S. HRG. 112–812

THE POWER OF PENSIONS: BUILDING A STRONG MIDDLE CLASS AND STRONG ECONOMY

HEARING

OF THE

COMMITTEE ON HEALTH, EDUCATION, LABOR, AND PENSIONS

UNITED STATES SENATE

ONE HUNDRED TWELFTH CONGRESS

FIRST SESSION

ON

EXAMINING PENSIONS, FOCUSING ON BUILDING A STRONG MIDDLE CLASS AND STRONG ECONOMY

JULY 12, 2011

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C O N T E N T S

STATEMENTS

TUESDAY, JULY 12, 2011

THE POWER OF PENSIONS: BUILDING A STRONG MIDDLE CLASS AND STRONG ECONOMY

TUESDAY, JULY 12, 2011

U.S. SENATE,
COMMITTEE ON HEALTH, EDUCATION, LABOR, AND PENSIONS,
Washington, DC.

The committee met, pursuant to notice, at 2:35 p.m. in Room 430, Dirksen Senate Office Building, Hon. Tom Harkin, chairman of the committee, presiding.

Present: Senators Harkin, Hagan, Merkley, Franken, and Enzi.

OPENING STATEMENT OF SENATOR HARKIN

The CHAIRMAN. The Committee on Health, Education, Labor, and Pensions will please come to order. I want to welcome everyone to the latest in our series of hearings focusing on retirement security. Today we are going to take a close look at the important role pensions can play in building a strong and vibrant middle class, both in terms of the economic security that they provide to retired Americans and because of the role they play in growing our Nation's economy and creating jobs.

This hearing we called the Power of Pensions because traditional pensions, defined benefit pensions, really are very powerful. They have the power to afford millions of middle class families the opportunity to feel secure in retirement, to enjoy their older years without being afraid that their money is going to run out. Retired Americans need to know that they can get that check every month for as long as they live. That is real retirement security. Plus, studies show that people with pensions are less likely to wind up living in poverty.

Pensions are a powerful economic tool also for employers. They have proven to significantly increase retention. Of course, that reduces costs, improves productivity, leads to higher returns. Employers can also use pensions to get people a much cheaper retirement benefit than a 401(k). That's because pensions typically have a better return on their investments and they can take advantage of economies of scale to keep down the management fees. So, in short, pensions are a better bang for the buck.

But I believe perhaps one of the most overlooked powers of pensions is the power to grow our economy. There is somewhere between $6 and $9 trillion in the pension system. Now, those dollars are not put in a shoe box someplace. They are not buried underground. Those dollars are invested back in the economy, and they

go toward developing, in many cases, most cases, long-term development for our country—technology, building roads, bridges, and schools. Many communities go to pension funds to borrow the money that they need for infrastructure projects; good, solid, long-term investments.

They also invest money in businesses to get them off the ground, to fuel innovation, job creation. So I've often said, after looking at all this, that pensions really are the grease that keeps the economic engine running pretty well.

But despite all of the economic benefits of pensions, fewer and fewer people are earning a new benefit every year. Now, most people don't have any retirement plan at all, let alone a pension. And millions of Americans are seeing their retirement dream slip through their fingers. Our hearings before this have pointed out that a quarter of workers do not have any meaningful retirement savings at all, none. One out of every four working Americans have nothing, zero.

Nearly half of the oldest baby boomers, those that are 65 this year, are at a risk of not having sufficient resources to pay for basic retirement expenditures and uninsured health care costs. That's one out of every two. In other words, they're going to run out of money, basically, is what's going to happen before they die.

In September, this committee heard testimony that the gap between what people need for retirement and what they actually have is somewhere between $4.6 and $6.6 trillion. I don't think it has to be like that. We can put a retirement system in place that offers the promise that if you work hard and play by the rules, you have an opportunity to ensure your later years and live with dignity and financial independence. That will go a long way toward rebuilding our middle class, and it will go a long way toward finding the money that we need for long-term growth and economic stability, and that's why this committee has been holding hearings on retirement security.

We're taking a hard look at the private retirement system, trying to figure out how we can make it better, how to work for every American. I'll be the first to admit, it's not easy. I don't have all the answers. But I think we're going to have to make some bold changes. That means taking the best of what both 401(k)s and pensions have to offer.

Earlier this year, this committee heard testimony about some of the things from 401(k)s that have worked, like automatic enrollment, simplification, transparency. Today, hopefully we're going to hear about some of what has worked so well for defined benefit plans, giving people certainty that they're going to get a check in retirement, making sure that they are being prudently and professionally managed.

We have an excellent panel of witnesses. I'm looking forward to all of your testimony. I thank you all for being here. There's so much that we need to learn about this important topic. I hope those in the academic and research communities will continue to look at the economic benefits of pension plans so that lawmakers here in Washington have the information they need to make smart policy decisions.

I'm also looking forward to working with my colleagues on this committee in the search for a way to solve the retirement crisis, and that's what it is, a retirement crisis. When one out of four don't have anything, when the baby boomers, they say about half of them will not have enough money to last them through the years until they die, we have a crisis out there.

Retirement issues have always been an area of great bipartisan interest, so there's a real opportunity to work together to improve retirement security for families all across America, and I'm confident that the hearing today will give us a lot to think about. And again, I thank all of you for taking the time to be here today.

And with that, I'll recognize Senator Enzi.

STATEMENT OF SENATOR ENZI

Senator ENZI. Thank you, Mr. Chairman.

Over the past couple of years we've looked at various systems within our Nation's retirement security system. Back in February, we looked at the defined contribution systems, specifically at 401(k) and Individual Retirement Accounts, and last year we looked at the multiemployer pension system. Today we will review the state of our defined benefit retirement system known by many as the traditional pension.

Looking back at statistics compiled by the Department of Labor and the Pension Benefit Guaranty Corporation, the height of the traditional defined benefit plan occurred in the mid-1980s, when there were more than 112,000 plans that were counted by the PBGC.

By 2008, that number shrunk to a little bit more than 27,000 plans, and I'm sure that the economic downturn caused that number to go down even further. More sobering are the statistics of traditional defined benefit plans that have 100 or more participants, the medium to large-size plans. According to the Department of Labor, there are only 9,500 of these plans left.

We also have to keep in mind that when companies promise too much and can't maintain those promises, then those pensions get dumped onto the PBGC. The number of legacy industry companies that tried to game the system or promised more than they could shoulder led us to the passage of the Pension Protection Act in 2006 in order to shore up the PBGC's insurance trust fund. Looking back at the beginning of 2008, nearly all defined benefit plans were coming close to being 100 percent fully funded. However, since that time, the number of pension plans that dropped to less than 90 percent funded has increased, and the PBGC's high deficits are back.

Through the years I've been a supporter of the traditional defined benefit plan system as it forms one of the key legs of our three-legged stool of retirement system, along with the 401(k)s, IRAs and Social Security. I also recognize that if people do not save enough through their 401(k)s and IRAs for retirement, then these people will place a greater strain on our very shaky Federal entitlement programs. The Congressional Budget Office tells us that these entitlement programs are currently not fiscally sustainable programs, especially in light of all the anticipated enrollees stemming from the President's health care law.

However, we have to be realistic. The private sector traditional defined benefit system is going toward extinction. The system has become too burdensome, too complex, too volatile, and too costly for companies to maintain. As an example of the complexity of the systems, Hillside Family of Agencies, a nonprofit organization that provides services to the juvenile and adoption systems, put together a 6-page chart showing the number of notices to employees required by Federal employee benefit laws. I request unanimous consent to have this chart entered in the record.

