coalition proposal applies to plans that have potential funding problems, defined as those with a funded ratio of less than 80%, using the market value of assets compared to the actuarial value (as used for minimum funding) of its actuarial accrued liability. Such plans would be required to develop and adopt a "benefit security plan" that would improve the plan's funded status. Plans in this category would not be able to adopt amendments to improve benefits unless the additional contributions related to such amendment more than offset the additional costs to the plan. Amendments that violate that restriction would be void, the participants would be notified and the benefit increase would be cancelled.

To provide additional tools to help multiemployer plans deal with looming funding problems, they would have "fast track" access to five-year amortization extensions and the Shortfall Funding Method if certain criteria were met. IRS authorization could be withheld only in certain circumstances and applications would need to be acted upon within 90 days or the approval would be automatic. Additional restrictions that currently apply to plans with amortization extensions would also apply, although it would be clarified that plans could increase benefits if the result would be to improve the plan's funding because the increase generates contributions above and beyond the amounts needed to pay for the benefit increases.

The third and most critical component involves plans that have severe funding problems or will be unable to pay promised benefits in the near future. The intent is to prevent a funding deficiency that could trigger a downward spiral of the plan and its contributing employers and ultimately thrust the funding of the benefits onto the PBGC. This would be accomplished by providing the bargaining parties and plan fiduciaries with additional tools beyond those currently available to bring the plan's liabilities and resources back into balance.

The Coalition proposal modifies the current multiemployer-plan reorganization rules to provide a useful mechanism for plan sponsors, much like a Chapter 11 bankruptcy reorganization. ERISA currently has reorganization rules governing plans that are nearing insolvency, but those rules were adopted at a time when the major concern was a plan's ability to meet its payment obligations to current pensioners. Today, even those plans with the most severe funding problems have sufficient assets to meet their obligations to current pensioners. The Coalition proposal suggests several new triggers to reorganization that reflect the problems of mature plans, recognizing that funding ratios below 65%, a plan's short term solvency and a plan's demographic characteristics (i.e. the relationship between the present value of benefits earned by inactive vested and retired participants to that of currently active participants) can play an important role in a plan's ability to meet its obligations to all participants, current and future.

Once a plan is in reorganization, notice would be given to all stakeholders and the government agencies with jurisdiction over the plans that the plan is in reorganization and describing the possible consequences. Once in reorganization, plans would be prohibited from paying out full or partial lump sums, social security level income options for people not already in pay status, or other 417(e) benefits (except for the $5,000 small annuity cashouts). Within thirty days, contributing employers would be required to begin paying a surcharge of 5% above their negotiated contribution rates. If the bargaining agreement covering such contributions expires more than one year from the date of reorganization, the surcharge would increase to 10% above the negotiated rate and remain there until next round of bargaining. Once in reorganization, the normal funding standard account continues to run, but no excise taxes or supplemental contributions will be imposed if the plan encounters a funding deficiency.

Not later than seventy-five days before the end of the first year of reorganization, the plan fiduciaries must develop a rehabilitation plan to take the plan out of reorganization within ten years. The plan would set forth the combination of contribution increases, expense reductions (including possible mergers), benefit reductions and funding relief measures (including amortization extensions) that would need to be adopted by the plan or bargaining parties to achieve that objective. Annual updates to the plan of rehabilitation would need to be adopted and reported to the affected stakeholders. Although the proposal anticipates the loosening of the current anti-cutback rules with respect to ancillary benefits (such as subsidized early retirement benefits, subsidized joint and survivor benefits, and disability benefits not yet in pay status), a participant's core retirement benefit at normal retirement age would not be reduced. Additionally, with one minor exception which follows current

law regarding benefit increases in effect less than 60 months, no benefit for pensioners already in pay status would be affected. Finally benefit accruals for active employees could not be reduced below a specified "floor" as a means of ensuring that the active employees whose contributions support all plan funding, remain committed to the plan.

The proposal anticipates that these ancillary benefits become available as part of a menu of benefits that can modified to protect plans from collapsing under the weight of previously adopted plan improvements that are no longer sustainable, but that cannot be modified under the current anti-cutback restrictions. Without such relief participants would receive lower overall benefits on plan termination and the plan would be eliminated for future generations of workers. Within seventy-five days of the end of the first year a plan is in reorganization, the plan trustees must provide the bargaining parties with a schedule of benefit modifications and other measures required to bring the plan out of reorganization under the current contribution structure (excluding applicable surcharges). If benefit reductions alone are insufficient to bring the plan out of reorganization, the trustees shall include the amount of contribution increases necessary to bring the plan out of reorganization (notwithstanding the floor on benefit accruals noted above). The trustees shall also provide any other reasonable schedule requested by the bargaining parties they deem appropriate.

The bargaining parties will then negotiate over the appropriate combination from among the options provided by the trustees. Under this proposal, benefits for inactive vested participants are subject to reduction to harmonize the impact on future benefits for this group as well as for active participants.

The proposal includes suggestions for: bringing the current rules on insolvency in line with the proposed reorganization rules; strengthening withdrawal liability provisions; and providing construction industry funds with additional flexibility currently available to other industries to encourage additional employer participation. It also includes provisions that address recent court rulings. One suggested change would allow trustees to adjust the rules under which retirees can return to work and still receive their pension benefits and another would confirm that plans can rescind gratuitous benefit improvements for current retirees adopted after the date they retired and stopped generating employer contributions.

The Challenge

For more than half a century, multiemployer plans have provided benefits for tens of millions of employees who, using standard corporate rules of eligibility and vesting, would never have become eligible. They offer full portability as workers move from one employer to another, in a system that should be held out as a model for all defined benefit plans. More importantly, the system of collective bargaining and the checks and balances offered by joint employer—employee management has enabled the private sector to take care of its own without the need for government support.

Yet the current funding rules, previously untested under the unprecedented unfavorable investment climate experienced in recent years, have the potential not only to undermine the retirement income security of millions of current and future workers and their dependents, but to force large numbers of small businesses out of business and eliminating participants' jobs.

Your Committee has an ideal opportunity to enact meaningful reform supported by both the employer and employee communities, who have coalesced behind a responsible proposal that will enhance plan funding and provide safeguards to plans, participants, sponsoring employers and the PBGC, without adding to the already burgeoning debt. We know that our proposal is unlikely to be the last word, of course, and we embrace the opportunity to work with the Committee and with others, including others in the private sector with a stake in multiemployer plans, to strengthen and polish the ultimate result. Along those lines, there are a few points regarding the way H.R. 2830 adapts the ideas that have been put forth that we believe deserve mention at this stage.

Section 202 of the Bill contains new funding and other requirements for multiemployer plans that are in "endangered" status that go well beyond what the Coalition has recommended for plans facing potential funding problems (colloquially referred to as the "Yellow Zone"). While we think there may be some merit in further tightening the reins on plans that may be heading for serious trouble, it is important that the standards not be so stringent that they could create insupportable costs for employers and thereby harm rather than help with plan funding. With that in mind, we are continuing to work with all concerned to come up with workable targets and correction mechanisms to help endangered plans to recover.

Section 202 also creates a new category—multiemployer plans in "critical" status—which is set up to address the special problems of plans that are near the brink of failure. As noted, the Coalition agrees that a program like this is needed (in our proposal, it takes the form of a redesigned approach to plan reorganization). However, the role of plan trustees at this point is vital to plan survival and, we believe, they need additional authority to restructure and revitalize seriously troubled plans substantially beyond what is proposed in H.R. 2830. Again, we anticipate working with you and your staff to come up with a suitable solution to these important policy questions, as well as to deal with the inevitable technical issues that arise in any legislative effort in this extraordinarily complex area.

Conclusion

The Coalition understands that whatever legislation is ultimately passed will include some provisions that are distasteful to the employers, the employees or both, because it will of necessity be a compromise. Our aim is to make sure that, in the end, the environment for multiemployer plans will be improved, so that they, their contributing employers and their participants are all well-served. The alternative is not the continuation of the status quo, but a much worse fate that includes: the loss not only of accrued ancillary benefits, but a substantial portion of a participant's normal retirement benefit as plans are assumed by the PBGC; the demise of potentially large numbers of small businesses and the loss, not only of pension benefits, but the jobs from which such benefits stem; and an increase in taxpayer exposure at the PBGC, an agency that is already overburdened.

In closing, I would like to thank you for taking the time to engage in this important discussion and for the opportunity to be with you here today.

MULTIEMPLOYER PENSION PLAN COALITION: SPECIFICATIONS FOR MULTIEMPLOYER PENSION FUNDING PROPOSAL

I. FOR ALL MULTIEMPLOYER PLANS

A. Faster funding

• Ten-year amortization of the net increase or decrease in unfunded actuarial accrued (past service) liability (AAL) due to a plan amendment increasing or decreasing benefits.

• If the increase or decrease in AAL results from an amendment adding a benefit (not payable as a life annuity) that is payable over less than 10 years, amortization over the benefit payout period.

B. Deductibility

• The deduction limits for negotiated employer contributions to multiemployer pension plans would be 140% of the otherwise applicable funding limits spelled out in IRC section 404(a)(1).

• The combined limit on deductions for defined benefit and defined contributions would be repealed for multiemployer plans.

II. MULTIEMPLOYER PLANS WITH POTENTIAL FUNDING PROBLEMS

A. Trustee-Designed Program for Funding Improvement

• If, as of the first day of a plan year, a multiemployer plan's funded ratio is less than 80%, the trustees shall design and adopt a benefit-security program that is reasonably expected to improve the plan's funded status. The benefit-security program shall be adopted by the due date, plus extensions, and filed with the plan's Form 5500 for that first plan year, and shall be updated and modified annually thereafter until the plan's funded ratio reaches 80% or more.

B. Restrictions on Amendments Increasing Past Service Benefits

• If a multiemployer plan's funded ratio would be below 80% after taking into account an amendment increasing the amount or value of the plan's AAL (benefits related to past service), the amendment is prohibited unless——

1. the plan is not in reorganization and will not be put into reorganization as a result of the increase, and

2. reasonably anticipated employer contributions for the plan year equal or exceed the sum of the plan's normal cost plus the annual payment needed to amortize either——

(a) the increase in the plan's unfunded AAL attributable to the benefit increase over a 10-year period and the remaining (pre-existing) unfunded AAL over a 20-year period, or

(b) interest on the plan's unfunded actuarial accrued liability (including liability attributable to the benefit increase) and the plan is not projected to have a funding deficiency by the end of the 10-year period.

Technical Notes: Paragraph (a), above, is determined as if all the provisions of the plan amendment and the current contribution rate or, if applicable, the ultimate (last) contribution rates provided for under the then-current collective bargaining agreements take effect on the first day of such year.

The actuarial determinations under (a) or (b) may be based on a reasonable estimate of the plan's AAL and normal cost as determined in the actuarial valuation for the preceding plan year. For purposes of applying 2), any credit balances are not taken into account.

Enforcement of benefit restrictions. A benefit increase that violates the above restrictions would be void, and the participants would have to be notified that the benefit increase is cancelled.

C. IRC Section 412(e) Extensions of Amortization Period

• Fast-track extensions for multiemployer plans. The Secretary shall grant a 5-year extension of amortization periods to a multiemployer plan that demonstrates, with such supporting documentation as the Secretary may require, that the plan:

1. is projected, using reasonable actuarial assumptions, to have a funding deficiency within 10 years, unless benefits are reduced, contributions are increased and/or the amortization extension is granted; and

2. has developed and is carrying out a formal remedial plan that, in combination with the amortization extension, would improve the plan's long-term funded status, including the ratio of assets to accrued liabilities, and prevent the funding deficiency from materializing ("Remedial Plan"); and

3. would require substantially greater benefit reductions or contribution increases in the absence of the extension to avoid the funding deficiency, and

4. is projected to have enough assets to meet its anticipated cash-flow needs if the extension is granted.

• The extension shall be granted unless, within 90 days, the IRS denies it on the ground that the submission is incomplete or that the actuary's analysis or projections are erroneous or unreasonable.

Technical Note. If a rejected submission is resubmitted within 30 days, the initial 90-day IRS consideration period, plus an additional 45 days, applies. If a plan fails to take the steps described in its remedial plan (including modifications in the remedial plan that are agreed to by IRS), the fast-track amortization extension would expire as of the first day of the plan year following the failure and the remaining unfunded portion of each charge would be amortized over the remainder of the original amortization period, in accordance with the regular funding rules.

All of the conditions of IRC section 412(e) (as modified below) apply to a fast-track extension.

• Additional provisions regarding benefit restrictions for multiemployer plans receiving an amortization extension under IRC section 412(e). The existing section 412(e) benefit restrictions would apply. To encourage increased net contributions to the plan, a benefit increase would be permissible if the enrolled actuary certifies (and submits the supporting demonstration) that the additional charges to the funding standard account attributable to the benefit increase would be lower than the projected increase in credits due to a contribution rate increase that takes effect no later than the effective date of the benefit increase. A contribution increase can only be counted against the cost of a benefit increase if the added contributions were not identified in the remedial plan as a source of the plan's improved funding or, if so identified, if the related benefit increase was addressed in the plan as well.

D. Shortfall Funding Method

• A multiemployer plan may adopt the shortfall funding method, or go off the shortfall method, once every five years, without IRS permission, but only if it is not currently on a fast-track extension of amortization period under IRC section 412(e).

Technical Note. In the legislative history to ERISA, Congress called on the IRS to create the shortfall funding method to protect employers from a funding deficiency between collective bargaining sessions (but not for more than 5 years).

The proposed change would not affect the plan's ability to adopt an IRS-approved funding method without consent, or to adopt or go off shortfall before the end of a 5-year period with IRS consent.

• Prohibition on Benefit Increases. Amendments increasing benefits would be restricted in a plan that elects an automatic change to the shortfall method in the same manner that they are restricted in a multiemployer plan that has an amortization extension under IRC section 412(e).

III. MULTIEMPLOYER PLANS WITH SEVERE FUNDING PROBLEMS—REORGANIZATION

A. In General

• Plan reorganization is a process, like Chapter 11 of the Bankruptcy Code for a corporation, that provides a plan with additional tools to bring its benefit promises and resources into balance.

• A plan enters reorganization if it is expected to have a funding deficiency or to be unable to pay promised benefits in the near term (B, below).

• A plan in reorganization has latitude to reduce benefits (other than core benefits payable at normal retirement age) (E., F., below), and employers that contribute to such a plan must make additional contributions but are temporarily protected from unaffordable contribution increases resulting from funding deficiencies. (D, below).

B. Reorganization Triggers

A multiemployer plan is in reorganization as of the first day of a plan year (and remains in reorganization for at least 2 plan years) if the plan's actuary certifies, by a date no later than 2½ months before the end of the prior plan year, that any one of the following tests is reasonably projected to be met:

1. Solvency/funded-ratio test: assets at market plus anticipated contributions equal less than 7 years' projected benefit payments plus administrative expenses and, as of the first day of the plan year, the plan's funded ratio is less than 65%, or

2. Short-term solvency test: assets at market plus anticipated contributions equal less than 5 years' projected benefit payments plus administrative expenses, or

3. Funding deficiency/funded-ratio test: plan is projected to have a minimum funding deficiency for any of the following 3 plan years (without regard to any applicable amortization extension under IRC section 412(e)) and, as of the first day of the plan year, the plan's funded ratio is less than 65%, or

4. Short-term funding deficiency test: plan is projected to have a minimum funding deficiency for either of the following 2 plan years (without regard to any applicable amortization extension under IRC section 412(e)), or

5. Contribution/funding deficiency test: As of the first day of the plan year——

• projected contributions for the year are less than the sum of the plan's normal cost for the year plus interest on the unfunded liabilities (regular minimum funding assumptions for assets and liabilities), and

• the present value of the benefits of retired and terminated-vested participants is greater than the present value of the benefits of active participants accrued by the date of the calculation, and

• the plan is projected to have a funding deficiency for any of the 3 following plan years (without regard to any applicable amortization extension under IRC section 412(e)).