[The information referred to follows:]

Hillside
Family of Agencies

Federal Notice Requirements – Health and Welfare Benefits

Law	**Notice Requirement**	**Notice Timing** (based on calendar plan year)
Patient Protection and Affordable Care Act (PPACA)	Statement of grandfathered status	Initial notice required by 1/1/11. Ongoing notice must be provided in plan materials provided to participants that describe plan benefits (e.g., SPD, open enrollment materials).
	Special enrollment notice of dependent coverage up to age 26	One time notice requirement required by 1/1/11.
	Special enrollment notice of no lifetime maximum benefit	One time notice requirement required by 1/1/11.
	Notice of rescission	Participant-specific notice requirement. Must be provided to affected participants at least 30 days before coverage rescission occurs.
	Notice of patient protections and selections of providers	Initial notice required by 1/1/11. Ongoing notice must be provided whenever the SPD or similar description of benefits is provided to participants.
	Waiver of annual limit requirements	For plans that received waiver approvals for plan years beginning before 2/1/11, the deadline for providing notice to current and eligible participants was 2/7/11.
	Early retiree reinsurance program (ERRP) notice	Notice required to be made to all participants (not just early retirees). Must be provided within a reasonable period of time after receipt of first ERRP reimbursement.
	Claims and benefit determination notices	Communications regarding claims and adverse benefit determinations. Model notice not yet issued by the DOL.
	IRS Form W-2	Reporting of aggregate cost of employer-sponsored coverage provided to employees was to have been reported on W-2s starting in 2011. This requirement has been delayed without specific guidance on when it will be required.
	Uniform summary of benefit coverage	A uniform summary of plan benefits and coverage (HHS to develop standards) to be provided to applicants/enrollees before enrollment. Tentative initial compliance date is March 2012.
	Notice regarding eligibility for health insurance exchange	Tentative initial compliance date is 2013.
Consolidated Omnibus Reconciliation Act (COBRA)	Initial/general COBRA notice	Initial notice required to be made within 90 days of when coverage begins to participants (covered employees and their spouses).
	Notice to plan administrator (Qualifying event notice)	Required to notify plan administrator within 30 days of a) qualifying event or b) the date coverage would be lost as a result of the qualifying event, whichever is later.

Law	Notice Requirement	Notice Timing (based on calendar plan year)
Consolidated Omnibus Reconciliation Act (COBRA) (continued)	COBRA election notice	Plan administrator must provide the election notice within 14 days after being notified by the employer or qualified beneficiary of the qualifying event (or 44 days after qualifying event if the employer is also the plan administrator).
	Notice of unavailability of COBRA	Plan administrator must provide this notice within 14 days after being notified by the individual of the qualifying event (or 44 days after qualifying event if employer is also the plan administrator).
	Notice of early termination of COBRA coverage	Plan administrator must provide as soon as practicable following the plan administrator's determination that coverage will terminate.
	Notice of insufficient payment	Plan administrator must provide reasonable period of time to cure deficiency before terminating COBRA coverage (e.g., 30-day grace period).
	Premium charge notice	Plan administrator should provide at least one month prior to effective date.
	COBRA conversion notice (180-day letter)	Plan administrator must provide conversion information to COBRA participants 6 months prior to the termination of their COBRA coverage.
Health Insurance Portability and Accountability Act (HIPAA)	Notice of special enrollment rights	Must provide notice at or before the time an employee is initially offered the opportunity to enroll in the group health insurance plan.
	General notice of pre-existing condition exclusion	Must provide notice as part of any written application materials distributed for enrollment. If the plan does not distribute such materials, the notice must be provided by the earliest date following a request for enrollment that the plan, acting in a reasonable and prompt fashion, can provide the notice.
	Individual notice of pre-existing condition exclusion	Must provide notice as soon as possible following the determination of creditable coverage.
	HIPAA portability (certificate of creditable coverage)	Must be provided automatically when covered individuals lose group health plan coverage, become eligible for COBRA coverage, and when COBRA coverage ceases.
	HIPAA privacy and security – Notice of privacy practices	Must be provided when a participant enrolls in health plan coverage, upon request, and within 60 days of a material revision to the notice. At least once every three years, participants must be notified about the availability of the Notice of privacy practices.
	HIPAA privacy and security – Notice of breach of unsecured PHI	Covered entities (includes Hillside) and their business associates must provide notification following a breach of unsecured PHI without unreasonable delay and in no case later than 60 days following the discovery of a breach.
	Wellness program disclosures – Notice of alternative standard	Must disclose the availability of an alternative standard in all materials describing wellness program.

Law	Notice Requirement	Notice Timing (based on calendar plan year)
Childrens Health Insurance Program Reauthorization Act (CHIPRA)	Annual CHIP notice	First annual notice must be sent by the first day of the first plan year beginning after 2/4/10 (1/1/11). Ongoing notice requirement each 1/1. Must be sent as a separate document, cannot be bound in enrollment materials, must be sent to all employees, not just those enrolled in the health plan.
Mental Health Parity and Addiction Equity Act (MHPAEA)	Notice of cost exemption	Plans claiming the increased cost exemption must promptly notify the appropriate federal and states agencies, plan participants and beneficiaries.
Michelle's Law	Michelle's law notice	Must include notice with any notice regarding a requirement for certification of student status.
Newborns' and Mothers' Health Protection Act (NMHPA)	NMHPA notice	Must include notice within SPD (or SMM) timeframes.
Women's Health and Cancer Rights Act (WHCRA)	WHCRA notice	Must provide notice upon enrollment in the plan and annually thereafter.
Uniformed Services Employment and Reemployment Rights Act (USERRA)	USERRA notice	Must provide notice by posting where other employee notices are customarily posted, or provide to employees by alternate means.
Medicare Part D	Disclosure notices for creditable or non-creditable coverage	Notices need to be sent to active health insurance plan participants and their spouses, and retirees and their spouses, who are Medicare eligible at the following times: • Prior to each annual Medicare Part D election period; • Prior to an individual's initial enrollment period for Part D; • Prior to the effective date of coverage for any Medicare eligible individual that joins the plan; • Whenever prescription drug coverage ends or changes so that it is no longer creditable or becomes creditable; and • Upon request by a Medicare Part D eligible individual. Note – because employers have no way of knowing whether employees' eligible dependents may be Medicare-eligible, it is recommended that this notice be sent to all active employees. Notice must be a separate document or if bound in other materials there must be a prominent reference to the notice in 14 point font on the first page.
Medicare Part D – Retiree Drug Subsidy	Retiree drug subsidy application	At least 90 days before the beginning of each plan year, plan sponsors must apply for retiree drug subsidy, unless CMS approves request for extension.
Medicare Secondary Payer (MSP)	MSP reporting requirements	Quarterly report requirement to the CMS.

Law	Notice Requirement	Notice Timing (based on calendar plan year)
Family Medical Leave Act (FMLA)	General notice	Must be posted conspicuously (it can be done electronically, as long as it's accessible to employees and applicants). This notice must also be distributed to employees, either as part of the employee handbook or other written materials or as part of the paperwork given to each new hire.
	Eligibility notice	Must be provided to employees who request FMLA leave. The notice must indicate whether the employee is eligible for leave; if not, the notice must state at least one reason why the employee is ineligible (e.g., the employee has not yet worked for the employer for 12 months). This notice must be provided within five business days after the employee's request.
	Rights and responsibilities notice	Provides a variety of information about FMLA leave, including whether the employer will require a medical certification and/or fitness for duty certification, payment of healthcare premiums, using paid leave, and more. This notice must be provided within five business days after the employee's request.
	Designation notice	Either designates time off as FMLA leave or notifies the employee that time off will not be designated as FMLA leave. For FMLA leave, the notice must indicate how much leave will be counted against the employee's 12-week entitlement. This notice must be provided within five business days after the employer has obtained the necessary information to make the determination.
Genetic Information Non-Discrimination Act (GINA)	Health plan provisions	No general notice requirement. To satisfy the requirements for the research exception, plans must provide participants with a written request and must complete a Notice of Research Exception and file it with the designated federal agency.
	Employment provisions	No general notice requirement. Individual notice required if genetic information used for toxic substance monitoring or for certain disclosures of genetic information.
Employee Retirement Income Security Act (ERISA)	Qualified Medical Child Support Orders (QMSCOs) – Medical child support order notice	Upon receipt of medical child support order, plan must promptly issue notice, including plan's procedures for determining its qualified status. Within a reasonable time after its receipt, plan must also issue separate notice as to whether the medical child support order is qualified.
	Qualified Medical Child Support Orders (QMSCOs) – National medical support notice	Within 20 days after the date of notice or sooner, if reasonable, plan must send Part A to NYS agency. Plan must promptly notify affected persons of receipt of notice and procedures for determining its qualified status. Plan must within 40-business days after its date or sooner, if reasonable, complete and return Part B to NYS agency and must provide required information to affected persons.

Federal Notice Requirements – Health and Welfare & Retirement Benefits

Law	Notice Requirement	Notice Timing (based on calendar plan year)
Employee Retirement Income Security Act (ERISA)	Summary plan descriptions (SPDs)	Plan must provide SPD automatically to participants within 90 days of becoming covered by the plan. Updated SPD must be furnished every 5 years if changes made to SPD information or plan is amended. Otherwise, must furnish every 10 years.
	Summary of material modifications (SMMs)	Plan must provide SMM automatically to participants within 210 days after the end of the plan year in which the change is adopted. If benefits or services are materially reduced, participants must be provided notice within 60 days from adoption; or, where participants receive such information from the plan administrator at regular intervals of not more than 90 days, notice of materially reduced benefits or services must be provided within the regular internal.
	Plan documents	Plan must provide copies of plan documents no later than 30 days after a written request.
	Notification of benefit determination (claims notices, adverse benefit determinations, appeals procedures)	Notice requirements vary depending on type of plan and type of benefit claim involved.
	Summary annual reports (SARs)	Must provide SAR automatically to participants within 9 months after end of plan year, or 2 months after due date for filing Form 5500 (with approved extension).
	Summary of material reduction in covered services or benefits	Must provide within 60 days of adoption of material reduction in group health plan services or benefits.

Federal Notice Requirements – Retirement Plans

Law	Notice Requirement	Notice Timing (based on calendar plan year)
Employee Retirement Income Security Act (ERISA)	Special tax notice (402(f) Notice)	Must be provided to participants 30 days prior to taking a distribution/rollover (although the participant can waive 30-day notice period).
	Periodic benefit statements	DC Plans – quarterly (for participant directed accounts) or at least once per year (for non-participant directed accounts). DB Plans – at least once every three years, or notice provided at least once per year informing participants on how to obtain benefit information, and upon request (up to one request per year).
	Qualified domestic relations orders (QDROs)	Plan, upon receipt of the DRO, must promptly issue the notice (including the plan's procedures for determining its qualified status). The second notice, regarding whether

Law	Notice Requirement	Notice Timing (based on calendar plan year)
		the DRO is qualified, must be issued within a reasonable period of time after receipt of DRO.
Employee Retirement Income Security Act (ERISA) (continued)	Qualified joint and survivor annuity (QJSA) notice	Must be provided 30 to 180 days prior to the date distribution commences.
	Qualified optional survivor annuity (QOSA) notice	Must be provided 30 to 180 days prior to the date distribution commences.
	Section 404(c) plan disclosures	Certain information should be furnished to participants before the time when investment elections are to be made; certain information must be furnished upon request.
	Notice of significant reduction in benefit accruals (204(h) Notice)	Generally must be provided 45 days in advance of the effective date of certain types of plan amendments (e.g., reduction in benefits).
	Notice of blackout period for individual account plans	Must be provided 30 days but not more than 60 days in advance of blackout period.
	Notice to interested parties (Determination letter request notice)	Notice must be given not less than 10 days or more than 24 days before the day that the application is submitted.
	Safe harbor notice	Must be provided 30 days and not more than 90 days in advance of the plan year in which safe harbor contributions will be made.
	Suspension of benefits notice	During first month or payroll period in which the withholding of benefit payments occurs.
	Notice of failure to meet minimum funding standards	Must be furnished within reasonable period of time after the failure.
	Notice of funding based limitations (Notice of restricted benefits)	Generally within 30 days after a plan becomes subject to a specified funding based limitation.
	Notice of transfer of excess pension assets to retiree health benefit account	Must be made no later than 60 days before the date of the transfer.
	Notice of intent to terminate	Must be made at least 60 days and no more than 90 days before proposed termination date.
	Notice of plan benefits	No later than the time Form 500 (Standard Termination Notice) is filed.
	Qualified pre-retirement survivor annuity (QPSA) notice	Must be provided during the period beginning when a participant is age 32 and ending with the close of the plan year before the participant is age 35,or within one year from when an employee becomes a participant hired after age 35.
Pension Protection Act (PPA)	Annual funding notice	Annually by 4/30.
	Eligible automatic contribution arrangement notice (EACA)	Annually by 11/30.
	Qualified default investment arrangement (QDIA)	Annually by 11/30.
	Notice of right to divest	No later than 30 days before the first date on which individuals are eligible to exercise their rights.
Pension Relief Act (PRA)	Notice of alternative amortization schedule	Required for first time – no later than 5/2/11.

Senator ENZI. We also have three Federal agencies overseeing the defined benefit system, the Employee Benefit Security Administration at the Department of Labor, the PBGC, and the Internal Revenue Service. One only has to look at the regulatory dockets for the Department of Labor's fiduciary rule proposal, the IRS' proposal for hybrid pension plans, or the PBGC rule proposal on plant closures to recognize that the agencies do not work in tandem but each have their own agendas for how the retirement system should be run. This is not only detrimental to the retirement system, but it also discourages the business community from participating in the voluntary retirement systems that we have today. I'm very disappointed that there was not a greater inclusion of retirement employee benefit issues by these agencies in carrying out the Presi-

dent's recent Executive order to reduce regulatory burden and overlap.

There's little doubt about the power of retirement dollars in our economy. The Investment Company Institute recently reported that $18.1 trillion of U.S. retirement assets are invested in our economy. However, the greatest share of that comes from 401(k) and Individual Retirement Accounts and not from traditional pensions.

Mr. Chairman, I thank you for holding this hearing. I'm looking forward to hearing from our witnesses today on what can or should be done to help encourage greater participation in the private sector and our retirement system, and whether the traditional defined benefit system can be saved or is it indeed heading for extinction.

Unfortunately, I will not be able to stay for all of the hearing because I had a number of things that were already scheduled before this, and many of them involve Wyoming people. So I'd like to thank the witnesses for taking the time out of their jobs and lives to be with us here today.

Ms. Oakley, thank you for sharing on behalf of the Institute.

In addition, I'd like to thank Mr. Bertheaud, who I invited. He's with the DuPont Company, which has an excellent pension plan, and he's also representing members of the American Benefit Council.

I also would like to acknowledge Mr. Stephen with the Rural Electric Cooperatives as we did a lot of work with the co-ops during passage of the Pension Protection Act in 2006.

And finally, I understand that Mr. Marchick's family is from Cheyenne, WY.

So we invite all of you, of course, to come to Wyoming.

I do have questions for the record for each witness, and I thank the Chairman for holding this hearing.