Technical Note: The actuarial determinations must be reasonable projections as of the first day of the plan year for which the plan will be in reorganization, with the value of the plan's accrued liabilities based on the actuarial assumptions used for ongoing plan funding. The projections may be based on the valuation for the plan year immediately preceding the plan year for which the determination is being made, or, if that valuation has not been completed by the end of the 6th month of the plan year, a reasonable projection of the liabilities determined as of the valuation date for the plan year preceding that one. The projected value of assets shall be the market value of the assets as of the last day of the 6th month of the plan year preceding the year for which the determination is being made (based on the most reliable information available to the trustees as of the determination date), projected forward at the plan's assumed earnings rate.

C. Reorganization: General Requirements

• Notice would have to be given, by the end of the first month that the plan is first in reorganization, to the participants, contributing employers, unions, employer bargaining representatives and the PBGC, IRS and DOL that the plan is in reorganization, with a description of the possible consequences.

• Trustees must develop a rehabilitation plan as is discussed in greater detail in Subsection G that would take the plan out of reorganization within 10 plan years. The rehabilitation plan (including the schedules described in, G, below) would describe the combination of contribution increases, expense reductions (including possible mergers), funding relief measures and benefit reductions (including benefit reductions permitted because the plan is in reorganization) that would be adopted or proposed to the bargaining parties, to achieve this. The rehabilitation plan must be filed by 2½ months before the end of the first plan year that the plan is in reorga-

nization. If within 60 days of the due date for the rehabilitation plan the Trustees have not agreed upon a plan, then any Trustee may require the plan to enter into an expedited dispute resolution procedure to determine the rehabilitation plan.

• If, under all of the circumstances, emergence from reorganization within that time frame is not reasonably possible, the rehabilitation plan would describe the alternatives considered, explain why emergence from reorganization is not feasible, and lay out steps to be taken to postpone insolvency or otherwise resolve the matter.

• A summary of the rehabilitation plan and each yearly update would have to be distributed to participants and employers with the annual multiemployer plan funding notice. The full document would be available to them upon request.

D. Funding Requirements for Plans in Reorganization

• Thirty days after the plan provides the contributing employer with notice of its reorganization status, there will be automatic employer contribution surcharges as follows:

  • The first year, the surcharge is 5% of the contribution rate required by the collective bargaining agreement.

  • The second year and thereafter while the plan is in reorganization, the surcharge is 10% of the contribution rate required by the collective bargaining agreement.

  • The surcharge will terminate upon the execution of a new collective bargaining agreement which adopts a schedule of benefits published by the trustees pursuant to the rehabilitation plan.

• The plan shall have a statutory cause of action to collect surcharges.

• Surcharge contributions may not be the basis for benefit accruals.

• Normal funding standard account continues to run during reorganization except there will be no excise taxes or additional contributions if a funding deficiency occurs while a plan is in reorganization.

E. Benefit Restrictions for Plans in Reorganization

• Effective as of the first day of the plan year that the plan is in reorganization, the plan shall not pay the following to people retiring on or after that date: lump sums, partial lump sums, social security level-income payments or other 417(e) benefits, except for $5,000 small-benefit cashouts.

• The IRC section 412(e) restrictions on benefit increases apply.

F. Benefit Reductions for Plans in Reorganization

• In General: Core benefits payable at normal retirement age will be protected as provided under current law. However, the anti-cutback rules will be revised to permit limited modifications of certain protected benefits, as follows:

• The otherwise-prohibited benefit reductions that would be allowed while a plan is in reorganization would be limited to:

1. "benefits, rights and features" (e.g., post-retirement death benefits, 60-month guarantees, disability benefits not yet in pay status, early retirement benefits and the like),

2. retirement-type subsidies (including, e.g., unreduced QJSA), early retirement benefits and payment options other than the 50% joint-and-survivor benefit and single-life annuity, and

3. as provided under current law, benefit increases that would not be eligible for PBGC's guarantee on the first day of reorganization because they were adopted or, if later, took effect less than 60 months before that.

• Except as provided above, the accrued benefit at normal retirement age could not be reduced under the plan reorganization rules.

• Except for rescission of recent benefit increases, the reorganization rules would not authorize reduction in protected benefits of participants who were in pay status one year before the first day of the year the plan enters reorganization. .

• Benefit reductions made under the special authority of plan reorganization would be reflected in the minimum funding standard account but not in withdrawal liability calculations; surcharges would not be reflected in the employers withdrawal liability allocations.

G. Procedures for Benefit Modification

• By 2½ months before the end of the plan year in which a plan goes into reorganization, the Trustees must provide to the negotiating parties a sliding schedule of benefit modifications and contribution increases that would meet the rehabilitation plan. At a minimum, the Trustees must provide the parties with the following schedules:

1. A schedule of the benefit cutbacks and other measures required to bring the plan out of reorganization if there are no further increases in contributions to the

plan. If the plan cannot emerge from reorganization without contribution increases, then the Trustees shall provide a schedule showing the amount of contribution increase necessary to bring the plan out of reorganization assuming all benefits are cut back to the extent permitted by law, provided that future accrual rates are not reduced below an accrual rate equivalent to a) 1% of the contributions made with the respect to the participant's work or, b) if the current accrual rate on the effective date is less than 1% then no less than the current accrual rate.

• In the event the parties do not adopt a schedule approved by the trustees then the trustees shall impose this schedule as the default schedule except that the mandatory surcharges described at Subsection D above shall remain in effect.

• If the employer refuses to comply with the default schedule then at the discretion of the Trustees that employer's participation in the plan may be terminated in which case the employer will be deemed to have withdrawn or if applicable, partially withdrawn.

2. Upon the request of the bargaining parties the trustees shall provide a schedule of the contribution increases and other measures required to bring the plan out of reorganization assuming there are no cutbacks in protected benefits, and

3. The trustees may, in their discretion prepare and provide the bargaining parties with any additional schedules that they deem appropriate for the parties' consideration.

4. The schedules required in this Subsection shall in the discretion of the trustees be updated periodically to reflect the experience of the plan, but not less than once every three years. A schedule that has been adopted by the bargaining parties through the collective bargaining process shall remain in effect for the duration of the collective bargaining agreement.

• For active participants, the Trustees' decision to implement a benefit cutback would be driven by the contribution obligation negotiated by the parties, i.e., the impact on each group will depend on what they negotiate. The Trustees shall include an allowance for funding other participants' benefits in the schedules provided to the bargaining parties, and shall reduce their benefits to the extent permitted hereunder and deemed appropriate based on the plan's overall funding status and prospects in light of the results of the parties' negotiations.

IV. INSOLVENCY

A. As under current law, the plan administrator would have to perform a PBGC-prescribed solvency valuation for the first year the plan is in reorganization and at least every 3 plan years thereafter. If, as a result of one of these valuations, the plan is expected to become insolvent by the end of the 5th following plan year, annual insolvency valuations must be performed.

B. If the current market value of available plan assets (without regard to expected contributions and earnings) is equal to no more than 5 years of projected benefit payments, accrued benefits may be reduced to the level necessary to postpone insolvency by another 3 years, but in no event below the PBGC-guaranteed level. Any such reductions in accrued benefits must be matched by proportional reductions in the rate of future accruals.

C. In the year a plan becomes insolvent, accrued benefits must be reduced to the level supportable by the plan's available plan assets, but not below the PBGC-guaranteed level.

D. These requirements would run parallel to the plan reorganization rules and whatever rehabilitation measures the Trustees take pursuant to those provisions.

V. DEFINITIONS

A. For purposes of IRC Sections 412(e), 412(f), 412(o), the plan reorganization rules and the comparable ERISA sections plus section 204(h), "plan amendment", in the case of a multiemployer plan, means an amendment to the plan or related documents adopted by the Board of Trustees.

B. For purposes of the new provisions of the Code and ERISA added by this legislation, unless otherwise specified,

1. except with respect to the rules in I.A., "actuarial accrued liability" and "normal cost" are determined based on the unit credit actuarial funding method,

2. the value of plan liabilities is determined using the actuarial assumptions described in IRC section 412(b) that have been or are expected to be used for the plan year for which the determination is being made, and

3. A plan's "funded ratio" is the ratio of the market value of its assets to the actuarial value of its actuarial accrued liability.

VI. WITHDRAWAL LIABILITY REFORMS

A. Strengthen and clarify withdrawal liability rules for all plans

• Repeal ERISA section 4225, which reduces or subordinates withdrawal liability claims under various circumstances involving employer liquidations.

• Repeal ERISA section 4219(c)(1)(B) which arbitrarily limits an employer's withdrawal liability payments to twenty years of payments.

• ERISA section 4205 should be amended to make clear that an employer who performs work formerly covered by a pension plan incurs partial withdrawal regardless of whether the employer uses employees of a third party to perform the work.

B. Repeal the special trucking-industry rule.

C. Rationalize withdrawal liability rules for construction plans, by extending to them the following rules applicable to other plans.

• Ability of trustees to adopt a "5-year free look"

• Ability to amend the withdrawal-liability allocation rules to re-start presumptive-rule pools when plan as a whole is fully funded, to eliminate old remnants of individual employer's liability.

VII. MISCELLANEOUS OTHER ISSUES

A. Heinz fix, modeled after Alaska Teamsters fix—trustees would be allowed to adopt stricter benefit-suspension rules applicable to people who retire after adoption of the stricter rule—retroactive to 1/1/1976.

B. Sheet Metal fix: multiemployer plans can rescind benefit increases for retirees adopted after the date of retirement.

VIII. EFFECTIVE DATES

Unless otherwise specified, the effective date would be the first day of the first plan year beginning after enactment. New sections I.A and II.B—tougher standards for benefit increases—would not apply to previously negotiated benefit increases which restore benefits lost due to benefit cuts adopted between 2000 and the date of enactment, if, in connection with (and at the time of) the benefit reductions, the plan document, trust agreement or related documents promised to restore lost benefits if contributions were increased. Section II.D.—adoption of shortfall funding method—would be effective as of the 2003 plan year (retroactive filing of Schedule B permitted).

Chairman BOEHNER. Let me just say, I want to thank all three of you, and the various parts of the Coalition and people who aren't necessarily in the Coalition, for your willingness to work with us.

We strongly believe that if we are going to do comprehensive pension reform that it should include multiemployers as well as single employer plans, ought to include cash balance, ought to include investment advice and we ought to deal with this in a meaningful way.

And I appreciate there has been an awful lot of conversations, a lot of negotiations, but I have got to say I am a bit disappointed that we have yet to come to some agreement.

Now, Mr. Lynch, you referred to the benchmarks in the so-called yellow zone as insurmountable and unreasonable for those plans that would be moving from what we have been referring to from the red zone into the yellow zone. And some members of the Coalition have been critical of those benchmarks that Mr. Scoggin believes are necessary. But over the last several weeks, we have asked on numerous occasions for, all right, if these benchmarks aren't the right benchmarks and this time frame isn't the right time frame, what are the right benchmarks, what is the appropriate time frame, and yet nobody can share formation with us. And I have to say I am a bit surprised. I don't want to be in the

middle of your negotiations, but we are trying to be helpful in terms of trying to find the right mix.

I happen to believe what Mr. Scoggin and the FMI types believe, that having clear benchmarks are the surest way to get plans up to 100 percent funding. And we provide more flexibility by allowing the plans to be overfunded without the imposition of an excise tax. And so do we have some reason why we are stuck in neutral here?

Mr. LYNCH. I guess that one is for me, huh?

We had a meeting last week. It included something on the order of 10 actuaries representing various funds. I was disappointed I wasn't involved in that meeting.

Chairman BOEHNER. I am sure you were.

Mr. LYNCH. They were trying to work through from a real-life perspective. If these plans didn't exist and just started up today, I suspect maybe those benchmarks wouldn't be as difficult as we think they can be. But unfortunately, at some point when this becomes law, the plans that are going to fall in those categories, particularly, as I said, at the lower end of that category, may have a difficult time getting up and meeting the benchmark.

Does that mean they shouldn't meet some benchmarks? Of course not. It is just that the particular benchmarks and how they are calculated could result in very significant increases to the contributing employers and further benefit modifications to the plan beneficiaries.

Chairman BOEHNER. I fully understand that. I think all of you realize that it is in the interest of, it has been in my interest and I think in the interest of the members on both sides that both the contributing employers and the representatives of labor come to an agreement on this issue.

Now, we do have language in the bill currently. It is my intent to leave that language in the bill and continue to work with all of you to try to come up with the right formula. And I know that—let me ask you, Mr. Scoggin, since you had supported the benchmarks that we have in the bill, you understand the problems of companies that are coming out of the red zone and they are going to have a difficult enough time getting out of the red zone into the yellow zone where then we impose these hard benchmarks. Do you have ideas about how we can move forward here?

Mr. SCOGGIN. Thank you, Mr. Chairman. Oh, I do. I think FMI does, but to put it a little bit into perspective we have also done quite a bit of modeling based on a number of real-life situations with real-life funds that we have looked at to determine whether, because obviously we are committing ourselves to benchmarks in our industry as well, whether these are realistic and reasonable, and to date our modeling indicates that they are. And we would welcome, from the Coalition or from others, modeling that may be, you know, would show a different result so that we can understand that.

But I do understand the issues that the Coalition has raised and I will admit that our group looked primarily at keeping healthy funds healthy because we think that is the most important way to take care of problems. There may be some transitions, transitioning language or transitioning abilities that we could provide to funds coming out of the red zone. We certainly, from the

FMI standpoint, would be willing to listen to some of that. To date, you know, we haven't heard any of that, but we think even with transitioning language it ought to be solid, it ought to be firm and it ought to provide hard guidelines, because we think that it is true that trust funds and the bargaining parties in those funds are going to have to make hard decisions, and some of those hard decisions are going to be required to align contribution streams with promised benefits.

Chairman BOEHNER. Well, I don't want anyone to overread my remarks. I do appreciate the tremendous progress that we have made between the employer groups and the labor groups and your willingness to work with members on both sides of the aisle. It is just that I want to make it clear that I want to keep encouraging you to continue your conversation. We are going to a subcommittee markup next week. We will be in full committee markup the week after that. I don't want anyone to not be on notice that we are going to proceed, and we want to continue to work with you as we do that.

Chair recognizes—well, let me announce that we now do not expect to have votes until 1:45 to 2 o'clock. So if we work hard we will save you the problem of being gone for an hour and then coming back.

Chair recognizes the gentlemen from Michigan.

Mr. KILDEE. Thank you, Mr. Chairman. I am very concerned about the multiemployer plans out there. I have talked to a number of my people back home. I think we are reluctant and perhaps unlikely to write separate plans for the grocer chains than we would for the other, so it would be great if the three of you could come to the table, continue your dialogue and discussion, come to the table with a plan that would protect those things you feel are very, very important.

I would encourage you. I think what you have done so far is very encouraging. Mr. Boehner's bill has some differences from the Coalition's proposal. The inclusion of the zone benchmarks requiring plans to decrease the underfunding by one-third would be one area of difference. And the additional benefit restrictions in the yellow zone are tougher than the quotas in these proposals. Do you think that there is a possibility of you to resolve those differences and come with a single plan.

Ms. Mazo.

Ms. MAZO. I am very optimistic. Two of my actuarial colleagues were in these marathon conference calls that Tim Lynch described going on last week, and I think that it was helpful for the chairman to pound some heads, frankly, and make some people get in rooms that we might not have otherwise done. Some our concern is not just with the specific numbers in the benchmarks per se, but in some of the mechanisms and how they work, and I feel I would be a little bit remiss not to point out that the grocery industry is a tremendously important part of the multiemployer community. It represents more than 14 percent of the participants. But the construction industry, which represents something like 37, 38 percent of the participants in multiemployer plans and more than half of the plans, is structured—the plans in the industry itself are structured very differently. The people are very mobile. They really kind

of work for the industry rather than any one given employer. The contractors that are contributing employers, on average, are less than 20 employees per company, and so some of the mechanisms and the plans also tend to be much, much smaller.

The average, more than three-quarters of the multiemployer plans in this country are fewer than 5,000 people, something less than half are fewer than $100 million in assets. So some planning ideas, some forward-looking ideas, and some bargaining-related solutions that might fit in an industry that has major chains, largely major chains and a largely stable workforce might not work for other industries that are in the multiemployer world, and that is part of what we are trying to accommodate. We too would prefer not to have a bunch of bright mind—things as fundamental as basic funding rules, and we do think it is important, as I said, to have safeguards that prevent plans to the extent possible from falling into trouble.