[The prepared statement of Senator Enzi follows:]

PREPARED STATEMENT OF SENATOR ENZI

Mr. Chairman, in addition to my full statement above I would like to supplement my statement to further illustrate how we got to where we are with our traditional defined benefit system.

For its July 2011 newsletter *Insider*, Towers Watson released a report entitled, "Prevalence of Retirement Plan Types in the *Fortune 100* in 2011: Account-Based Benefit Plans Dominate." I am submitting the entire Towers Watson report for the committee's hearing record. This report looks at the types of pension plans held by *Fortune 100* companies since 1985. Towers Watson found that in 1985 there were 90 out of the 100 companies sponsoring defined benefit plans with only 10 companies offering a defined contribution or 401(k)-type plans. Even in 1998, these figures were the same—90 companies sponsoring defined benefit plans and 10 companies sponsoring defined contribution plans. However, in 2011, there were only 13 companies that offered a defined benefit plan to new hires while 70 companies offered a defined contribution plan. The change in statistics is a clear indication that defined benefit plans are heading towards extinction.

The reasons cited by Towers Watson for the decline in defined benefit plans include, "a desire to reduce overall retirement costs, . . . greater mobility in the workforce, the popularity of account-

based designs with employees, government and accounting regulations, market trends and board pressures, and a belief that such a shift reduces financial risk."

Based upon this list, it is clear that fundamental changes must be made to the system if we ever hope for defined benefit pensions to make a comeback. Hybrid and cash-balance pension plans might be a good way to go but Towers Watson found that there was a significant decline in the number of companies willing to sponsor hybrid pension plans. The regulatory uncertainty and regulatory burdens make these plans unappealing as well.

In my statement above, I mention three regulatory initiatives by the three Federal agencies with direct oversight of the defined benefit pension system. To demonstrate the concerns of the business community with the regulatory system and its uncoordinated nature, I am submitting the following comment letters from the business community:

(1) Letter from the American Society of Pension Professionals and Actuaries dated January 12, 2011, in response to a request for comment on proposed additional rules regarding hybrid retirement plans issued by the Internal Revenue Service on October 19, 2010, (REG–132554–08);

(2) Letter from the American Benefits Council dated February 3, 2011, in response to a request for comment on proposed regulations addressing the definition of fiduciary issued by the Employee Benefits Security Administration of the Department of Labor on October 22, 2010 (RIN1210–AB32); and

(3) Letter from the ERISA Industry Committee dated November 12, 2010, in response to a request for comment on proposed rules regarding liability for termination of single-employer plans: treatment of substantial cessation of operation issued by the Pension Benefit Guaranty Corporation on August 10, 2010 (RIN1212–AB20).

[The above referenced information may be found in Additional Material.]

Mr. Chairman, thank you again for holding this hearing and bringing this distinguished panel of witnesses together.

The CHAIRMAN. Thank you very much, Senator Enzi.

Again, we're fortunate to be joined by the distinguished panel.

Diane Oakley, executive director of the National Institute on Retirement Security. Before joining the Institute, Ms. Oakley served as the senior policy advisor to Congressman Earl Pomeroy and held leadership positions with TIAA–CREF, a leading financial services provider.

Chris Stephen is an employee benefits legislative counsel and senior associate director for the National Rural Electric Cooperative Association. Prior to joining NRECA in 2001, Mr. Stephen worked for Baker and Hostetler, LLP, the U.S. Attorney's Office, and the Office of Counsel to the President.

Mr. Bertheaud is the chief actuary and director of Corporate Insurance for DuPont, where he leads the in-house actuarial consulting team that oversees global pension funding and accounting. He also serves as DuPont's representative on the policy board of directors of the American Benefits Council.

Finally, Dave Marchick, managing director of the Carlyle Group. Prior to joining Carlyle, Mr. Marchick was a partner and vice-chair of the International Practice Group at Covington and Burling.

All of your statements will be made a part of the record in their entirety. I'd like to ask if you could sort of sum it up in 5 minutes so we could have a discussion; I would certainly appreciate that. We'll start with Ms. Oakley and work across.

Ms. Oakley, again, welcome, and if you can sum up in 5 to 7 minutes, I'd appreciate it.

STATEMENT OF DIANE OAKLEY, EXECUTIVE DIRECTOR, NATIONAL INSTITUTE ON RETIREMENT SECURITY, WASHINGTON, DC

Ms. OAKLEY. Chairman Harkin, Ranking Member Enzi, Senators on the committee, I'm the executive director of the National Institute on Retirement Security. NIRS and all the research I'm going to talk about today is available on our Web site at *nirsonline.org*, and Americans, we found, are very anxious about retirement. Eighty-four percent of Americans are concerned about their retirement prospects and worry that stock market volatility makes it impossible for them to accurately predict what they need in retirement savings.

Americans also believe that the disappearance of traditional pensions makes it harder to achieve the American dream. This occurs at a time when 15 percent of workers are covered by a defined benefit plan, and yet we still find in our survey that 81 percent of Americans believe that all workers ought to have access to a defined benefit pension so that they can be independent in retirement. They appreciate that pensions deliver what I'd like to call high-fives all around. They deliver $5.4 trillion in assets invested for the future. We know that they also provide 5 million Americans sufficiency in terms of their income so that they're not subject to poverty.

It also supports 5.3 million American jobs as retirees spend those monthly checks in their communities, and they do it at a cost that's nearly 50 percent less than what would happen if you tried to provide the same benefits in a defined contribution plan.

In Wyoming, when a retiree receives a payment such as the $320 million disbursed by the public system in Wyoming, they use it to purchase local goods and services. For this hearing, NIRS conducted a very preliminary analysis using our Pension Economics Model of the $320 billion in benefits paid from both private and public pensions in 2009. Assuming that each dollar of retirement income supported $2.36 in economic activity, we know that pensions had an economic impact of more than $750 billion and supported those 5.3 million jobs here in the United States.

Pension payments are particularly vital to small communities. For example, Iowa PERS checks go to retirees who number 10 percent of the active payroll in Madison County. Also, for example, $2 million in pension checks go from the Colorado PERA to its employees in rural Costilla County, and that comprises 35 percent of the earned income in that county. And just this morning, CALPERS released a study of its economic impact of the $12 billion in benefit

payments throughout California, and in Sierra County those payments increased the gross regional product by 7¾ percent.

At the end of the first quarter of 2011, assets in public plans—and private plans—stood at about $5 trillion, recouping most of the losses that occurred in 2009 and 2006. The numbers point to the role that pensions also play in capital development, acting as an intermediary in challenging times, giving our market steps and liquidity.

We also know from our pension factor research that Americans see their parents being kept out of poverty. In fact, 5 million older Americans are kept from being considered poor or near poor because of the pension, and therefore less reliant on their families and on government assistance. The pension incomes received by older American households keep hundreds and thousands of retirees from experiencing food, shelter, or health care hardships. Older Americans with pensions, in fact 1.35 million of them, are not on our rolls for means-tested public assistance. This saves government $7.3 billion.

We also know that pensions have built-in savings. They're more efficient than defined contribution plans. And NIRS has determined that with regard to the savings that individuals get by using a pension for protecting against running out of money, if you looked and tried to take your 401(k) plan over your life expectancy, you'd have a 50/50 shot of running out of money. Pensions can save people over $100,000 more that they should be saving for retirement to assure that they don't run out of money in retirement. They also end up delivering benefits or investment returns much more significantly than the private sector does individually with individuals making those investment decisions. If you assume at least 100 basis points added return in a defined benefit plan, the pensions end up coming up with a 26 percent cost advantage when that's compounded over someone's working career and retirement years.

In short, we know Americans are anxious about their retirement, yet our Nation faces a good deal of economic challenges. Pensions are one place where the economy delivers for American households, for employers, for our communities and our financial markets. They should remain a centerpiece of our retirement income policy, and I thank you very much, Mr. Chairman, Senator Enzi, for examining this issue.

[The prepared statement of Ms. Oakley follows:]

PREPARED STATEMENT OF DIANE OAKLEY

SUMMARY

Americans are highly anxious about retirement. Some 84 percent of Americans are concerned about their retirement prospects, while an overwhelming majority believes the Nation's retirement infrastructure is crumbling and that stock market volatility makes it impossible to predict retirement savings. Simultaneously, the Nation faces severe fiscal challenges with the economy struggling to recovery, budgets under pressure, and millions of Americans are looking for jobs.

Americans also believe that the disappearance of pensions has made it harder to achieve the "American Dream." In the1980s, some 38 percent of all private sector employees were covered by pensions, and only 15 percent have pensions in 2009. Yet, pensions are the most cost-efficient means for delivering a modest, stable income for older Americans so that they can be financially secure. In fact, 81 percent

of Americans believe all workers should have access to a pension so they can be independent in retirement.

Pensions Strengthen National and Local Economies

The benefits provided by pensions reaches beyond the retirees, as they buy goods and services. For this hearing, NIRS conducted a very preliminary analysis using its *Pensionomics* methodology on the $320 billion in pension benefits paid from State and local pensions and private sector pensions. The numbers, while still rough, and the finding from 2006 data that each dollar of income supported $2.36 in economic activity, suggest that pensions:

- Had a total economic impact of more than $756 billion.
- Supported more than 5.3 million American jobs.
- Supported more than $122 billion in annual Federal, State, local tax revenue.

PENSIONS ENSURE RETIREMENT SELF SUFFICIENCY, PREVENT ELDER POVERTY

Pension income plays a critical role in reducing the risk of poverty and hardship for older Americans. *The Pension Factor* finds that pension income received by nearly half of older American households in 2006 was associated with:

- 1.72 million fewer poor households and 2.97 million fewer near-poor households.
- 560,000 fewer households experiencing a food hardship.
- 380,000 fewer households experiencing a shelter hardship.
- 320,000 fewer households experiencing a health care hardship.

The rate of poverty for older households without pension income was six times greater than for households with pension. The billions of dollars in savings for public assistance due to pensions are significant given the fiscal pressures on government safety net programs across the country.

Pensions Are the Most Economically Efficient Retirement Plan

Due to their group nature, pensions possess "built-in" savings, which make them highly efficient retirement income vehicles, capable of delivering retirement benefits at a low cost to the employer and employee. NIRS research finds that a pension can deliver the same level of retirement income as an individual 401(k) type savings account at *half* the cost.

Thank you Chairman Harkin, Ranking Member Enzi, and Senators on the Health, Education, and Labor Committee for the opportunity to testify today. I am Diane Oakley executive director of the National Institute on Retirement Security, or NIRS. NIRS is a not-for-profit research and education organization committed to fostering a deep understanding of the value of retirement security to employees, employers and the economy. Our work is available on our Web site *www.nirsonline.org*.

Today, I would like to share our research regarding defined benefit (DB) pensions. I will focus on pension trends, how pensions fuel the American economy, how pensions ensure Americans can be self-reliant in retirement, and the economic efficiencies of pensions.

Before I get into the details, let me say a few words on the current state of retirement security in America.

For working American families, a key facet of the American Dream is to live in dignity and maintain financial independence in later years. Simply put, Americans do not want to be a financial burden for their families. Unfortunately, NIRS recent polling research finds that some 75 percent of Americans believe the disappearance of pensions has made it harder to achieve the American Dream. (Boivie, Kenneally, & Perlman, 2011)

When examining private sector pension coverage trends over the past three decades, we find that fewer and fewer employees are participating in pensions. In the 1980s, some 39 percent of private sector employees were covered by pensions, and this number has plummeted to 15 percent of private sector employees in 2009. (EBRI, 2011)

NIRS research finds that traditional pensions are essential to ensuring self-sufficiency for middle class Americans. More specifically, pensions enable nearly 5 million older American households to stay above the poor or near poor threshold levels, and thereby avoid reliance on assistance from family or the government to meet their basic daily living expenses.

Given the disappearance of pensions, it's not surprising that our polling research also found that 84 percent of Americans are anxious about their retirement prospects. An overwhelming majority also believe the Nation's retirement infrastructure

is crumbling and that stock market volatility makes it impossible to predict retirement savings. (Boivie, Kenneally, & Perlman, 2011)

This high level of anxiety about retirement security is echoed by others. An Associated Press/LifeGoesStrong.com poll found that 89 percent of baby boomers are not convinced that they will be able to live in comfort in their later years. (AP/LifeGoesStrong, 2011) Also, the 2011 Employee Benefits Research Institute Retirement Confidence Survey found confidence in retirement at a low point, with only 13 percent of respondents feeling very confident about retirement. (EBRI—RCS, 2011)

The retirement savings shortfall for Americans is startling. The Center for Retirement Research at Boston College, calculated that the estimated national retirement income deficit facing American households is some $5.2 to $7.9 trillion. (Retirement USA, 2010) This retirement under funding for private sector workers could have significant negative impacts for individuals, the national economy, and struggling government budgets.

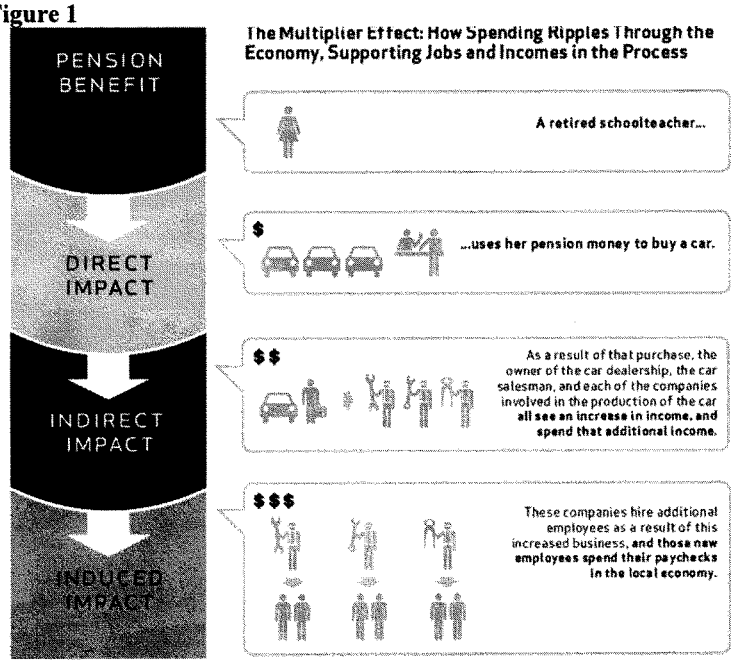
Therefore, we applaud the committee's careful examination of the role of pensions for middle class Americans and the broader economy.

PENSIONS STRENGTHEN NATIONAL AND LOCAL ECONOMIES

The benefits provided by pension plans also have an impact that reaches well beyond the retirees who receive pension checks. Public and private pensions play a vital role in the national economy as well as in local economies across the country.

The steady, monthly benefit payments offered by pension plans provides peace of mind and security for retirees. At the same time, the national and local economies benefit from the regular expenditures retirees.

Figure 1



Source: *Pensionomics*, 2008.

As Figure 1 illustrates, a retiree in Iowa, Wyoming or Colorado, who receives a benefit payment from their pension fund, spends the money on goods and services in her community, thus supporting the local economy and industries. For example, a retiree may purchase food at the local diner or grocery store, medical services at

their pharmacy or hospital, an automobile at the local dealership, clothing at the local mall, or tickets at the movie theatre.