But we are trying to accommodate the different shapes and sizes and capabilities of the different plans.

Mr. KILDEE. And there are different shapes and sizes. I pulled wire for IBEW for a while, and of course worked out of the hall, was assigned to an employer who needed electricians. So there are differences. But if you can kind of bring this together so everyone can find some satisfaction and come united to this table, it would be very, very helpful.

Ms. MAZO. And hopefully we will be able to do that.

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

Mr. KLINE [presiding]. I thank the gentleman. I am mindful of Chairman Boehner's timetable. I would like to keep moving. I would like to take a couple of minutes. I have a whole list of questions.

First, I want to say that I think it is very, very important that this committee took up multiemployer plans and I know that the three panelists agree with that and it seems to me that we have done a pretty good job so far. We are looking forward to continuing the work. One of my concerns has, all along, been in the multiemployer plans, how do the smaller employers gain visibility and gain more ability to participate in the decision making process?

And it could go to any of you. I have written down here by my question Mr. Scoggin. Do you think that this bill, this Pension Protection Act, is going to enhance the ability of smaller employers to be involved?

Mr. SCOGGIN. Let me begin by pointing directly to the transparency rules in this bill, which I think are well thought out. And I believe that they will provide those small employers who today maybe have more difficulty obtaining insight into the health, the funded status of a plan, where that plan is going, even though they are contributing to that plan.

Mr. KLINE. Isn't it true that there are many small employers who have no visibility?

Mr. SCOGGIN. I would agree.

Mr. KLINE. I am just sorry. Just so everybody understands, we have a situation where you have employers who are paying benefits into a plan and they have no idea about the status of that plan.

Mr. SCOGGIN. Yes, sir, that is exactly where I wanted to go, is to point out that we have hundreds, if not thousands of employers out there who are very good, unionized, honest employers who make significant contributions to benefit funds and do not have an ability to obtain direct access to information. And in our industry and through the FMI, we believe that the transparency rules that have been built into this bill will provide great benefit to those employers and certainly will allow them to address issues also in their collective bargaining when they have more full access to information as they engage in that collective bargaining.

Mr. KLINE. Either of you have any comments on that.

Mr. LYNCH. I think part of the issue there, Congressman, is not only the lack of access to information, but I think some of the folks who have mentioned this also have concerns about the ability to have representation as trustees on these plans. When you look, we contribute to something like 90 different multiemployer plans around the country. They range in size from the biggest, the Western Fund, the Central States Fund in the mid $20 billion asset range, all the way down to plans that may involve only one local in the East with a couple, $100,000 or million dollars in assets.

We believe pretty strongly that the contributing employers need to be better represented on the plans. It is somewhat interesting how some of the management trustees find their way on the plans, and that takes a process, frankly, of changing the plan documents, and we have undertaken an effort, at least my association has, to try and carefully look at that and try and ensure that there is a little better cross-representation of the contributing employer base.

Mr. KLINE. Thank you.

Ms. MAZO. I guess I have a couple of, just a few little points to say. The point that Mr. Lynch just raised, I just want to emphasize that is exclusively a management issue, the decision on how management trustees are selected. In fact, it is illegal for the union side to have any input on that. So that is something that the employers need to work out.

The other point, and I do think that transparency will help small employers understand what they are doing, and the smaller local plans in fact do pretty much know what is going on because it is all kind of one community. It is the very large plans which in fact are some of the most efficient and the most effective ways to deliver benefits with the greatest capability of meeting all of the administrative needs that does end up kind of swamping the smaller local contributor. And the point of the plans is, in fact, that both the employees and the employers delegate their responsibilities to their representatives to handle things.

In my testimony I mentioned that multiemployer plans for many of the employers are really an outsourcing. The multiemployer group, including the multiemployer bargaining agent which the Motor Freight Carriers Association serves as, handles the process for—in many places, for their members, the Associated General Contractors does that. They are kind of like a union of employers.

And so the small employers are welcome to take part, but they may find that they regret what they wished for when they see the documentation, the overwhelming degree of work that goes into paying attention to this. They can't have every one employer deter-

mine its own employee's benefits and still be part of a big pool of benefits. That is why multiemployer plans work.

Mr. KLINE. Thank you for your comments. I must say, however, I think it would be very useful for those employers, large or small, to know what is going on in a plan that they are participating in.

Ms. MAZO. And we have no concern about transparency. That I agree with.

Mr. KLINE. Thank you very much. My time has expired. The gentleman from New Jersey, Mr. Andrews.

Mr. ANDREWS. Thank you, Mr. Chairman, I want the record to reflect my appreciation for the efforts of Mr. Boehner, and Mr. Johnson, and obviously Mr. Miller and the staffs on both sides to try to solve this multiemployer problem. It is a significant problem, and we need to fix it.

I frankly believe we should have fixed it last year. That was a subject of rather intense debate around here, and I want to commend all those involved in these very Churchillian negotiations we went through and are continuing to go through.

I would echo Mr. Boehner's admonition that you keep at it, try to find a way to reach accommodation with his view and other views as well. One of the things that I would like to make sure we get on the record is the benefits of the agreement or something like the agreement that you have reached. There is a lot of difficult aspects of this agreement.

No one here ever wants to say that he or she voted for a decision making system that could result in not being able to increase people's benefits, no one wants to do that, and certainly no one here wants to be accused of in any way contributing to the reduction of people's benefits, and that is politically a volatile discussion.

The reality is, and it is a hard reality, for some beneficiaries and some plans, I think the choice is whether they have any benefits at all or whether their benefits are cut dramatically or whether they can be largely preserved, and that is a hard problem to be working on. You have my support and my appreciation.

But I think we should also get on the record the benefits. If we have real and meaningful relief for multiemployer plans, we are told by Ms. Mazo's testimony that right now about 15 percent are in some trouble, and I think it was 13 percent. The number may grow to 15 percent in 2008. What happens when we don't do these hard things? Let's paint the most troublesome scenario. If we don't give multiemployer plans the relief that they need, what would happen to the people covered by these plans that are in difficult shape? And any of you can answer that question.

Ms. MAZO. If we were to start to have funding deficiencies in multiemployer plans, we fear that could really be catastrophic. First of all, it could have a domino effect based on the loss of confidence that employers and employees would have in their plans. A funding deficiency would mean that the employers would be faced with contributions mandated on them well beyond what they had promised and collective bargaining and all the parties agreed to.

Mr. ANDREWS. I know all the members of the committee know this, but I think it is important to let the record reflect, Ms. Mazo, what happens when one or two employers in a multiemployer plan

have a hard time meeting their obligations? What happens to the other people that are left?

Ms. MAZO. This in fact is part of what we are struggling with now. It is the mature plan. The plans are designed to be funded with each employer paying essentially a uniform share. There are variations. But roughly so, it doesn't matter how old or young their workforce is. Everybody contributes to a common pool and that funds all of the benefits. If some employers stop funding, they go out of business or they get seriously delinquent, the costs still have to be met, and that rolls over on to the other employers. And if that then makes the burden too heavy on the other employers, some of them are likely to tumble down, thus increasing and increasing and increasing the burden until it becomes completely supportable for the employers that are left.

Mr. ANDERSON. It sort of has a pancaking effect, doesn't it? One leaves and that puts more stress on the group that is left, then someone else leaves and that puts more stress, and so on. I think it is very important that we get the word out that the work you have done is to preserve full and robust pensions for millions of people.

And I firmly believe if we don't give plans the tools to deal with these problems, that we are going to have a much more serious one. So I would reflect what Mr. Boehner said, that we should all work as hard as we can to make sure that everyone's interests are accommodated. There will be no perfect compromise. I am sure that the compromise that was originally reached and not in the bill was very difficult for a lot of people to swallow.

But you know, I, for one, am a member that is prepared to work with you and sustain the political blows that may come from such a compromise in order to help. I appreciate your efforts.

Ms. MAZO. Thank you.

Mr. KLINE. Thank you. I thank the gentleman.

And the gentleman from Texas.

Mr. MARCHANT. Thank you, Mr. Chairman. The question I have has to do with the companies that go to the bargaining table for new agreements, and because it is easier, or has been in the past, easier to offer increased benefits in many occasions than it is to actually offer cash, is there anything in the Pension Protection Act that you see that will disincentivize that kind of activity or protect it?

Mr. LYNCH. If I can take a stab at that, Mr. Congressman, when we negotiate and I do the negotiations on behalf of these companies, we don't negotiate the benefit level, we don't negotiate an administration of the plan. We negotiate a contribution level and then essentially it is left to the trustees of the plan to decide how they are going to use those assets to cover the promised benefits.

One of the things that frankly we worked on in this Coalition proposal was a balancing act between the responsibilities of trustees on these plans and the responsibilities of the bargaining parties. Both the union representatives and the management representatives felt very strongly that you have to maintain the sanctity of the bargaining process, and so consequently some of the difficult choices that Congressman Andrews was referring to, they

will in fact still be issues at the bargaining table because we think that is where we belong.

Mr. SCOGGIN. If I might, there are provisions within this bill which do cause the bargaining parties to think carefully about what sort of benefits they are committing themselves to, and I think one is a change in the amortization that is proposed in this bill for new benefits that are negotiated into a plan, because it will be shortened from a current 30-year period to a 15-year period, and I think that is responsible because it causes those benefits to be paid in a reasonable manner and shortens your mortgage, if you will, but it also causes all parties to think very carefully about what benefits are going to be promised and to ensure that contributions that are promised and the benefit that is promised will align.

Ms. MAZO. The point that Mr. Lynch made deserves some underscoring, and that is that the bargaining parts typically negotiate contributions to a multiemployer plan, and then the trustees, trustees based on the anticipated flow of contributions plus other earnings, determine what the benefits are.

So in the multiemployer world, it is not the case as it has been characterized sometimes in the single employer world, that it is cheaper for an employer to just promise benefits and pay for them 30 years from now than it is to pay current wages, because the employers in the multiemployer world are agreeing to pay the cash into the plan come what may. They aren't putting anything off and making kind of a promise and I will see if I can pay for it tomorrow. They are promising the money and then it is up to the trustees to arrange the plan so that the money is spent responsibly. And as Mr. Scoggin said, the bill tightens the rules so that in order to spend the money on benefits, you have to have essentially more money coming in faster to pay for them. So you can't make those promises unless you are quite sure that you will be paying for them responsibly. And if you are in any kind of trouble, then you have much faster rules for—well, under the bill you can't make additional benefit promises.

So the bill would tighten it, but also it has not been the same kind of temptation, I think, in the multiemployer world than it has been in the single employer world.

Mr. MARCHANT. We just recently, I think the country just recently began to understand a little bit more about how the pension guaranty fund works when it was announced at the United pension would be basically 40 percent, or $4,000, around $4,000 cap, for many of the lower back standers, et cetera, that covered their employees.

Do you think that the participants in the multiemployer plans fully understand how the pension security fund interacts with their personal pensions and what their provisions are? Are there documents that they sign that say, we understand what kind of pension plan we have, we understand what kind of insurance we have on this pension plan, we understand the maximum amount of money we can draw per month if this plan goes under?

Ms. MAZO. If I may, the short answer to your question is no. I doubt that any multiemployer plan participants even think about whether their PBGC aren't immune. The PBGC guaranty for multiemployer plans is much, much lower than it is for single employer

plans. It is roughly for somebody with 30 years of service, it is maybe close to $13,000 a year as compared with maybe $45,000 a year. But the guarantee also works very, very differently in the multiemployer world, for just the reason in fact that Mr. Andrews was identifying and that we are all here to try to resolve, and that is in the multiemployer plan all of the employers are sort of guarantors of one another, so that if one person's employer goes out of business they don't lose their pension plan. It doesn't go to PBGC. The benefits stay there and the other employers and hopefully new employers coming into the plan continue to fund it.

So multiemployer plans hardly ever have, in fact since 1980, 36 or so of them have had any contact with the PBGC in terms of guaranteed benefits. They don't go to the PBGC, they don't get their benefits cut until the plan runs out of cash completely, and even for a severely underfunded plan that would be a very long time. So they don't know what the level is for their guarantee, and for most of them it really is and has been and we hope will continue to be irrelevant.

Mr. KLINE. The gentleman's time has expired. The gentlemen from Virginia, Mr. Scott.

Mr. SCOTT. Thank you. Thank you, Mr. Chairman. As Mr. Andrews from New Jersey has suggested, we are looking at this from a perspective of what can we do to maximize the chances that employees will actually get their promised pension, and so we want to see how this bill affects that.

First, let me ask a question on management of these pension funds. I haven't heard anything about fees paid for management. Is that an issue that we should be looking at?

Mr. SCOGGIN. The law currently provides that, and I think we are talking about the trustees and the fees that are paid to the trustees? Is that the question?

Mr. SCOTT. Management generally. I know you pay a fee for—mutual funds get a fee, and some charge more than others.

Mr. SCOGGIN. Okay, I misunderstood the question. So with respect to the managers who would handle the funds that the trust fund has, I think given fiduciary rules that are very, very heavy on trustees at the trust table,at least for all the funds I have been involved with, the trustees take those all very seriously. Those funds, or those charges, those administrative charges, are in line with or less than I think what I have seen in any other given areas there. Really, truly we fight them hard to make sure that they are as low and as reasonable as they can be.

I turn to the panelists.

Mr. LYNCH. We made a very concerted effort about 5 years ago to try and start encouraging the people who would be trustees on the management side to have a blend, have people with a finance background, investment background, benefits background. That wasn't always the case.

So I think the caliber of trustee that we are getting on the management side has improved dramatically over the last, say, 10 years. And consequently decisions about investment advisors, actuarial advisors, et cetera, et cetera, has also gone up. We also tried to institute something of a best practices where one fund, if they

think something hasn't quite gone the way it should, we let the trustees know about that in other funds.

Ms. MAZO. One of the points of the multiemployer plans is that a whole lot of small employers can, as I said, basically band together and have the fund as a larger entity handle the investment and the benefit management. And, accordingly, in every case the fees are much less, except you know there may be some oddball cases, but the fees are much less than the great majority of the employers would ever be able to get if they tried to have their pension plans on their own.

Mr. SCOTT. I didn't hear any numbers as to what percentage funds are paying for management of the accounts. One percent? Half a percent? Two percent? Three percent? Does anybody know?

Ms. MAZO. I think it depends on the portfolio. Every manager——

Mr. SCOTT. Mutual funds, and you have the EFT funds go from anywhere from .1 percent to 2 or 3 percent.

Ms. MAZO. The funds are usually large enough to get less than 1 percent management fee. But this is something that we could check out and supplement the record with information if you like.

[The information follows:]

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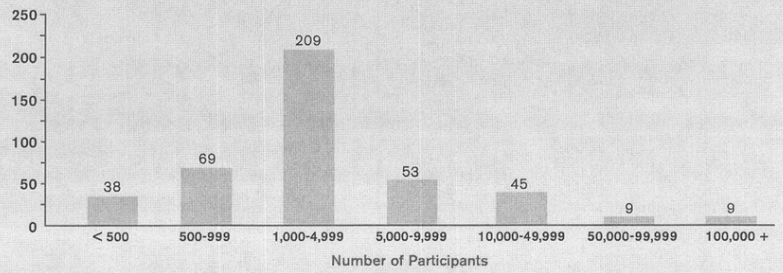
Benefits, Compensation and HR Consulting SPRING 2005

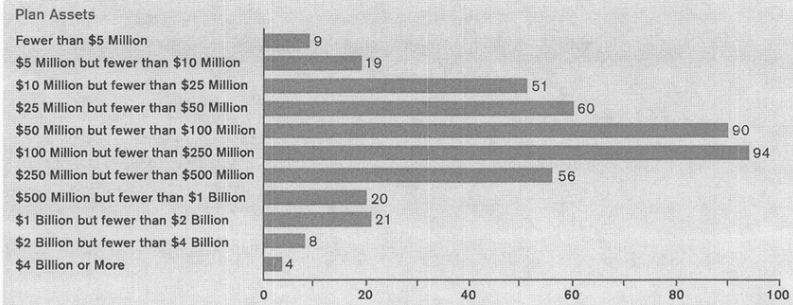
Supplement to the Report of Results of the 2004 *Survey of the Funded Position of Multiemployer Plans*

Number of Surveyed Plans by Number of Participants



Source: The Segal Company's 2004 *Survey of the Funded Position of Multiemployer Plans.*

Number of Surveyed Plans by Plan Assets



Source: The Segal Company's 2004 *Survey of the Funded Position of Multiemployer Plans.*

A brief report of other data from the 2004 *Survey of the Funded Position of Multiemployer Plans* is available, in PDF format, on the following page of The Segal Company's Web site: http://www.segalco.com/publications/surveysandstudies/spring05fundingsurvey.pdf

Atlanta	Chicago	Hartford	Minneapolis	Philadelphia	Toronto
Boston	Cleveland	Houston	New Orleans	Phoenix	Washington, DC
Calgary	Denver	Los Angeles	New York	San Francisco	

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Survey

Benefits, Compensation and HR Consulting SPRING 2005

Still Solid Funded Position of Multiemployer Pension Plans Reflects Additional Erosion

The Segal Company's 2004 *Survey of the Funded Position of Multiemployer Plans* found that the average withdrawal liability funded ratio of multiemployer pension plans was 83 percent. That figure represents a decline of four percentage points from the previous year's survey. The average withdrawal liability funded ratio continues to reflect the results of prior years of disappointing equity market returns coupled with the downside effect of computing liabilities at record-low interest rates.

The Segal Company, consultants and enrolled actuaries for all of the plans in the survey, compiled the data by examining each plan's actuarial present value of vested benefits as calculated for withdrawal liability purposes under the Multiemployer Pension Plan Amendments Act of 1980 (MPPAA).[1] This year's survey is primarily based on data available from plan years that ended in 2002 or 2003. Consequently, the results do not fully reflect the recovery of the U.S. equity markets or the continued decline in interest rates in 2004.

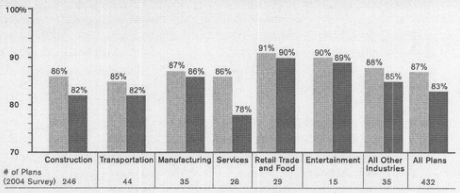
For most of the surveyed plans, the *funded* portion of the value of vested benefits was determined using adjusted interest rates based on rates prescribed by the Pension Benefit Guaranty Corporation (PBGC). To illustrate how interest rates have declined, consider that the immediate annuity valuation interest rate prescribed by the PBGC fell from 5.3 percent in December 2002 to 4.7 percent in December 2003. When computing liabilities, lower interest rates result in higher liabilities.

Survey Highlights

Survey highlights follow:

- ***The surveyed plans' average withdrawal liability funded ratio was 83 percent.*** This represents a decline of four percentage points from the previous survey and a decline of 12 percentage points from the 2002 survey. (In order to ensure that the overall survey statistics are not distorted by overfunded plans, *Segal excludes assets in excess of 100 percent of vested benefits from the calculation of average funded ratios.*)
- ***The average withdrawal liability funded ratios also declined in all industries.*** As Graph 1 shows, the retail trade and food industry and the entertainment industry had the highest funded ratios (90 percent and 89 percent, respectively), which were well above the average. Plans in the services industry experienced the greatest decline — from 86 percent in 2003 to 78 percent in 2004 — and also represented the lowest average funded ratio.
- ***The 2004 survey found that the average withdrawal liability funded ratios were highest for plans with the largest number of participants: 87 percent.*** As Graph 2 on the next page illustrates, declines in the average withdrawal liability funded ratio between the 2003 and 2004 surveys occurred for almost all groups. Plans with 10,000-49,999 participants were the exception because their average withdrawal liability funded ratio remained the same.
- ***The percentage of surveyed plans that were fully (i.e., 100 percent) funded for their vested benefits***

Graph 1: Average Withdrawal Liability Funded Ratios by Industry Group, 2003 and 2004 Surveys



Key: ▨ 2003 Survey (generally based on data available from plan years that ended in 2001 and 2002)
■ 2004 Survey (generally based on data available from plan years that ended in 2002 and 2003)

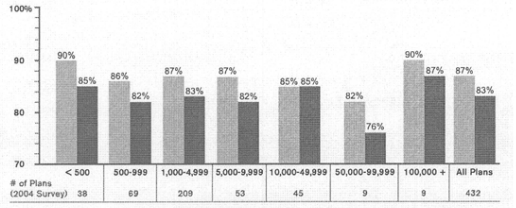
Note: Although the 2003 and 2004 survey samples were not identical, a comparison of the two years' results is valid because most of the funds in the 2003 survey were also in the 2004 survey.

[1] MPPAA assesses an employer that withdraws from a multiemployer plan a portion of the plan's obligation for vested benefits not matched by its assets. The withdrawal liability funded position of multiemployer plans is one indication of these plans' financial stability.

SEGAL

Survey

Graph 2: Average Withdrawal Liability Funded Ratios by Number of Participants, 2003 and 2004 Surveys



Key: ■ 2003 Survey (generally based on data available from plan years that ended in 2001 and 2002)
■ 2004 Survey (generally based on data available from plan years that ended in 2002 and 2003)

Note: Although the 2003 and 2004 survey samples were not identical, a comparison of the two years' results is valid because most of the funds in the 2003 survey were also in the 2004 survey.

declined by 14 percentage points since the previous survey. The 2004 survey found that only 17 percent of the surveyed plans were fully funded (down from 31 percent in the prior year's survey). This rate represents the lowest percentage since the survey was first conducted in 1983.[2] Although the percentage of multiemployer pension plans that were fully funded for their vested benefits declined through early 2004 (the endpoint of this survey), as noted, their average withdrawal liability funded ratio was 83 percent.

The Survey Sample

For the 2004 survey, Segal examined 432 plans, more than one-quarter of all multiemployer pension plans. Combined assets totaled almost $140 billion compared to the $132 billion in the prior survey. The surveyed plans covered almost 4.3 million participants, or 44 percent of all participants in multiemployer plans.

The surveyed plans, which represented a wide range of industries from across the country, varied greatly in size, ranging from those with less than $5 million in assets covering fewer than 500 participants to plans with more than $4 billion in assets covering more than 100,000 participants.[3]

Withdrawal Liability

Under MPPAA, employers withdrawing from plans whose assets fall below the actuarial present value of their vested benefits may incur withdrawal liability.[4] The amount of an employer's withdrawal liability is based essentially on the extent of the plan's unfunded vested benefits as of the end of the plan year preceding the withdrawal. The decline in the number of plans that are fully funded may result in increased assessments of withdrawal liability. The number of plans that have assessed liability to withdrawn employers increased from 146 to 163 since the last survey.

Outlook

As noted, this year's survey shows that the funded position of multiemployer plans continues to reflect the effects of several years of disappointing investment performance, record low interest rates for liability calculation purposes and a challenging economy. Moreover, changing participant demographics — higher ratios of retirees to active plan members — are expected to become an increasing concern for pension plans.

Looking ahead to next year's study, the environment is mixed: interest rates declined from 2003 to 2004, but there was a recovery in the investment markets during 2004. While it is impossible to predict whether the precise conditions will ever be present for funds to replicate the results of the late 1990s, the fact remains that the average withdrawal liability funded ratio for multiemployer plans was 83 percent.

■ ■ ■

Segal Company consultants and actuaries, together with investment consultants from Segal Advisors, our investment consulting affiliate, can be of assistance in developing the appropriate strategies for maintaining and enhancing benefit security.

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Atlanta	678.306.3100
Boston	617.424.7300
Calgary	403.692.2264
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Phoenix	602.381.4000
San Francisco	415.263.8200
Toronto	416.969.3960
Washington	202.833.6400

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[2] It is important to note that PBGC interest rates were much higher in 1983 than they are today.

[3] Graphs that break down the number of surveyed plans by participant size and plan assets are available on the following page of Segal's Web site: http://www.segalco.com/publications/surveysandstudies/spring05fundingsurveysupplement.pdf

[4] Segal's November 2002 *In Depth* presents an overview of MPPAA's withdrawal liability provisions. This publication is available, in PDF format, on the following page of Segal's Web site: http://www.segalco.com/publications/indepths/nov02withdrawalliability.pdf

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Mr. SCOTT. What are you recommending, and what does the bill recommend in terms of cutting benefits? And we talked about restrictions and tools, management tools and all that, and I think the employee is looking at benefit cuts. What kind of cuts are proposed for those in the yellow and red zone?

Mr. LYNCH. The cuts in the yellow zone that we had proposed would really be essentially all of those tools that are currently available to trustees now, reducing the accrual rate, ancillary benefits in certain categories, so in that category the tools are essentially the ones that are currently available.

Mr. SCOTT. Accrual means future benefits. What you have, what you thought you had earned and are entitled to, are different than

accruals in the future. Are you talking about reducing what had been promised in the past?

Mr. LYNCH. It would be the accrual rates. For example, you would take the rate—funds have taken the rate from say 2 percent accrual rate down to 1 percent accrual rate, which is what they are permitted to do now.

Mr. SCOTT. What does that have to do with somebody's check?

Mr. LYNCH. It probably as a practical matters means that on a sliding scale employees would have to work longer to earn essentially the same benefit.

Mr. SCOTT. Now, if you have worked and you want to quit today and you have accrued certain benefits, are you talking about anything that could adversely affect what someone thought they had already earned?

Mr. LYNCH. No. But if they were a 20-year employee and were planning to work 30 years, what they had earned at the 20-year stage would not be touched. What goes forward it would be or could be touched.

Mr. SCOTT. Is that everybody's understanding? That what you have earned and kind of have in the bank will not be adversely affected by any of these recommendations, but what you may be able to earn in the future may be affected?

Mr. LYNCH. Under the Coalition proposal the two areas that were absolutely untouchable was benefits for in-pay status, somebody who is already retired, and then essentially cutting back on the accrued benefit.

Mr. SCOTT. Okay. That is the Coalition plan. How is that different from what is in the bill?

Mr. LYNCH. At the moment in the red zone there is not a provision for that, but nor is there a provision for the mandatory additional employer surcharge.

Mr. SCOTT. Wait a minute. You mean what is not in the bill is a protection of what you thought you had earned? That is not in the bill?

Ms. MAZO. If I may, the Coalition proposed that if you are in the red zone, the trustees sub could make recommendations that the bargaining parties could act upon to cut side benefits, ancillary benefits, early retirement subsidies even if they had been earned, but generally not except for very recent benefit increases to cut the core retirement benefit at normal retirement age. That proposal is coupled with mandatory contribution increases for a period of time by the employers in the Coalition proposal and protection for the employers from funding penalties while the plan works outs its problems. The benefit changes, the existing accrued benefit changes, and the protections for the employers against funding penalties and the additional surcharges, none of those really very difficult features are in the bill as it stands now.

Mr. SCOTT. Mr. Chairman, my time has expired. I think it would be helpful as we go forward to get a little chart about how these various proposals actually affect someone's check because that is really what—I mean, some of this discussion is a little esoteric. The people want to know. You have been promised benefits. Am I going get the benefit or not if this bill passes? That would be helpful to

see what the various proposals are and how someone's check is affected.

I appreciate the extra time.

Chairman BOEHNER. Well, I am not sure somebody could provide you with a specific. What has been discussed and what has been agreed to by the Coalition would be tools available to the trustees of a multi-employer pension plan that are in fact in the red zone as a way of trying to protect benefits for all of the members. And these provisions are not in the bill as we speak because in fact they are controversial, and we wanted to study this a little further. But I would note and congratulate both sides of this discussion because while no one would want to employ some of those tools, they may in fact be—I think the trustees probably ought to have those tools in a situation where they are trying to save the benefits for the vast majority of their members.

Mr. SCOTT. Mr. Chairman, that is what we want to see because when you say tools, some people hear cuts. And if a little cut is necessary to avoid going to the pension fund, and as I understand it, a lot of people are getting more from their pensions than would be guaranteed in the pension fund, then a little cut would be better than losing half of it and getting just the guaranteed benefit.

Chairman BOEHNER. The gentleman is exactly correct.

Mr. SCOTT. But we want to know exactly what tools, restrictions and all those other verbs or nouns mean so that we know exactly what is on the table.

Chairman BOEHNER. I understand.

Mr. SCOTT. Thank you.

Chairman BOEHNER. Just to point out, in fairness, that those schools that would be available to the trustees in terms of actually reducing or adjusting ancillary benefits is coupled with a significant increase, a surcharge and increase to be paid by employers. And so I think we see both sides willing to come to the table to design a way out of a very difficult situation.

Mr. SCOTT. Mr. Chairman, you have used the term kind of ancillary benefits and we have talked about core benefits. I think we need to make sure everybody understands what that means, what those mean too. I understand the ancillary benefits are from time to time when the trust fund is doing well, some extra kind of bonuses are thrown in where people can get to retire early but that was not really promised. It is kind of things are going well and they kind of get that. But if we are starting to cut back, those unpromised benefits would be the ones cut, not the promised benefit, when someone is working and expected a core benefit pension, that is not in jeopardy. I think that is what I mean when we talk about tools and what we are talking about so people will understand what chance they have of actually getting their promised benefit. And I think under some of these proposals it is almost guaranteed, although you might not get some of the extra things that have been thrown in along the way. You are guaranteed under this proposal to get your core benefit and you have the full faith and credit of every business involved in the multi-employer plan. Unlike the single employer plan where if that business goes under you are in tough shape. In this situation, you have got the full faith and credit of quite a number of different businesses guaranteeing

the fund. So it is a little bit more solvent, if one of these tools is not going after your core benefit. That is what we need to kind of make sure that we have got.

Chairman BOEHNER. I want to thank my colleague from Virginia. I thank our witnesses today for your excellent testimony and for helping us understand more clearly how these reforms will affect the multi-employer plans. We look forward to continuing to work with you.

The hearing is adjourned.

[Whereupon, at 1:45 p.m., the committee was adjourned.]

[Additional statements submitted for the record:]

Prepared Statement of Hon. Jon C. Porter, a Representative in Congress From the State of Nevada

Good Morning, Mr. Chairman. Thank you for calling this important hearing today. The issues that we explore in this hearing, and seek to resolve in the legislation under examination, today are of the greatest importance for all Americans, of all ages. I appreciate the opportunity to continue the work that we, on this Committee and in this Congress, need to complete in order to strengthen the retirement security of all Americans. I look forward to the testimony of both panels here today, and would like to thank our witnesses for appearing before us today to offer their expert testimony.

The financial health of the defined benefit pension system is a critical issue for the millions of workers that participate in these plans. The funding of these plans has become more challenging for many employers because of the unanticipated economic factors which they face today. As a result, the number of employers offering defined benefit pension plans has declined and some have even frozen or terminated their traditional pension plans altogether. Congress must work to provide an adaptable environment for these plans where employers are able to reasonably fund the pension benefits of their employees and retirees.

I believe that this legislation makes excellent strides in resolving this situation. As we all work together to achieve this goal, we must protect the American tax payer from shouldering the burden of these plans. I am glad to see that this bill makes strong improvements in securing the financial stability of these plans, as well as providing the Pension Benefit Guarantee Corporation with the sound financial footing that will protect the American tax payer.

I am also pleased at the inclusion of Multi-Employer Pension Plan reform. This necessary step will benefit the thousands of employees and employers who are responsible for supporting so much of the growth we have in Southern Nevada. We rely upon these workers to complete the transportation, infrastructure, and construction projects which make our community one of the Nation's most vibrant.

One particularly important aspect of improving retirement security is providing the financial savvy and intelligence of all Americans. H.R. 2830 provides greater transparency for plan beneficiaries, as well as providing increased access to financial advisors. Only through allowing American workers to engage in the process that provides for their retirement can we expect the system to be fundamentally sound.

Again, thank you Mr. Chairman, for introducing this necessary and important legislation, and for holding this hearing today. As we strive to improve retirement security for the American worker, we must strive to balance the needs of beneficiaries, employers, and taxpayers. I look forward to working with my colleagues on this committee and throughout Congress, as we seek to improve the retirement security of all Americans.