Pension payments are particularly vital to small communities and economies across the country where there is a lack of diverse local industries or where other steady sources of income may not be readily found. For example, the Colorado Public Employees Retirement Association made pension benefit payments of $2.1 million in 2009 to its retirees in rural Costilla County and those payments comprise 35 percent of the earned income in that Colorado county.

In 2006, NIRS conducted the first national economic impact analysis of pension expenditures based on public pensions. In *Pensionomics* (2009), NIRS calculated that each dollar of the over $151.7 billion in DB pension benefit expenditures made from State and local pension benefits in 2006 supported $2.36 in economic activity which:

- Had a total economic impact of more than $358 billion. (Almeida & Boivie, 2009)
- Supported more than 2.5 million American jobs that paid more than $92 billion in total compensation to American workers. (Almeida & Boivie, 2009)
- Supported more than $57 billion in annual Federal, State, local tax revenue. (Almeida & Boivie, 2009)
- Nationally, had the largest economic impact in manufacturing, health care and social assistance, finance and insurance, retail trade and accommodations and food service sectors. (Almeida & Boivie, 2009)

Traditional pensions also have large multiplier effects, especially from the viewpoint of each taxpayer dollar contributed to pensions as part of public employees' compensation. Each dollar of the $64.5 billion public employers contributed to State and local pensions supported $11.45 in total economic activity.

NIRS will update the *Pensionomics* report in early 2012 and we will be pleased to share a copy of the final report with the committee. For today's hearing, we took a preliminary look at the latest data on 2009 expenditures made from State and local governmental pensions and single-employer private sector pension plans combined. These rough data suggest that public and private sector DB pensions:

- Had a total economic impact of $756 billion.
- Supported more than 5.3 million American jobs.
- Supported more than $121.5 billion in annual Federal, State, local tax revenue.

Additionally, one lesson from the recent recession and the sharp decline in the stock market values is that reliable sources of pension income may be especially important in stabilizing local economies. Comparing pensions to individual retirement accounts, we note that guaranteed pension income means retirees need not worry about reducing spending with every dip in the stock market. Thus, pensions are all the more important in times of financial crisis and economic instability. Pension expenditures play an important role in providing a stable, reliable source of income for the local economies in which their retirement checks are spent—and therefore help the national economy recover as well.

It is also important to highlight the magnitude of pension assets. According to the Flow of Funds Accounts of the United States released by the Federal Reserve System on June 9, 2011, assets in Private Sector Retirement Funds and State and Local Government Employee Retirement Funds have almost reached their 2007 year-end values, recouping losses that occurred as a result of the stock market collapse of 2008–9. At the end of the first quarter 2011, the value of financial assets in private sector defined benefit stood at $2.32 trillion and the value of financial assets held by public pension plans was $3.03 trillion. (BOG, 2011)

In the 2 most recent years for which we have complete data (2008 and 2009), total contributions to pensions exceeded $350 billion. Amounts contributed break down by sector as follows: sponsors of pensions among the Fortune 1000 companies contributed $96.4 billion (Warshawsky, 2011), public sector employers contributed $168.9 billion and public employees contributed $76.2 billion to their pension plans. (NASRA)

These numbers call attention to one aspect of pensions and the economy that often is overlooked, pensions are critical to our Nation's capital development. Because pension plans are long-term investors, they can play a critical intermediation role in the economy at the most challenging times giving our financial markets depth and liquidity. While other lenders may close their doors to many kinds of financing due to higher risks during periods of tightening credit, pension plans have continued to lend and invest in areas like venture capital that grow new companies. Their longer view gives financial markets patient capital that can wait for investment returns to be fully realized over long periods. Thus, pension plans are com-

pensated with higher returns while still maintaining properly diversified investments in their portfolios.

PENSIONS ENSURE RETIREMENT SELF SUFFICIENCY, PREVENT ELDER POVERTY

In addition to the economic benefits of traditional pension plans, they also are of great value to Americans. They provide peace of mind and self-sufficiency with a secure, predictable retirement income that cannot be outlived.

Having pension income can play a critical role in reducing the risk of poverty and hardship for older Americans. In 2006, the mean annual pension income for elderly persons from their own employers was $15,784 and the mean pension income rose to $18,195 when pension income from a spouse was also counted. (Almeida & Porell, 2009)

NIRS research, *The Pension Factor* (2009), finds that pension income received by nearly half of older American households in 2006 was associated with:

- 1.72 million fewer poor households and 2.97 million fewer near-poor households;
- 560,000 fewer households experiencing a food hardship;
- 380,000 fewer households experiencing a shelter hardship;
- 320,000 fewer households experiencing a health care hardship. (Almeida & Porell, 2009)

Overall, the rate of poverty for older households without pension income was six times greater than the rate among households that had income from a pension. (Almeida & Porell, 2009)

Moreover, NIRS found that pensions reduce—and in some cases eliminate—the greater risk of poverty and public assistance dependence that women and minority populations otherwise would face. (Almeida & Pore11, 2009)

For almost 71 percent of the pension recipients in 2006, the source either in whole (63.7 percent) or in part (7 percent) of their pension income was a pension sponsored by a private employer they worked for. A little more than 36 percent of pension recipients had all or some pension income come from a public pension they earned while employed by a State or local government. (Almeida & Porell, 2009) Retirement income from individual 401(k)-type DC accounts play a lesser role in meeting the retirement security needs of elderly Americans, who were more likely to be covered by a pension during their careers. Based on DC plan income from their former employers, only 5.1 percent of all persons age 60 and older had such income and the percentage with DC income increased to 7.2 percent when spouses' DC plan income was counted.

When older Americans with pensions are able to be self-sufficient in retirement, the financial burdens on governments ease. In 2006, 1.35 million fewer households received means-tested public assistance as a result of having pension income. This translated into a $7.3 billion savings in public assistance expenditures, which is about 8.5 percent of aggregate public assistance dollars received by all American households for the same benefit programs in that year. (Almeida & Porell, 2009)

These impacts are significant, particularly given the pressures on safety net programs during the current fiscal crises experienced at all levels of government throughout the country. The American public sees the value that pensions give to their parents and grandparents today, and that could explain why some 81 percent of Americans believe that all workers should have access to a pension plan so they can be independent and self-reliant in retirement. (Boivie, Kenneally, & Perlman, 2011)

PENSIONS ARE THE MOST ECONOMICALLY EFFICIENT RETIREMENT PLAN

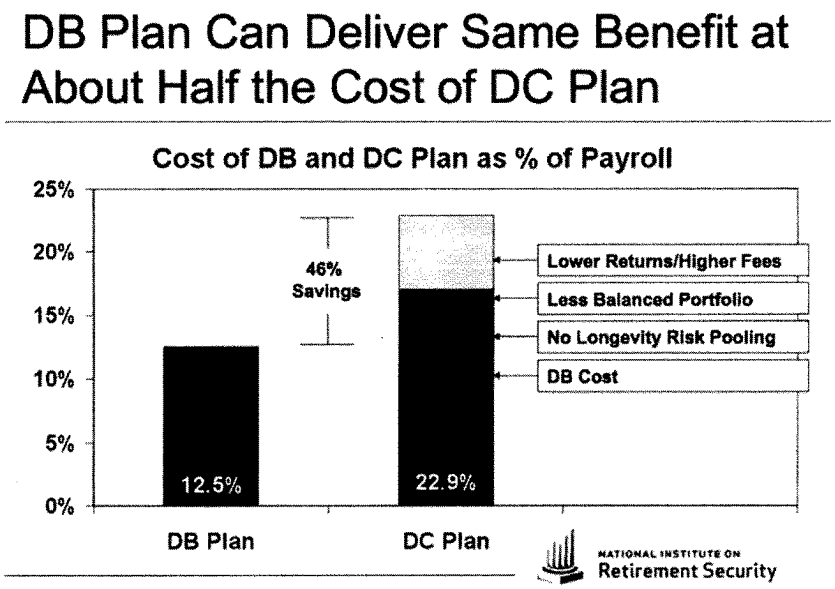
Pensions provide retirees and workers with a secure, predictable retirement income that cannot be outlived. One element of pensions that is not widely understood is their inherent economic efficiencies. Due to their group nature, pension plans possess "built-in" savings, which make them highly efficient retirement income vehicles, capable of delivering retirement benefits at a low cost to the employer and employee. NIRS research finds that a pension can deliver the same level of retirement income as an individual 401(k) type savings account at half the cost. (See Figure 2)

These savings derive from three principal sources.