Prepared Statement of Herve H. Aitken, Alliance President, the Multiemployer Pension Plan Alliance

Executive Summary

Chairman Boehner and members of the committee, the Multiemployer Pension Plan Alliance appreciates your efforts to enact comprehensive reforms to both single employer defined benefit plans and multiemployer pension plans. While most of the attention has been focused on single employer plans, particularly in the airline industry, there are a number of Teamster multiemployer plans, involving the trucking industry, that now confront a financial crisis, as well.

The MEPA Alliance was formed last year in response to financial crisis that arose in the Central States pension plan. All our members are long time contributing employers to that plan. It is an understatement to say they were shocked to learn that this plan had become so severely underfunded that it reached a deficiency in 2004 that would trigger federal excise tax penalties and additional contributions that our small business members could not afford to pay.

Unless significant reform is enacted, multiemployer plans will ultimately lose the fight. Rather than creating an environment that encourages employers to grow their businesses and participate in these plans, the law has created a death spiral with traps and penalties that will forever drive current and prospective employers away. In fact, in a March 5, 1982 Wall Street Journal article, George Lehr, the Executive Director of the Central States pension plan said in a reference to withdrawal liability: "In theory, it's a wonderful law; in practice, it doesn't work. In the long run, employer liability is the single most damaging thing pension funds will be facing." [Exhibit 1]

The Pension Protection Act of 2005 is a significant improvement over the current multiemployer pension laws. We appreciate that it will now require greater transparency and disclosure by the plans. The smaller businesses that have participated in the Central States pension plan were kept in the dark about its financial deterioration; neither the plan administrator nor the trustees informed us of the dire financial condition until they needed our assistance in seeking legislation that would allow them to postpone this deficiency.

H.R. 2830 also addresses one of the primary concerns facing smaller business in these plans: the significant financial penalties that would result under current law when a plan, such as the Central States plan, reaches a funding deficiency. Simply put, the excise tax penalties and additional contributions associated with a funding deficiency would drive them out of business within a year or two.

The Alliance members support the bill's establishment of new reorganization rules for severely underfunded (red zone) plans and at-risk (yellow zone) plans. However, Congress is now delegating to the plan trustees unprecedented authority to impose additional pension contributions upon employers when the current collective bargaining agreements expire. While we recognize that more contributions will be needed in these underfunded plans, there must be some safeguards against plan-mandated contributions, of 100 percent or more, than can force smaller businesses into bankruptcy. We, therefore, are recommending a 15 percent cap on plan mandated additional contributions, which is a slight increase over the 10 percent surcharge that is permitted upon enactment of this bill into law. It bears emphasis that small employers lack trustees on these plans and those trustees have historically been unresponsive to our needs and concerns.

Ideally, the withdrawal liability rules should be repealed, rather than tightened. Short of this, we support reenactment of the law prior to the Multiemployer Pension Plan Amendments Act of 1980 (MPPAA) that properly and fairly held that no more than 30 percent of an employer's net worth can be taken when it withdraws from an underfunded plan. It is patently unfair that a family-owned company can be stripped of all of the assets it has built up over generations notwithstanding that the company has made all its required pension contributions. The Alliance ask that H.R. 2830 be amended to reestablish this 30 percent rule.

This committee should remove from H.R. 2830 the changes making the withdrawal liability rules even more onerous. UPS and the Teamsters proposed these changes to the existing rules that would result in withdrawal liability when a company uses independent contractors or third party driver leasing companies to meet customer needs. The trucking industry rule should not be repealed and the current rule that reduces liability for a company in liquidation should be maintained. As will be discussed, the withdrawal liability rules established in 1980 have discouraged new employers from entering these plans and have sealed the fate of these plans by causing a declining participation base.

The Alliance members also believe that the controlled group rules, under current law, need to be reformed. Withdrawal liability should be confined to the contributing employer and any related, fractionalized entities that were separated out from the contributing employer to avoid withdrawal liability. We also support repealing the "pay now and dispute later" provisions of MPPAA.

Importantly, H.R. 2830 does establish objective funding standards for all plans that would prohibit benefit increases when there is insufficient income and assets to fund those benefit promises. Benefit increases should not be allowed in plans that have a funding ratio below 90 percent. As early as 1996, the Multiemployer Plan Solvency Coalition reported that trustees of the Central States plan had imprudently increased benefits beyond the means to pay for them and that it would exacerbate the underfunding crisis. Benefit promises should be made only when they can

be paid. Similarly, the Alliance applauds the committee for substantially increasing high end caps on funding of the plans and permit funding up to 140% of full funding without penalty.

We appreciate the new requirements in H.R. 2830 that will now provide timely and accurate disclosure of the key financial information by the plans to all participating employers, their employees and the PBGC. There needs to be sunshine in the dark rooms of these plans that have withheld information from contributing employers and plan participants in the past. Too much is at stake to tolerate the non-disclosure of this financial and actuarial data to all but the union and the employer companies that have trustees on these plans.

The Alliance also recommends that this committee, as part of this legislation, create a Congressional commission to objectively study and make recommendations on how to fairly apportion and pay for the huge underfunding that has arisen in these plans, and in particular the benefits being paid to retirees that no longer have an employer contributing to these plans. The Central States plan currently pays approximately $1 billion annually to 100,000 retirees that lack a contributing employer. Those benefits consume nearly 100 percent of the annual contributions received by the plan from all the remaining employers. Contributing employers can no longer shoulder this entire burden which is mounting each year.

The Alliance members are committed to achieving these legislative reforms for multiemployer plans to promote plan solvency, preserve reasonable pension benefits and save our smaller companies through a fair realignment of pension responsibilities and liabilities.

The Plight of Smaller Businesses

As hard as it may be to believe, the federal pension law created by the Multiemployer Pension Plan Amendment Act of 1980 severely penalizes companies for growing union jobs.

In fact, that law has also made it impossible to sell a private company. No prudent investor is willing to inherit the mounting liabilities that come with acquiring a unionized firm that participates in an underfunded plan, such as the Central States plan.

Contrary to the principles of the American dream, growing a company now significantly increases liability and wipes out any stake that is built up in the business. Sadly, MPPAA even precludes an employer from applying its expertise to other business ventures. Under the so-called controlled group regulations, the assets of an affiliated company are also at risk to pay for withdrawal liability if the owners have controlling interest in the participating employer.

Many of you on this committee may have been owners of small businesses or worked in a family owned business. Consider for a moment what you would do if your family business were faced with a decision to participate in a multiemployer pension plan like Central States? Would you do it knowing that one day you could wake up and your family's life work was wiped out because of it? Of course not. Yet, that is the stark reality faced by all the Alliance members. Only Congress has the ability to rectify the problem.

Smaller businesses lack both the capital and diversification to weather much longer the financial crisis in these multiemployer pension plans. They have absolutely no control over the negotiation or setting of benefits or contributions in these plans and, as mentioned earlier, it is difficult for them to even obtain timely and accurate financial information from them. The trustees are not accountable to them. They represent either the Teamsters union or one of the major national companies that pay their salary. Smaller companies also lack the leverage at the collective bargaining table of those national companies. In sum, they cannot reform or change these plans from within, or at the bargaining table. They need your assistance.

The Deteriorating Financial Condition of the Major Teamster Pension Plans

Much of the discussion in these comments focuses on the Central States pension plan. That is because all the Alliance members participate in that multiemployer pension plan and it is the second largest Teamster pension plan with over $17 billion in assets. However, financial information on several other significant Teamster plans, which are also severely underfunded or at risk, is attached to this testimony. [Exhibits 2–4]. Central States may be one of the worst plans, but it is not alone.

The deteriorating financial condition of these plans is widespread because no new employers are willing to join and be exposed to withdrawal liability. Deregulation of the trucking industry and the passing of MPPAA in 1980 commenced the slow, but steady, decline of the unionized trucking industry. Many unionized employers have ceased operations and the Teamsters have lost over 100,000 jobs in the freight sector. This in turn has dwindled the contribution base of these plans.

For example, there are now more retirees drawing pensions from the Central States plan than active workers on whose behalf employers are making contributions. [Exhibit 5]. The plan is experiencing a two percent decline annually in the contribution base. With more and more workers reaching retirement age, the situation worsens each year. The average age of a union truck driver is approximate 55 years old.

Consequently, the Central States pension plan has an annual negative cash flow of over $1 billion. It must rely on the returns on its investments each year to cover this expanding shortfall in revenue. For a while the rapid increases in the stock market masked these problems. But the stock crash in 2001 caused these plans assets to plummet and they are unlikely to change in the near or long-term future. The Central States plan, which reached a funding deficiency in 2004, is experiencing another bad year in 2005. It is projecting another $1.2 billion operating loss. For the first quarter 2005, it lost $451 million and had a negative return on investments.

Since the passage of the Multiemployer Pension Plan Amendments Act of 1980, there has been a steady decline in these multiemployer plans. There were approximately 2200 plans in 1980 and fewer than 1700 remained by 2003. Only five new plans have been created since 1992. The number of active participants in these plans has decreased by 1.4 million since 1980. Thus, Central States is not alone in this financial struggle; it is however on the front burner having already reached a funding deficiency.

The seven largest Teamster plans were collectively underfunded by $16-23 billion in 2002, depending on the method of calculating the assets. In 2003, the Central States plan alone was underfunded by $11.1 billion. It has been estimated that underfunding in this plan has further increased in 2004 to $15 billion. Many of these other plans are as financially strapped as the Central States plan, based on the 2002 data. These Teamster plans account for one quarter of the $100 billion in total multiemployer pension plan underfunding.

However well intentioned, the changes made to the pension laws in 1980 have exacerbated the financial problems of these plans rather than strengthened them. These plans cannot continue to exist without new employers and more active participants. MPPAA shut the door on future participation by imposing withdrawal liability on all employers for plan underfunding. The problems confronting these multiemployer plans are systemic and they will not solve themselves.

It is both shortsighted and patently unfair to propose an alleged solution which could force smaller contributors out of business rather than a solution that encourages them to grow their businesses, increase union jobs and continue to make plan contributions.

The Impact of Plan Underfunding On Smaller Businesses

Underfunding in multiemployer plans creates serious financial problems for all employers in the plans, but especially for smaller firms that lack access to capital that is available to publicly-traded companies.

First, there is a cash flow problem when a plan, like Central States, reaches a funding deficiency. The employers, by law, are obligated to pay for this deficiency to put the plan back within the minimum funding standards of ERISA. Compounding the funding deficiency payments are excise tax penalties that are imposed.

Exhibits 6–8 illustrate how the combination of additional contributions and excise tax penalties would destroy the finances of a smaller company with 100 employees. A funding deficiency of approximately $400 million, an amount consistent with the Central States plan's estimates for 2004, would increase this company's pension contributions by 40 percent. It would incur an additional 5 percent excise tax penalty that goes not to the plan but the general treasury and therefore does not help plan solvency. This company may be able to survive the first year of the funding deficiency. However, in the second year, it will be forced out of business because the additional contributions then would increase to 135 percent of current contributions to the plan, and the excise tax penalty would be an additional 100 percent of the prior year's deficiency.

The second way in which plan underfunding harms employers is when a withdrawal from a plan occurs. While a cessation of operations is the most common way in which withdrawal liability results, it can also arise through a change in operations, a terminal shutdown, a decline in union workers, involuntarily by strike or decertification of a union by the employees, expulsion by the pension fund, or disclaimer of continued representation of the bargaining unit by the union.

The financial impact of withdrawal liability is now overwhelming. The amounts of liability, which are calculated on a pro-rata share of underfunding, now far exceed the ability of most companies to pay; it exceeds their entire net worth.

For the MEPA Alliance members, the costs associated with withdrawal liability that would be owed the Central States plan can be as high as five times their net worth and ten times the profits in their most profitable year.

While the MEPA Alliance has focused on the harsh financial reality of underfunding on employers, ultimately it will impact the employees' pensions and the federal government through the PBGC. If these plans cannot regain solvency, they face termination. The employees are only guaranteed payments of approximately $1,000 per month, which is far below the $3,000 a month maximum benefit under the Central States plan. Therefore, they could lose up to two-thirds of their benefits. The PBGC would be obligated to pay that amount, if plan assets were insufficient.

Therefore, employers, employees and their Union representatives, and the federal government all have a vested interest in solving this problem promptly.

The Needed Congressional Reforms

1. Full and Timely Disclosure of Plan Financial Information:

The time is long overdue for complete, timely and accurate disclosure of the key financial information by these plans. The financial condition of the Central States plan has been a guarded secret, with only the union and four major transportation companies privy to the most up-to-date information.

Under current law the multiemployer pension plans provide annual reports almost nine months after the end of the current fiscal year. Therefore, the Central States plan will release its 2004 information in September of this year. There is simply no reason why this annual report information in the Form 5500 cannot be disclosed much sooner, such as within 3 months after the end of the fiscal year. The key financial information, including the annual actuarial reports, should be released to all participating employers and employees, by written communication or posting it on the plan's website. The Alliance members also believe that these pension funds, like mutual funds, should be required to provide quarterly updates. These updates are now provided by the Central States plan to the court overseeing the fund, so this would not be a new or burdensome requirement.

Consideration should also be given to mandating a change in the make-up of the Board of Trustees, which is now controlled by the union and largest transportation companies. A rotation of employer representation, to allow for participation by smaller employers, may be appropriate.

2. Repeal of the Federal Excise Tax and Current Funding Deficiency Rules is Essential:

Under current law, the combination of federal excise tax penalties and additional mandated payments under the minimum funding standards will drive smaller trucking companies out of business within one to two years. They simply lack the cash to pay an additional 135 percent of contributions. These rules should be replaced with new reorganization procedures that apply to any plan that is severely underfunded or at risk of becoming severely underfunded. A severely underfunded plan should be defined as one that has a funding ratio of assets to liabilities of 65 percent, An at-risk plan should be defined as one with a funding ratio below 80 percent. It is simply imprudent to wait for a plan to become severely underfunded, or near terminal, before remedial, reorganization measures are imposed.

While the Alliance members support the general framework of H.R. 2830, safeguards need to be built into that proposal to protect smaller employers. Under this bill, when a plan goes into reorganization, additional contributions can be imposed on employers up to 10 percent of the existing contribution rate of the employer. This 10 percent cap remains until the next collective bargaining agreement is negotiated. At that time, the pension plan will become involved in the collective bargaining process by submitting schedules to the parties based on the funding needs of the plans. The pension plan could submit a schedule that requires a 40 to 100 percent, or more, increase in pension contributions that a smaller employer cannot afford to pay. An employer would be expelled from the plan, if it fail to pay the plan-mandated contributions. Withdrawal liability then would be imposed, forcing bankruptcy upon the company. This unprecedented delegation of power to the plan to impose additional contributions needs to be restrained for the good of all employers. The Alliance members believe that a cap on additional contributions should be set a 15 percent above the rate under the prior collective bargaining agreement.

3. Re-establishment of Limitations on Employer Liability:

Nothing could be more unfair or more anti-business than a law that provides that even though you have made all of the pension payments agreed to with your union, you still can lose all of your company's assets if a plan becomes underfunded resulting from the actions of others outside your control. Essentially, the changes made to the federal multiemployer pension laws in 1980, made all contributing employers bear the burden for the pensions of workers who never performed any jobs for their company and for the pension obligations of their competitors who have gone out of business. That violates the most basic American principle, that a person and business should be allowed to prosper from the fruits of their labor.

The Alliance members believe that Congress should restore the law in effect prior to 1980 that limited the liability of an employer in an underfunded plan to 30 percent of the employer's net worth. Ideally, the concept of joint liability of all employers for plan underfunding should be repealed. It has only served to deter new employers from joining these plans and it has not improved the financial condition of the plans which was the main rationale behind the concept of withdrawal liability.

Even unions recognize this plight. As stated as early as 1982: "The International Ladies Garment Workers Union hopes the PBGC will permit its multiemployer plan to exempt the small entrepreneur who simply wants to sell his business and retire. 'He's tired, he wants to quit or he has a few bad seasons and feels another bad season would wipe him out,' observes the union's president, Sol Chaikin. 'My own feeling is that it would be cruel and unusual punishment for our union pension fund to demand his unfunded liabilities going back 20 years. That would leave him without a penny.'"

The plans will tell this Committee that they generally only collect 10 percent of the amount owed when an employer withdraws because few assets are left when an employer ceases operations. The PBGC has testified that they collect a comparable 10 percent amount when a single employer goes into bankruptcy.

Just as the Federal Government has found it intolerable that 90 percent of these costs in single employer plans are passed on to the PBGC, the employers in multiemployer plans find it intolerable that they are made to bear this huge expense. In fact, they can no longer shoulder this cost. No company should have all it assets on the line for an obligation it never made to workers who were never employed by them. The 30 percent net worth standard needs to be restored by Congress.

4. Withdrawal Liability Rules Should Be Eliminated Not Made More Onerous:

The current law is extremely onerous on contributing employers to multiemployer pension plans. First, they are made liable for plan underfunding that they had no part in the making. Then, they are required to pay the withdrawal liability assessed by a plan before they have the right to contest it in arbitration. Moreover, the plan's determination and calculation of withdrawal liability is presumed correct until proven otherwise by the employer. It is patently unfair and contrary to normal rules of American jurisprudence to require employers to pay this alleged liability before the liability is even established.

Likewise, the fund can sue all the affiliated companies and individuals that have majority ownership interest in the participating company and affiliated companies and seek to make them jointly liable for the withdrawal liability. All employers would be well served by repealing these "pay now and dispute later" rules and controlled group liability regulations.

Further, it is wholly inappropriate to tighten the withdrawal liability rules. No company should be exposed to withdrawal liability when it uses owner operators, independent contractors or third party leasing companies to perform transportation services at its facilities. That is contrary to federal labor law and labor policy. It will only harm trucking companies and their customers. It will provide a basis for these plans to expel employers and drive them into bankruptcy.

The trucking industry rule should also not be repealed. This rule is one of the few beneficial exceptions to withdrawal liability that Congress created in 1980. More trucking employers will only enter these plans if they have an assurance that they will not be on the hook for past underfunding. Congress must resist attempts to tighten the noose of these withdrawal liability rules.

5. Pension Promises Should Be Made Only When They Can Be Paid:

In 1992, the PBGC became aware that the alarming rise in pension plan underfunding was due in part to benefit increases that could not be sustained by the income to these plans. It is neither fair to the employers nor to the employees to increase benefit levels that cannot be sustained by the contributions to the plan and the return on the investments. Yet that is what has occurred. Consequently, these

plans have had to make recent changes to future benefit accruals and in other areas permitted under current law.

What is needed is an objective standard that governs future benefit increases. In the past, bills have been introduced in Congress that would allow a plan to increase benefits only when it is at least 90 percent funded. Such an approach makes sense and the Alliance members support it to ensure that future benefits can be paid. Otherwise, they are only false promises that increase the withdrawal liability of employers.

6. The Need For A Congressional Study On Long Term Solutions To Plan Underfunding:

While all the above reforms are vital to the short-term viability of these plans and their contributing employers, there remains a need for Congress to address the significant past underfunding in these plans. The Central States plan has $11-15 billion in accumulated underfunding. Our recommended reforms will prevent this plan from becoming worse, but it will not solve the ills created in the past.

At best, we project that the plan, which is now about 65 percent funded, may become 75 percent funded with our suggested changes. The reason for this modest improvement is that cost of the benefits to the retirees, who have no contributing employer, is consuming all the contributions to the plan, a situation that is getting worse each year. It is unsustainable over the long term. We believe that an objective study is necessary to remedy the problem. A Congressional study commission is an appropriate method to develop meaningful and fair solutions for employers, retirees and the Government. We therefore ask that Congress fund such a study and require a report back, with recommendations, within one year.

Conclusion

The Alliance members recognize that defined benefit plans, both single employer and multiemployer plans, once were the pillars for creating a sound retirement income for workers in this country. The sad reality today, however, is that countless numbers of businessmen and women will not offer them to their workers because of the onerous rules and liabilities that attach to them under ERISA and MPPAA.

The basic elements of opportunity and incentives are missing from the equation. Meaningful reforms of the law, as discussed above, can revitalize these plans. Without change, the plans will continue to decline in numbers, in financial strength and as retirement vehicles for workers.

The Alliance sincerely appreciates the important changes in the law that this committee is making in H.R. 2830. We will do all we can to assist you in this difficult, but critical, decision-making process. This is the single most important legislative issue confronting unionized trucking companies. It is not an overstatement to say change is necessary for the very survival of the smaller, family-owned, union trucking company members of the Alliance.

Many Large Funds Faced Significant Underfunding in 2002

Plan Name	Liabilities (millions)	Shortfall (millions)	Percent Funded
Western	28,523.0	(3,214.7)	92%
Central States	30,978.5	(10,211.7)	64%
New York State	2,931.4	(837.6)	76%
Central Pa.	820.9	(216.5)	68%
Phila. & Vicinity	2,210.1	(962.1)	53%
Western Pa.	1,407.7	(320.1)	72%
Local 705	1,539.9	(425.8)	70%

Note: All figures are in millions and are for 2002.

Exhibit 2

Participant Ratios Suggest Future Funding Challenges

Plan Name	Active Employees / Beneficiaries	Active Employees / Total Participants
Western	2.60	0.96
Central States	0.87	0.63
New York State	1.11	0.86
Central Pa.	0.62	0.44
Phila. & Vicinity	0.81	0.61
Western Pa.	0.59	0.42
Local 705	0.79	0.61

Note: All figures are for 2002.

Exhibit 3

Financial Status Continues to Deteriorate

- Underfunding in 2004 continues to climb
  - Central States – $11.2 billion
  - New England – $945 million
- Participant ratios continue to deteriorate
  - Central States
    - 2002 – 87%
    - 2004 – 74%

Exhibit 4

Central States Pension Plan: Active Participants and Beneficiaries Comparison

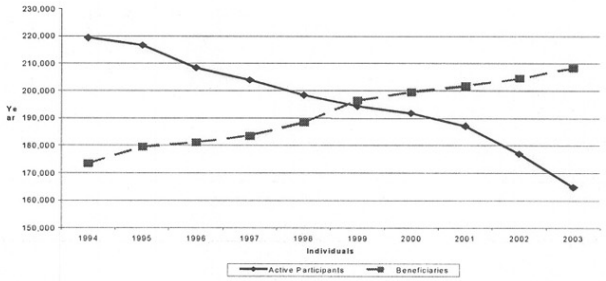

Exhibit 5

What happens in the event of a funding deficiency?

- ERISA requires employers to make up the deficit. This is in addition to normal contributions.
- In 1st year, we must pay to the IRS a 5% excise tax.
- In 2nd year, if all employers do not make required payments, then we must pay to the IRS a 100% excise tax.

Exhibit 6

EXAMPLE: Company with 100 Employees in Plan:
Contribution Rate = $89.00 per week

Contributions Last Year / Total Contributions Last Year	X	$ Deficiency	=	Our Share
1st Year:				
$462,800 / $1,000,000,000	X	$393,000,000	=	$181,880
		+5%	=	9,094
		Total	=	$190,974
2nd Year:				
$462,800 / $1,000,000,000	X	$1,346,000,000	=	$622,929
		+5%	=	31,143
		+100%	=	181,880
		Total	=	$835,952
3rd Year:				
$462,800 / $900,000,000	X	$2,536,000,000	=	$1,304,067
		+5%	=	65,203
		+100%	=	622,929
		Total	=	$1,992,199

Exhibit 7

Central States'Estimate s of Deficiency:

- 2004: $0.40 per dollar of contributions
- 2005: $1.41 per dollar of contributions
- 2006: $2.73 per dollar of contributions
- 2011: $15.29 per dollar of contributions

Exhibit 8

Prepared Statement of the American Association of Retired Persons (AARP)

June 15, 2005

The Honorable John Boehner
Chairman
Committee on Education
and the Workforce
U. S. House of Representatives
1011 Longworth H.O.B.
Washington, DC 20515

Dear Chairman Boehner:

AARP is writing to express its concerns with H.R. 2830 and H.R. 2831. Both bills deal with issues of considerable importance to AARP members, almost half of whom continue to work. We request that you include this letter and the attached statement as part of the record of this hearing.

H.R. 2831 – The Pension Preservation and Portability Act of 2005

AARP believes that cash balance plans have a role to play in the private pension system if -- and only if -- they are designed and adopted in a manner that protects the millions of older workers who have given up wages in exchange for traditional defined benefit pensions.

A careful review of the legal distinction between defined benefit and defined contribution plans makes clear that hybrid cash balance plans do not fit within the current legal framework. The court decision in Cooper v. IBM agreed that cash balance plans do not fit within current law. We urge the Committee to address the legal framework for cash balance plans, and at the same time, provide strong and effective protections for older workers involved in cash balance pension plan conversions.

Traditional defined benefit plans typically provide only small benefits early in a worker's career and larger benefits later in the career for those who devote much of their working lives to an employer. It is therefore unfair for companies that have sponsored this type of plan to eliminate these promised larger, late-career benefits just when long-serving workers are about to obtain them. Yet that is precisely the damage caused by conversions of traditional pensions to cash balance plans, unless older workers are given appropriate transition relief to address the "pension pay cut" brought about by conversions.

Plan conversions change the rules in the middle of the game, and older, longer-service workers are at considerable risk. They generally lose out on the larger late career benefits, have less time to accumulate benefits under the new cash balance formula, and

National Office | 601 E Street, NW | Washington, DC 20049 | 202-434-2277 | toll-free 888-OUR-AARP (888-687-2277)
toll-free TTY 877-434-7598 | Marie F. Smith, President | William D. Novelli, Chief Executive Officer | www.aarp.org

are less able to leave their current job if benefits are cut because they typically have fewer job prospects.

We do not believe that H.R. 2831 provides the protections for older and longer-service workers that are necessary, reasonable and fair. The bill represents a step back from the legislative proposal the Treasury Department submitted to Congress last year. That proposal would eliminate wearaway (both normal and early retirement), and provide some transition rules, albeit weak, to protect some benefits of current workers. The Treasury proposal clearly recognizes the need for transition rules to protect promised benefits, but falls short of adequately protecting the most vulnerable older, longer service workers.

H.R. 2831 would lower the bar in establishing transition protections for older and longer service workers involved in cash balance plan conversions below the standard set in the Treasury proposal. This bill would also lower the bar substantially below the "best practices" follow by companies involved in conversions over the past few years. Many employers, recognizing the harm to older workers, have adopted transition rules such as the choice to remain under the old plan formula, or have "grandfathered" older, longer service workers under the traditional plan.

We urge you and the other members of the Committee to follow the lead of many in the employer community and report a bill that not only clarifies the legal framework for cash balance plans, but adopts necessary transition provisions that protect older workers.

H.R. 2830 – The Pension Protection Act

A. Pension Funding

The past several years have been turbulent for pension plans. The decline in the economy, stock market losses, and interest rate pressures are some of the factors that have placed significant stress on the funded status of defined benefit plans. Declines in the stock market eliminated much of the investment income that defined benefit plans had relied on to fund promised benefits and decreased the value of assets underlying the plans. Low interest rates increased required contributions at the same time that the recession made available resources scarce. As a result, pension plans and their sponsors have experienced a funding crunch. Company bankruptcies resulted in more plans being adopted by the Pension Benefit Guaranty Corporation, (PBGC) whose finances also became more tenuous. While the PBGC was designed to provide benefit guarantees in just such circumstances, it is important that the agency remains financially stable in the future.

The Pension Protection Act attempts to address some of the shortcomings of the current pension funding rules. The legislation would require that plan sponsors bear increased responsibility with respect to their defined benefit plans in terms of increased risk and increased contributions. In addition, the bill would increase the level of premiums paid by employers to the PBGC.

The reaction of plan sponsors to these proposals could have a significant impact on individual workers. Defined benefit plan sponsors would face greater funding restrictions under the provisions of H.R. 3820. As a result, marginal plans may choose to respond by freezing or terminating their plans, with a substantially negative impact on workers. Workers who are close to retirement could also be made worse off by certain provisions, such as freezing of benefits and the elimination of lump-sum payments by underfunded plans. We urge the members of the Committee to ensure that the value of the accrued benefits of workers in the case of termination, layoff, and retirement are not reduced or diminished by pension funding reforms. We also urge the Committee to ensure the proper balance between the need for adequate plan funding and the need to encourage the continuation of the defined benefit plan system.

B. Investment Advice

AARP is opposed to the elimination of conflict-of-interest protection in the investment advice proposal included in H.R. 3820. We share the Chairman's goal of increasing access to investment advice for individual account plan participants. However, the approach advanced in this bill would, for the first time, permit plans to provide advice subject to inherent financial conflicts. This is inconsistent with Employee Retirement Income Security Act's (ERISA) long-standing protections for plan participants. While we agree that individualized advice can be helpful, such advice must be subject to ERISA's fiduciary rules, be based on sound investment principles, and protected from conflicts of interest.

H.R. 3820 would replace ERISA's prohibition on conflicts of interest with a disclosure model -- an inappropriate and unnecessary step given today's marketplace. Approximately fifty-four percent of existing plans provide investment advice to their employees through financial institutions and other firms that do not have a financial conflict. In fact, most large financial service providers have already developed alliances with independent advisors to make such advice available.

Conflict disclosure is simply not sufficient to protect the retirement savings of plan participants. There are numerous examples of problems associated with conflicts of interest that underscore that disclosure alone will not always mitigate the potential problems that will arise. Indeed, there has been a steady stream of reports in recent years showing that broker conflicts have harmed the advice received by individuals, that audit conflicts have undercut the value of audits of financial firms, and that reports of stock analysts have been used to influence the ratings of companies to the detriment of investors. In addition, the revelations of market timing, late trading and other abuses of the public trust within the mutual fund industry have underscored the need for vigorous oversight.

Rather than permit advice subject to financial conflict, we urge this Committee to encourage more employers to provide independent advice by addressing the key barrier -- employer liability. We urge the Committee to clarify that the employer would not be

liable for specific investment advice so long as the employer undertook due diligence in selecting and monitoring the independent advice provider. It is in the best interest of both the plan and participants to enhance the independent advice market, and we urge the Committee to adopt this approach.

AARP commends the Committee for holding this hearing on the need to strengthen funding in the private pension system, expand access to investment advice and address the issues raised by cash balance plans and the conversion to these plans. We look forward to assisting this Committee in this work. If there are additional questions or you need further information, please feel free to call me or have your staff contact Frank Toohey at (202) 434-3760.

Sincerely,

David Certner
Director
Federal Affairs

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Prepared Statement of the American Society of Pension Professionals & Actuaries (ASPPA)

The American Society of Pension Professionals & Actuaries (ASPPA) appreciates the opportunity to submit our comments to the House Committee on Education and the Workforce on H.R. 2830, The Pension Protection Act of 2005.

ASPPA is a national organization of almost 5,500 retirement plan professionals who provide consulting and administrative services for qualified retirement plans covering millions of American workers. ASPPA members are retirement professionals of all disciplines, including consultants, administrators, actuaries, accountants, and attorneys. Our large and broad-based membership gives it unusual insight into current practical problems with ERISA and qualified retirement plans, with a particular focus on the issues faced by small to medium-sized employers. ASPPA's membership is diverse, but united by a common dedication to the private retirement plan system.

Small Business Defined Benefit Plans should be Exempt from Proposed New Disclosure

Section 501 of the Pension Protection Act (PPA) of 2005 (H.R. 2830) would require that all defined benefit plans provide participants and the Pension Benefit Guaranty Corporation (PBGC) with an annual funding status notice within 90 days after the end of the plan year (e.g., by March 31 for a calendar year plan). This proposed new notice is based on a similar notice required for multiemployer plans, but which are not required under current law to be provided until 60 days after the due date for the plan annual report (e.g., by December 15 for a calendar year plan). Specifically, the notice would be required to provide:

- A statement as to whether the plan's funded current liability percentage for the plan year is at least 100 percent;
- A reasonable estimate of the value of plan assets for the plan year[1], the projected liabilities for the plan as of the end of the plan year taking into account any significant events, and the ratio of such assets to such projected liabilities;
- A summary of the rules governing termination of single-employer plans;
- An explanation of the benefits protected by the PBGC and any limitations on such benefits;
- The ratio as of the end of the plan year of the number of vested participants no longer employed by the plan sponsor to the number of active participants; and
- A statement on the funding policy of the plan and the asset allocation of investments under the plan on a percentage basis as of the end of the plan year.