First, pensions better manage longevity risk, or the chance of running out of money in retirement. By pooling the longevity risks of large numbers of individuals, pensions avoid the "over saving" dilemma. Half of the retirees who plan on drawing down their savings in their 401(k) account over their life expectancy will run out of money. To protect against outliving their money, these individual workers should save more so they have a bigger nest egg when they start retirement. In fact, to assure an adequate retirement income over the "maximum life expectancy" one

would need about $100,000 more in a 401(k) account than what would be required in a pension. (Almeida & Fornia, 2008) Consequently, pension plans are able to do more with less.

Figure 2



Source: A Better Bang for the Buck, 2008.

Second, because pensions, unlike the individuals in them, do not age, they are able to take advantage of the enhanced investment returns that come from a balanced portfolio throughout an individual's lifetime. Financial advisors recommend that individuals gradually switch away from high risk/high return assets in their 401(k) as they approach retirement as a way of avoiding the downside risk of losses in stock values, for example. Consistently, maintaining a well-diversified portfolio gives a DB pension a 5 percent cost advantage. (Almeida & Fornia, 2008)

Third, professionally managed pensions achieve greater investment returns as compared with individual accounts. Research from the global benchmarking firm CEM, Inc. concluded that between 1988 and 2005 pensions showed annual returns 180 basis points higher than DC plans. (Flynn & Lum, 2007) Watson Wyatt found that, between 1995 and 2006, large pensions outperformed DC accounts by 121 basis points. (Watson Wyatt 2008) Also, Morningstar compared returns from retail mutual funds with returns from traditional public pensions and found public plans outperformed by 3.22 percent. (Morningstar, 2007) A retirement system that achieves higher investment returns can deliver any given level of benefit at a lower cost. Over time assuming a 100 basis point advantage for DB pensions each year compounds to a 26 percent cost advantage for the traditional pension. (Almeida & Fornia, 2008)

One can think of pensions as a buying club similar to Costco or BJ's. These buying clubs add value by operating on a large scale and using professionals who know markets to find high quality products at the lowest price for customers. Similar to buy clubs, pensions operate on a scale much larger than the average size individual 401(k) account plan, and also utilize professionals to manage pension assets. As a result, pensions can deliver a secure retirement income at a lower cost thanks to their economic efficiencies, professional asset management, lower costs, and better investment returns.

These findings are contained in NIRS' report, *A Better Bang for the Buck; The Economic Efficiencies of Defined Benefit Pension Plans*. Again, this analysis finds pensions can offer the same retirement benefit at close to half the cost of an indi-

vidual account. Specifically, the cost to deliver the same level of retirement income to a group of employees is 46 percent lower in a pension than it is in an individual DC plan. Hence, it makes sense that pensions should remain a centerpiece of retirement income policy and practice in light of current fiscal and economic constraints facing plan sponsors. (Almeida & Fornia, 2008) As a nation, we need to deliver retirement benefits in the most economically efficient manner possible.

CONCLUSION

Pensions are the most cost-efficient means for ensuring Americans can be self-sufficient in retirement. Moreover, spending of pension benefits provides important economic stimulus and jobs nationally and across virtually every city and State from coast to coast. Americans are highly concerned about their retirement prospects, while the Nation continues to face severe economic challenges. As such, policymakers are wise to focus on protecting pensions that remain in place, and finding ways to expand pension coverage for middle class Americans. I thank you for holding this hearing today to examine these issues.

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The CHAIRMAN. Thank you very much, Ms. Oakley.

Mr. Stephen, welcome. Please proceed.

STATEMENT OF CHRISTOPHER T. STEPHEN, ESQ., EMPLOYEE BENEFITS LEGISLATIVE COUNSEL AND SENIOR ASSOCIATE DIRECTOR, GOVERNMENT RELATIONS DEPARTMENT, NATIONAL RURAL ELECTRIC COOPERATIVE ASSOCIATION, ARLINGTON, VA

Mr. STEPHEN. Chairman Harkin, Mr. Enzi, members of the committee, my name is Chris Stephen. I'm Employee Benefits legislative counsel at the National Rural Electric Cooperative Association,

the national service organization for over 900 rural electric utilities that provide electricity to 42 million people in 47 States, is very well represented here on the panel today.

Most NRECA members, as you know, are consumer-owned, not-for-profit electric cooperatives dedicated to the delivery of safe, reliable and, most importantly, affordable electricity, and also contributing to the economic development of our consumer owners.

This committee has long recognized the special, unique nature of multiple employer plans sponsored by rural cooperatives. Mr. Enzi mentioned it in his opening. This is not to be confused, of course, with multiemployer plans that are administered subject to a collective bargaining agreement with unions.

Electric co-ops are defined by their employees; and, like police, fire, and other emergency personnel, electric co-op employees often find themselves in harm's way in carrying out their duties sometimes, and sometimes often, during and immediately after a natural disaster. Take, for example, in January 2011 during an ice storm in Greenfield, IA, when Farmers Electric co-op responded to 211 downed lines in the middle of the storm to make sure the lights were on as soon as possible. Or more recently, just last month in Saratoga, WY, when the flooding North Platte River was at 10 percent above flood stage and linemen from Carbon Power and Light Cooperative donned wet suits, got into rafts, and went into the middle of the river, the raging river I was told, to get to an island in the middle of the river to make sure that the downed lines were up in 4½ hours instead of 4½ days, working with the National Guard and fire and rescue teams.

I could go on for hours and hours on this type of work that goes on at rural electric co-ops, but today I want to focus on trying to keep our rural consumers and our rural Americans in our rural areas. Over the last several years, keeping our best and brightest at home has become ever more difficult, which has just been exacerbated by the economic downturn. The strongest recruitment and retention tool that electric cooperatives have to keeping our best and brightest at home is our employee benefit program, and today I'm going to focus on our defined benefit plan.

NRECA is proud that the vast majority of our members offer their employees, 63,000 employees total, both the comprehensive defined benefit plan as well the NRECA-sponsored 401(k) plan. Both are multiple employer plans under 413(c) of the Internal Revenue Code that are operated to maximize retirement savings for employees and retirees and provide each and every co-op with a convenient and affordable mechanism to pool resources and utilize economies of scale that would otherwise be unavailable to small businesses like electric cooperatives.

As you know, our 900-member cooperatives have as few as 4 employees and a median of 48 employees on the payroll. And unlike other sectors, fortunately, electric co-ops see a less than 5 percent annual turnover. This allows us to invest in our current employees for the long-term, and, in fact, two-thirds of co-op employees that leave the co-op retire, spending their entire working career in the cooperative family.

Our DB plan rewards long service and allows our members to invest in employees without facing the substantial replacement cost

to go out and find a new one. As a result of the market collapse, unfortunately, contributions to our plan last year rose by 35 percent, by $225 million. This dramatically increased our short-term liabilities and forced some co-ops to make the sometimes impossible choice of either raising electricity rates, eliminating or reducing retirement benefits, or laying off quality employees to make up the difference. Co-ops now, on average, contribute 23 percent of payroll to the plan, making it an even larger part of total comp.