The apparent purpose of this proposed notice is to give participants and the PBGC rapid information about the funding status of the plan. It is unclear what will be the practical value of such information to participants, particularly in the non-union environment.

While some accelerated information might be helpful to provide an early warning system to protect the PBGC, an exemption from the new proposed notice should be made for plans sponsored by small companies. In fact, the Administration which proposed a similar early-warning disclosure earlier this year did provide for a small business exception.

Small businesses would incur substantial additional administrative costs if they were required to comply with the proposed notice. The notice will require a material amount of actuarial work, which will then, in many cases, have to be duplicated when the annual report (i.e., Form 5500) is prepared in the Summer or Fall (for a calendar-year plan). Also, the proposed new notice is required more than eight months earlier than the current law notice applicable to multiemployer plans. That is a particular hardship on small businesses with limited resources. Finally, the information required in the notice may simply not be available. For example, many small business plans invest in hard-to-value assets (e.g., real estate; limited partnership investments), and it may be several more months before valuations for such assets are completed.

Small business defined benefit plans have historically not been a burden on the PBGC since the owners are generally not covered under the PBGC pension insurance program.[2] A new, early notice requirement for small business defined benefit plans that do not pose a potential risk to the PBGC would unnecessarily increase administrative complexity and costs for practically no benefit.

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[1] Under the PPA, most plans are required to use a valuation date as of the first day of the plan year for plan funding purposes as well as this notice. Small business defined benefit plans (i.e., plans with 500 or fewer participants) may use any day during the plan year for these purposes (see sections 102 and 112 of the PPA).

[2] In other respects, the PPA recognizes the reduced risk posed by small business defined benefit plans. Sections 102 and 112 of the bill exempt plans with 100 or fewer participants from the quarterly contribution requirements applicable to underfunded plans (see sections 102 and 112 of the PPA).

Recommendation

ASPPA recommends that only plans with more than 500 participants should be required to comply with the proposed new notice requirements. The definition of small business defined benefit plans for purposes of this exemption would be the same as the definition of small business plans used in sections 102 and 112 of the PPA for purposes of permitting a valuation date for funding as of any day during the plan year.

Prepared Statement of the ERISA Industry Committee (ERIC)

Mr. Chairman and Members of the Committee, thank you for the opportunity to present the views of The ERISA Industry Committee (ERIC) on H.R. 2830, The Pension Protection Act of 2005, and H.R. 2831, The Pension Preservation and Portability Act of 2005.

ERIC is a nonprofit association committed to the advancement of the employee retirement, health, incentive, and compensation plans of America's major employers. ERIC's members' plans are the benchmarks against which industry, third-party providers, consultants, and policy makers measure the design and effectiveness of these plans. ERIC has a strong interest in proposals affecting its members' ability to provide employee benefits, incentive, and compensation plans, their cost and effectiveness, and the role of these plans in the American economy.

Challenges Before the Committee

News media and other public forums, including hearings before this Committee, have been filled for months with reports of problems concerning the funding of defined benefit pension plans as well as reports of court challenges to defined benefit hybrid plans. In the midst of this surfeit of information, Congress must separate real from perceived problems and fashion solutions that will, when enacted, actually enhance the retirement security of American workers. Too often today reports of problems in specific industries have led to suggestions that the entire system needs to be reformed to meet the most egregious circumstances. The debate has become imbalanced. The vast majority of plans are not a threat to the PBGC—but harsh and volatile rules are a threat to the vast majority of plans and the businesses that sponsor them.

The introductory summary to The Pension Protection Act states:

Employers making major financial decisions must be able to predict and budget for their pension contributions every year or they'll simply freeze or terminate their plans and stop offering these voluntary benefits altogether. Workers also need to know that employers are making timely contributions to adequately fund their pension plans.

In this statement, the Chairman and the other sponsors of H..R. 2830 have correctly identified the challenge before the Committee. Pension funding rules are perpetually challenged by the need to balance the goals of affordability and security. These dual goals must be premised upon a realistic view of long-term pension liabilities, which no single snapshot can provide. Funding rules must secure benefits for workers, but they must also enable a company to allocate cash in its business in a way that ensures the continued viability and growth of that business.

Similarly, the introductory summary to The Pension Preservation & Portability Act states:

Cash balance pension plans—a type of defined benefit plan that is employer-funded, insured by the PBGC, and portable from job to job—represent an important component of worker retirement security....The threat of legal liability [associated with these plans] is creating ongoing uncertainty and undermining the retirement security of American workers.

Again, the Chairman and other sponsors of H.R. 2831 have correctly identified the challenge before the Committee. Without legal certainty, innovative and popular benefits particularly suited to a mobile and dynamic workforce, including women, will disappear—and soon.

Employers and employees will continue to want defined benefit plans in the future. They are a very cost-effective way to provide real retirement income to workers. If you start with the same pot of money, larger benefits can be provided to individuals through a defined benefit program because longevity and investment risks are pooled and calculated over a longer period of time than any single individual's lifespan. In addition, the benefits do not fluctuate with investment performance or the economy. Employees appreciate and benefit from the certainty provided by having defined benefit plans in their retirement portfolio. Before their legal status was called into question, many employers were turning to hybrid defined benefit plans

that are well-suited for the modern workforce, and some of these employers had never sponsored a defined benefit plan before. Under a rational and predictable regulatory scheme, recent declines in the numbers of defined benefit plans can be brought to a halt and perhaps reversed.

We discuss both bills in further detail below, beginning with H.R.2831.

H.R.2831, The Pension Preservation & Portability Act of 2005

ERIC urges in the strongest possible terms that the Committee include the substance of H.R.2831 in the longer pension bill (H.R.2830) when it considers these matters in the next few weeks. The Congress can construct the most perfect funding rules possible—but without certainty for hybrid plans those rules are likely to apply to a rapidly dwindling universe.

Hybrid plans are important to workers' retirement security:

• Approximately 25% of defined benefit plans today are of hybrid designs.

• They provide secure retirement benefits to over 7 million American workers, and they are even responsible for about 20% of premium-taxes paid to the Pension Benefit Guaranty Corporation (PBGC).

But companies cannot rationally maintain these plans in the face of potential legal liabilities that increase by millions, or in some cases hundreds of millions, of dollars every year and that can result in large legal expenses even when a plan is exhonorated. The issue has been festering for years. Time is of the essence and the time for action is now. The cost of inaction is unacceptable.

The promise of action, however, is that employers will be able to maintain their plans and to consider installing these plans for their employees in the future. It bears repeating that hybrid plans are secure retirement plans——

• They are paid for by the employer;

• The investment risk is borne by the employer;

• The benefit is determined by a formula, not by the ups and downs of the economy;

• The benefit is guaranteed by the PBGC;

• Annuity payout forms must be offered by the plans;

• Benefits accrue ratably over time so that even shorter service workers receive a meaningful benefit;

• Benefits are easily portable; and

• Employees like, understand, and appreciate these plans.

It is very likely that, with legal certainty, even employers who do not now offer a defined benefit pension plan will establish hybrid plans for their employees. If this is the result, this Committee could rightfully be proud.

H.R.2831 recognizes, however, that legal certainty at too high a cost is counterproductive. If a premium is charged for certainty, employers will choose other routes to create a compensation package. In this regard, H.R. 2831 takes the only rational approach——

• It validates hybrid plan designs without regard to whether the plan already exists or is established in the future.

• It provides a transparent test for age discrimination in conversions that does not mandate that a conversion follow a specific formula and does not require additional benefits to be provided just because the employer is changing the plan for the future.

• It also resolves a technical issue (called "whipsaw") that has been used to penalize employers who provide generous interest credits under their plan.

A few key points in the debate over hybrid plans should be highlighted:

• The preponderance of courts have determined that hybrid designs are legal and that they do not discriminate on account of age. The reasoning in a district court decision that ruled otherwise has subsequently been rejected by another district court.

• Employees have not lost earned benefits during conversions. Under current law all benefits are protected once they are earned and vested.

• If the "whipsaw" is resolved as it should be, employees will benefit because plan sponsors will be encouraged to provide higher interest credits under their plans.

Our Members have discovered several technical issues raised by the wording of H.R.2831. WE will identify those issues to the Committee and its staff shortly. In addition, there are several important technical issues that are not presently addressed by the bill; these issues are outlined in an attachment to this Statement, and we urge the Committee to address them in the bill. However, let there be no doubt; we are here principally to applaud the clarity of the vision in the bill regarding what must be done and to urge enactment of H.R.2831 as a part of H.R.2830.

H.R. 2830, The Pension Protection Act of 2005

ERIC Proposes Action: The ERISA Industry Committee has a proud history of advocacy of sound pension funding. The organization came into being in response to the government's call for assistance in implementing the landmark 1974 Employee Retirement Income Security Act. It was instrumental in fashioning the backstop funding rules of 1987 and in revising those rules in 1994. We do come to the current debate both with a sense of history and an understanding of the need for responsible action.

This year, ERIC put forward comprehensive Consensus Proposals for Pension Funding, PBGC Reform, and Hybrid Plans. (See the complete proposal on ERIC's web site: www.eric.org.) Key provisions of ERIC's proposals are summarized below.

To improve funding, ERIC proposes——

• faster amortization for plan amendments that increase benefits;

• a higher funded ratio threshold below which companies must commence accelerated contributions;

• inclusion of lump sum benefits in the calculation of current liability and coordination of the discount rate used for funding with that used to calculate minimum lump sum distributions;

• preservation, with modifications, of an employer's ability to pre-fund required contributions;

• increases in the contributions that employers can make on a deductible basis, and

• increased incentives to fund up plans by allowing excess assets to be used to fund savings plan contributions on behalf of the pension plan's participants.

To improve disclosure, ERIC proposes——

• To provide participants with plan-specific information parallel to that provided on an aggregate basis to investors, thereby providing participants valuable information on their plans on a dramatically accelerated schedule compared to current law.

To protect the PBGC against rapid deterioration of a plan, in addition to the funding proposals outlined above, ERIC also proposes——

• Prohibiting amendments to increase benefits in sharply underfunded plans;

• Ensuring more rapid funding of shut down benefits and limit PBGC guarantees where opportunity to fund has been truncated by a bankruptcy,

• At bankruptcy, restricting PBGC guarantees and limiting payouts of lump sum and shut down benefits; and

• Provide greater incentives for employees to take benefits in the form of an annuity.

ERIC also believes that there should be greater flexibility in developing solutions for specific industries that will increase the likelihood that companies will be able to restructure their enterprise and avoid termination of their pension plans while also ensuring that the funded status of a company's plans does not worsen.

Assessing the Problem: To determine the extent of the problem facing it, the Committee faces the difficult task of sifting through a confusing and sometimes misleading array of numbers describing the current and potential future state of pension funding and of the Pension Benefit Guaranty Corporation. The greatest danger is overstating the problem, for that could easily lead to enactment of harsh measures that themselves precipitate the problems they seek to avoid.

For example:

• In September 2004, the PBGC estimated that pension plans ensured by the agency were underfunded by $450 billion. The liabilities in this estimate are calculated as though every company involved were going to fail and be forced to terminate its plans. This simply is not going to happen. A recent analysis by Goldman Sachs states, "Quite frankly, if all of those sponsors were to fail, pension plan underfunding would be the least of the worries for the US economy and the capital markets."

• On June 7, the PBGC stated that underfunding in 1108 plans reporting to the PBGC increased from $279 billion at the end of 2003 to $354 billion at the end of 2004. However,

  • The same report also states that the funded ratio of these plans had remained virtually steady—69.7% at the end of 2003 and 69% at the end of 2004. Thus their funded status actually appears to have remained virtually constant over this period.

  • From 2003 to 2004, the PBGC reduced the arbitrary interest rate it uses to calculate liabilities from 4.7% in 2003 to 3.8% in 2004, a 90 basis point drop that dramatically increased estimates of liabilities in plans reporting to it.

  • The same report also notes that assets in these plans increased substantially during 2004—from $914 billion to $1.141 trillion—apparently enough to offset the increase in liabilities due to the change to a much lower discount rate.

Use of a more reasonable discount rate would produce a different picture. Moreover, like the $450 billion estimate, this estimate is predicated on all 1108 plans being terminated, an unrealistic assessment.

• The PBGC had a published deficit at the end of 2004 of $23 billion. If the agency used the yield curve interest rate proposed in the Administration's funding proposal, its deficit reportedly would have been $19 billion, a significant decrease.

• A June 7, 2005, Government Accountability Office report cited a drop in funding ratios in plans from 2000 to 2002, the latest date for which that agency had data. However, 2000-2002 includes the impact of the recent economic downturn, so the drop in the funded status of plans should not be a surprise. Initial evidence from 2003 and 2004, when the economy began to turn back up, presents a different picture.

• One recent analysis shows assets of defined benefit plans at approximately $2 trillion at the end of 1999, dropping to $1.5 trillion at the end of 2002, but climbing back up to $1.8 trillion at the end of 2004. That's not back to full health yet, but the direction is encouraging.

• While assets have increased in the last two years, some of their impact has been offset by a continued drop in long term interest rates, which Federal Reserve Chairman Alan Greenspan calls anomalous and unprecedented.

Avoiding Pitfalls: The sponsors of H.R.2830 have stated that, while the Administration's proposals are focused on the PBGC, their bill aims to provide a soundly financed system in which employers will maintain their plans rather than freeze or terminate them. We agree that this is the appropriate focus. Consider the following:

• Private sector defined benefit pension plans pay approximately $110-120 billion in benefits to retirees every year. By comparison, in 2004 the PBGC paid approximately $3 billion.

• Over 44 million Americans receive or will receive benefits from defined benefit plans. By comparison, the PBGC's present and future benefit population at the end of 2004 was approximately 1 million.

• The PBGC does not have a short-term crisis. At the end of 2004 it had resources sufficient to pay benefits for 20 to 25 years. In 2004 the PBGC received $1.5 billion in premiums and earned $3.2 billion on it assets—from which it paid $3.7 billion in benefits and administrative expenses. As new claims come in, the agency's asset base will continue to grow and it will also receive additional premiums.

H.R.2830, in supplanting a the Administration's short-term PBGC-focused view with a longer term objective of ensuring sound funding along with a robust defined benefit system, has avoided several key pitfalls in the Administration's approach.

• Averaging and Smoothing: Averaging of the funding discount rate and smoothing of assets are two concepts that are misapprehended in the current debate. These mechanisms were placed in the law not to obscure the status of the plan but to accomplish critical policy objectives. Specifically, because of current law averaging and smoothing, (1) the plan sponsor is better able to predict—and plan for—future cash contributions; (2) unnecessary and harmful volatility in cash calls on the company are somewhat ameliorated; and (3) accelerated funding requirements are less likely to occur as the country moves into a recession. Instead, the sharp cash calls on a company precipitated by accelerated funding waits until a short time later, typically as the economy begins an upturn. A February 2005 independent study conducted for the Business Roundtable showed that, if the Administration's spot rate and mark-to-market measures of assets had been the law, kicking in accelerated funding as the economy dropped into a recession in 2001 and 2002, the diversion of cash from business enterprises to pension funding requirements would have cost the economy 330,000 jobs in 2003 alone. In some cases, the lack of averaging and smoothing would have created a death spiral in companies, increasing, rather than reducing, liabilities faced by the PBGC. H.R.2830 wisely retains averaging and smoothing albeit for a shorter period of time than under current law. We caution, however, that further analysis of H.R.2830 is required to ascertain whether the funding scheme outlined in H.R.2830 will meet the critical funding policy requirements of predictability, stability, and economic compatibility.

• Credit Ratings: The Administration proposes that companies that fall below investment grade be required to fund their plans as though they were about to terminate. This is based on the faulty logic that a company's current investment grade determines the funded status of its plans as well as its ability to survive into the future. It does not. To the contrary, the increased call on the company's cash can easily precipitate the death spiral the proposal seeks to avoid. Moreover, the proposal raises the disturbing prospect of the U.S. government, not the marketplace, ruling on the financial soundness of companies, an unprecedented intrusion into the free market. H.R.2830 wisely rejects this approach, retains a more appropriate focus

on the funded status of plans, and imposes additional requirements only on plans that are significantly underfunded.

• Credit Balances: The Administration proposals abolish credit balances, not only removing a key incentive for employers to pre-fund future required contributions but also breaking faith with companies that have pre-funded their obligations in the past. H.R. 2830 wisely retains the concept of providing credits for pre-funding, including, based on our understanding from conversations with staff, taking into account all assets in the plan, including those contributed in advance of minimum requirements, in computing the funded status of the plan for funding purposes. The bill addresses problems that have arisen by ensuring that the value of the available credit matches the underlying available assets and by limiting the use of pre-funding credits if a plan becomes substantially underfunded. While the bill retains this necessary component of sound funding policy, we are very concerned that, as drafted, the bill would subtract credit balances from available assets in determining whether certain "non-funding" limits are met, such as those triggering benefit cutoffs and "at risk" status. This can force a waiver of a large part of a company's existing credit balance, undermining prior pre-payments made in good faith and discouraging pre-funding in the future. It is vital that this result be corrected.

• Deductible Contributions: Plan sponsors face various limitations on the contributions they can make to their plans on a tax-deductible basis. While the Administration provided some relief in this area, the approach in H.R.2830 is more complete and more useful to plan sponsors. The bill both allows deductions of contributions up to 150% of current liability and also of contributions, under certain circumstances, in excess of 25% of compensation. This latter provision is particularly important for so-called "legacy" plans where there can be far more retirees than workers and the 25% of compensation limit will severely limit the ability of the employer to fund the plan. ERIC also recommends that the 10% excise tax imposed on non-deductible contributions be abolished.

Important Actions: H.R.2830 proposes additional reforms that Congress should enact.

• Permanent Interest Rate: H.R.2830 establishes a permanent interest rate for calculating liabilities. Few circumstances have caused more confusion and created a greater impediment to employers maintaining defined benefit plans than the absence of a permanent discount rate since 2001.

• Coordination of Lump Sum Calculations: The bill coordinates the discount rate used for funding with that used to calculate minimum lump sum distributions, with a phase-in to prevent disruption of individuals' retirement planning. This is a critical step that will ensure that plans with lump sums are not stripped of assets when large numbers of employees leave at once. The bill, however, should be amended to provide for plans that, under current law, rely on rates other than the 30-year bond rate for the calculation of lump sums.

• Phase-in of Premium Increases: The bill contains substantial increases in premium-taxes paid to the PBGC. To ameliorate the impact of this change, H.R.2830 phases those increases in over time. (Note below, however, that ERIC strongly opposes indexing of premiums in the future.)

Areas for Additional Analysis and Areas of Concern: H.R. 2830 proposes a substantially new framework for funding requirements. This scheme must be carefully examined by real companies with real plans in order to ensure that it results in more soundly financed plans in both the short and the long term while making it possible—even inviting—for employers to maintain their defined benefit plans and establish new ones. This examination cannot be completed in less than one week. Nevertheless, we offer the following by way of a preliminary analysis to guide the Committee's further deliberations even as we continue our examination of the bill's provisions.

• Long-Term Funding Rules: Sponsoring a defined benefit pension plan is not a one-year, three-year, or even five-year commitment. It is a commitment that spans several decades. We are concerned that H.R.2830 repeals the long-term funding rules that form the bedrock of ERISA, under which plans experienced real growth and expansion, and which for decades have resulted in the vast majority of plans being well-funded and paying all promised benefits to participants. Maintaining the long-term perspective is vital in meeting the goal of encouraging employers to establish and maintain defined benefit plans and to providing a sound, predictable, and stable funding basis for companies sponsoring pension plans. We are concerned that repeal of these rules—and reliance solely on the short-term focus taken by H.R.2830—is likely to result in fewer plans and less well funded plans over time.

• Volatility & Harshness: The present current liability funding rules have already introduced significant volatility into funding and can confront sponsors with funding requirements that are sudden and harsh, which makes defined benefit plans less

attractive for businesses and, during the recent downturn precipitated the freezing of benefits in numerous plans. H.R.2830 appears to add significantly to the volatility and harshness of current law and to loop into this unfortunate circumstance plans that are actually very well funded. Additional volatility and harshness is caused by: (1) reducing the averaging and smoothing periods to three years; (2) reducing the corridor for valuing assets; (3) establishing a modified yield curve as the discount rate (where fluctuations in the rate and in the curve both affect sponsors liability calculations); (4) dividing the yield curve into three "buckets" each of which can fluctuate; (5) one-sided amortization (in which experience losses increases amounts to be amortized but the largest amortization amount is carried forward in spite of experience gains until the plan regains a 100% funded level; and (6) the 100% funding target itself. While the bill's four-month "lookback" in setting the plan's discount rate is helpful, we are very carefully examining whether its seven-year amortization period will work in the context of cyclical companies and we are very concerned that the bill's provisions appear to come down hard on plans that are extremely well funded—i.e. close to 100% funded—and are of no threat to the PBGC. ERIC has proposed a 90% threshold for accelerated funding. In setting an appropriate target, it is appropriate to remember that a 10-15% swing in the funded ratio of a plan is a normal result of economic ups and downs. If the threshold is set too high, then plans will be significantly overfunded at the top of the economic cycle, but will be provided no leeway for ordinary and normal downswings. The unnecessary pressure on a company's cash makes it less likely the company will maintain a defined benefit plan, defeating the purpose of the legislation.

• Yield Curve: H.R.2830 contains a modified yield curve designed to ameliorate problems stemming from the yield curve set out in the Administration's proposals. Unfortunately it does not achieve that goal and we remain convinced that adopting a yield curve for pension funding purposes is a mistake. If the Congress believes it is important to have different rates for mature and young plans, there are much simpler ways to accomplish that goal, and we would be pleased to discuss this further with the Committee. Some of our concerns include: (1) The modified yield curve does not simplify required calculations since each plan must still make estimates of future payouts for years into the future. (2) The underlying yield curve rate is only tangentially market-based and it is extremely opaque. A yield curve works well for financial instruments, such as mortgages or Treasury bonds, where the structure of the bonds is similar and the payout set. But the corporate bond market is very diverse—and future pension payouts are only guesses. They are not set. Moreover, at the durations that are most important for pension plans, the bond market often is thin or non-existent. So the Administration's yield curve actually is a fabrication constructed by agency officials. At best there will be errors in judgment. At worst the discount rate that must be used for a $2 trillion program is subject to manipulation that will be impossible for Congress to uncover. These problems are actually exacerbated by the vagueness in H.R.2830 where the Treasury apparently would have leeway to set rates anywhere within the three segments. (3) Use of a Treasury-constructed yield curve obliterates companies' ability to predict future contributions. (4) Use of a yield curve, even a modified one, adds to the volatility of required contributions since both the interest rate and the slope of the curve will move.

• Mortality Assumptions: While ERIC recognizes the RP2000 mortality table as published by the Society of Actuaries as a carefully constructed table that relies on data derived from existing pension plans, we are concerned that H.R.2830 requires use of discounts rates that are designed to reflect more precisely than current law the maturity of plan liabilities—but fails to allow similar precision regarding mortality assumptions. This will result in a mis-match of assumptions and severe inaccuracies in measuring liabilities for many plans. ERIC has proposed that plan-specific mortality assumptions be allowed, and the bill should be amended to make this possible.

• Effective Date: The bill assumes that plans can prepare for a significantly new funding scheme by 2006. This is simply unrealistic. Imposing changes of this magnitude that quickly is likely to result in chaos, followed by significant numbers of plans being terminated or frozen.

• Indexing of premiums: While ERIC recognizes that some increase in PBGC premiums is likely, we very strongly oppose indexing of the premiums in the future. This has the effect of increasing premiums on all plan sponsors regardless of whether the agency needs the money or not and in direct violation of the mandate contained in ERISA (sec. 4002) that premiums be kept at the lowest possible level. This is so that available money can go into the plan—not be diverted unnecessarily to a government agency. The result can only be that plans will become more unattractive to maintain over time. Moreover, under the bill, the variable rate premium would be indexed twice. Since it is expressed as percent (0.9%) of underfunding, the

variable rate is automatically indexed as the value of wages and benefits increase over time. The bill would impose a second wage index on top of the one already imbedded in the rate's structure. If Congress deems a premium increase is necessary, we urge that it provide plan sponsors the certainty of knowing what that increase is by setting out the amounts required in the law.

• Benefit Cut-offs: It is important to maintain benefits for participants in all cases where that is possible. H.R.2830, like the Administration proposal, focuses on the PBGC and not on the participants and, in so doing, eliminates or reduced benefits in ways that are counterproductive and completely unnecessary. ERIC has proposed a comprehensive set of measures that would protect both participants and the PBGC and we strongly urge that the bill be modified in line with those proposals. ERIC's proposals are appended to this testimony.

• Disclosure: The bill contains several new disclosure provisions. ERIC proposes an approach that is simpler, faster, and more relevant. We propose that the information prepared for a company's 10-K be provided, on a plan-by-plan basis, to plan participants. This means that every year participants will be getting the same information as investors—and they will be getting it 60 days after the close of the year (90 days for smaller companies).

Conclusion: ERIC is prepared to work with the Committee toward its goals—sound funding of defined benefit pension plans and an environment where employers face legal certainty regarding their plans and where they will want to establish and maintain these valuable retirement security programs.

Addendum #1

Additional Issues Regarding H.R.2831

The following provisions should be included in H.R. 2831:

1. Amendments to Anti-backloading Rules. Legislation should amend the anti-backloading rules, both prospectively and retroactively, to provide that if a plan provides participants with the benefit produced by two or more alternative formulas, the plan will comply with the anti-backloading rules if each of the formulas, tested separately, complies with those rules.

A. This allows an employer that converts its traditional defined benefit plan to a hybrid formula to offer generous transition benefits to affected plan participants.

2. Offset for Benefits Provided by Another Plan. The legislation should also clarify, both prospectively and retroactively, that if a plan provides for an offset for benefits provided by another plan, the plan will comply with the anti-backloading rules if the gross benefit formula (i.e., before application of the offset) complies with the anti-backloading rules.

A. In the case of a floor-offset arrangement involving a defined benefit plan and a defined contribution plan, where the benefits under the defined benefit plan are offset by the actuarial equivalent of the benefits under the defined contribution plan, the defined benefit plan complies with the anti-backloading rules if its gross benefit formula (i.e., before application of the offset) complies with the anti-backloading rules.

3. Nondiscrimination Rules. The legislative history should direct the Treasury not to revisit the nondiscrimination testing issue raised by the proposed Internal Revenue Code sec. 401(a)(4) regulations that the Treasury has withdrawn.

A. Because hybrid plans are defined benefit plans, it should always be permissible to test them as defined benefit plans under sec. 401(a)(4) as well as to cross-test them as defined contribution plans.

4. Determination Letters. The legislative history should direct the Treasury to begin issuing, by a date certain, determination letters to plans that have been converted from traditional designs to hybrid designs.

Addendum #2

Proposed Restrictions on Benefit Improvements and Payouts

1. Treat shut-down benefits as a plan amendment for funding and guarantee purposes as of the date they are triggered. Also apply to shut-down benefit payments the restrictions under present law and proposed below that apply to payment of lump sums.

The Administration's proposal would needlessly jeopardize benefits that are vital to workers, especially older workers, whose place of employment is being shut down. While it is true that under the current structure the PBGC's liability can be increased for shut down benefits for which no funding has been allowed under current law, the solution is not to abolish the benefits in all instances—including in ongoing, well-funded, and even over-funded plans that can easily afford them. The solution

is to adjust the funding and guaranty rules to protect the PBGC from sudden increases in its liability.

Shut down and other contingent benefits typically cannot be funded until they are triggered by the contingent event. This makes sense because the triggering of such benefits is nearly impossible to predict on a reliable basis. On the other hand, under present law, shut-down benefits are guaranteed by the PBGC. For shut downs that occur just before an underfunded plan terminates the PBGC must assume a liability for which there has been no opportunity for funding to occur.

Most shut down benefits are paid without imposing any liability whatsoever on the PBGC. They are paid from an ongoing plan that is not terminating or from a plan that is terminating but is well- or over-funded. Thus, if shut-down benefits are treated as a plan amendment for both funding and PBGC guarantee purposes, the PBGC's exposure is contained while preserving the payment of shut down benefits in the vast majority of circumstances. Moreover, such treatment would be consistent with other types of benefits that accrue shortly before termination but were previously unknown (i.e., plan amendments).

As an additional measure of protection, the same restrictions could be placed on payment of shut down benefits as are proposed below regarding payment of lump sum benefits.

2. Freeze the benefit the PBGC will guarantee at the time of bankruptcy.

Bankruptcy proceedings can stretch out over a long period of time. We agree with the Administration that the PBGC guarantee limit should be frozen for a plan at the time of the bankruptcy filing.

3. Prohibit amendments that increase benefits if the plan is less than 70% funded and has been less than 100% funded for more than a year.

Under current law, amendments that increase benefits are prohibited if they would reduce the plan's funded status below 60% unless simultaneous action is taken to restore the plan at least to a 60% funded level. The Administration proposes to raise this bar to 80%. This is simply too high. As we noted earlier, only 3.3% of the dollar amount of all claims received by the PBGC from 1975 through 2003 came from plans that were funded at a 75% or higher level on a termination basis. Plans that are reasonably well funded simply are not a threat to the PBGC and should be allowed to operate without government interference. Moreover, we have proposed that the amortization period for plan amendments that increase benefits be reduced from 30 to 10 years, a very significant change that will ensure that funding for plan amendments is significantly accelerated.

On the other hand, a plan that is 60% funded can present a significant exposure to the PBGC. Thus we propose that the 60% level be increased to 70%.

4. If the plan sponsor is in bankruptcy, limit the percentage of any lump sum that can be paid to the plan's funded status.

The Administration has proposed to prohibit payment of lump sums under a variety of circumstances in an apparent effort to curb the depletion of assets in a plan that might be transferred to the PBGC. Unfortunately, the PBGC's proposal is far too broad, sweeps into its net too many plans that will not be transferred to the PBGC, and thus will cause serious and completely unnecessary disruption for older workers who are nearing retirement and have little chance to rearrange their plans. Moreover, the PBGC's abrupt approach is likely to trigger the very "run on the bank" it seeks to avoid as workers eligible to take a lump sum will do so prematurely rather than risk losing it later.

A less disruptive approach that still protects the PBGC would be to apply restrictions only if the plan sponsor is in bankruptcy and, in these circumstances, to limit the percentage of a lump sum that can be paid to an individual to the plan's funded status. In other words, if the employer is in bankruptcy and the plan is 80% funded, then eligible individuals could receive 80% of their benefit in the form of a lump sum.

5. Retain present law prohibitions on benefit amendments in bankruptcy as well as present law prohibitions on lump sum and other accelerated forms of benefit payments in the case of a plan with a liquidity shortfall.

Bankruptcies can take several years to work through, and key to the employer's ability to turn the business around is its ability to retain knowledgeable and skilled employees. The Administration proposes to freeze the company's pension plan at the start of a bankruptcy, even if the plan is 99% funded. This hammer-blow approach will, in fact, harm rather than protect the PBGC by making it far more likely the company will not be able to retain the key employees it needs to effect a recovery.

Under present law, if the employer maintaining a plan is involved in bankruptcy proceedings, no plan amendment may be adopted that increases the liabilities of the plan—including by an increase in benefits or any change in the accrual of benefits or in the rate at which benefits vest under the plan. Plans that have assets equal

to less than three years of benefit payments may not make lump sum payments or other payments that deplete assets on an accelerated basis. These provisions of law should be retained.

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