A critical goal for cooperatives is to eliminate volatility and unpredictability in their annual budgets and ultimately electricity rates. The same principles applies to every single business that operates a defined benefit plan, including electric cooperatives. The Pension Protection Act codified the core fundamental principle that a promise made is a promise kept. We applaud that effort, supported the legislation, and thank you for recognizing that even a bill that has been a success in many, many ways, the economic calamity of the last several years has shown that even very good legislation does need to be refined to recognize new challenges. We thank you for passing short-term pension legislation last year.

Our plan is part of our members' core business strategy to recruit and retain long service employees and reward them with a financially secure retirement for that effort. The committee today has the opportunity to help our employees by supporting our plan in four specific ways.

No. 1, restoring a critical, logical element to when DB plans were most popular; that is, to allow companies to contribute more during good times and less during bad times when capital is at a premium.

No. 2, reject proposals to allow the PBGC to set its own premiums, let alone increase premiums by some $16 billion, which amounts to an unfair tax increase on current plan sponsors.

No. 3, prevent the IRS from eliminating or reducing benefits earned by employees who attain their plan's normal retirement age.

And No. 4, not impose additional taxes on retirement plans to address the national deficit. We believe that taxing electric linemen in their retirement savings in addition to current tax treatment is not the way to address the debt or the deficit.

We ask you to help us keep our promises by enacting new and innovative policies to encourage current plan sponsors to remain in the game, particularly multiple employer plans like ours, so they remain viable for future generations. I thank you for the invitation.

[The prepared statement of Mr. Stephen follows:]

PREPARED STATEMENT OF CHRISTOPHER T. STEPHEN, ESQ.

SUMMARY

Christopher T. Stephen is Employee Benefits Legislative Counsel at the National Rural Electric Cooperative Association (NRECA). NRECA is the national service organization for more than 900 rural electric utilities that provide electricity to approximately 42 million consumers in 47 States and sell approximately 12 percent of all electric energy sold in the United States.

Electric cooperatives are defined by their dedicated employees, who are committed to providing safe, reliable and affordable electricity to their consumer-owners. And, like police, fire and other emergency personnel, co-op employees frequently confront life-threatening situations and selflessly put themselves at great personal risk.

The vast majority of our members participate in the NRECA Retirement Security Plan (the "Plan"), a "multiple-employer" plan under IRC Section 413 (c) that plays a vital role in ensuring that our 63,000+ participants live with dignity in the communities they once served. It also provides a critical tool for our members to recruit and retain employees who can often earn higher wages in more urban areas, but value the long-term security provided by the Plan.

Keeping rural America's best and brightest "at home" has become an increasingly difficult task over the past several years. The strongest recruitment and retention tool for electric cooperatives continues to be their employee-benefits programs—particularly our defined-benefit plan. Unlike most other sectors, co-ops see less than a 5 percent annual employee turnover, with more than ⅔ of employees spending their entire careers within the cooperative family. Our Plan invests in these employees without facing the recruiting, training, and development costs for new hires.

This guaranteed security, however, has become much more difficult to sustain in recent years with economic uncertainty and volatility for all DB Plan sponsors. Cost uncertainty is anathema to any business, especially companies that run "at cost" like electric cooperatives. Some NRECA members ask, "If everyone else is cutting their defined benefit plans; why aren't we?" Congress should continually examine new and innovative policies to encourage current sponsors to remain "in the game" and reject policies that leave companies no choice but to abandon the system. We ask you to consider the following to help cooperative employees and retirees:

(1) **Accelerated funding requirements during down financial markets dramatically increases volatility and costs.** Congress should restore a critical, logical element from when DB plans were most popular: permit companies to contribute more during good times, and less during bad times. The current system often works the opposite way.

(2) **Allowing PBGC to set its own premiums, let alone increasing them by $16 billion without one congressional hearing, amounts to an unfair tax increase on plan sponsors that must be soundly rejected.**

(3) **Prevent IRS from eliminating or reducing benefits earned by employees who attain their Plan's normal retirement age (NRA).**

(4) **Do not tax retirement plans to address the national deficit.** Taxing electric linemen on their retirement savings is not the way to address the deficit.

Chairman Harkin, Ranking Member Enzi, and all committee members, I am Christopher T. Stephen, Employee Benefits Legislative Counsel at the National Rural Electric Cooperative Association (NRECA). NRECA is the national service organization for more than 900 rural electric utilities that provide electricity to approximately 42 million consumers in 47 States, and sell approximately 12 percent of all electric energy sold in the United States. Most NRECA members are consumer-owned, not-for-profit electric cooperatives and share an obligation to serve their members by providing safe, reliable and affordable electric service. I am honored to testify today regarding the voluntary employee benefit programs sponsored by our member co-ops for their employees, and how our defined-benefit plan remains a critical recruitment and retention tool for electric cooperatives.

The NRECA Retirement Security Plan (the "Plan") has long enjoyed strong support from this committee. Back in September 2005, this committee unanimously approved an amendment to what eventually became the Pension Protection Act (PPA) of 2006 (Pub. L. No. 109–280). Led by Senator Roberts, and cosponsored by you, Mr. Chairman, along with Senators Bingaman, Hatch, Alexander, Isakson and Frist to recognize the special nature of multiple-employer plans sponsored by rural cooperatives. Thank you all for this strong support, as well as you, Senator Enzi, who also strongly supported this effort as chairman of this committee during that time.

Our Plan plays a vital role in ensuring that our employees have a secure retirement that enables them to live with dignity in the communities they served. It also provides a critical tool for our members to recruit and retain employees who can often earn higher wages in more urban areas, but value the long-term security provided by the Plan. Today, I will discuss who we serve, what we do, and why maintaining our Plan is part of our member's core business strategy to recruit, retain and reward long-service employees with a secure financial retirement. But first, I want to emphasize upfront that this committee has the opportunity to help our employees by supporting our Plan. Specifically, as discussed further below, we ask you to consider the following:

(1) **Accelerated funding requirements during down financial markets dramatically increase volatility and costs.** We believe in the important reforms enacted by PPA. But, we have all seen the need to further supplement these important

reforms in light of the lessons learned from the economic downturn and from the very sad participation decline in the defined-benefit system. We are grateful for your leadership to enact a short-term adjustment last year. Going forward, we need to restore a critical, logical element from when defined-benefit plans were most popular: permit companies to contribute more during good times, and less during bad times. The current system often works the opposite way, unfortunately. We cannot have a vibrant defined-benefit system as long as the funding rules require exorbitant contributions at exactly the wrong time.

(2) **The Administration's proposal to increase premiums paid to the Pension Benefit Guaranty Corporation (PBGC) by $16 billion amounts to an unfair tax increase on defined-benefit plan sponsors.** This must be soundly rejected. No congressional committee has examined the true nature of the PBGC's deficit or the value of the coverage provided by the PBGC. And PBGC's own annual report notes that the PBGC will not have any trouble meeting its obligations for the foreseeable future. In that context, it is wrong for the government to even consider taxing plan sponsors.

(3) **The IRS has threatened to prohibit us from keeping our promises to our employees.** The Plan has long promised employees who attain normal retirement age (NRA) the right to receive their retirement benefits. Our employees need your protection.

(4) **We urge you not to tax retirement plans to address the national deficit.** Taxing electric linemen on their retirement savings is not the way to address the deficit.

Who We Serve

Last year, Agriculture Secretary Thomas Vilsack confirmed the economic downturn greatly impacted rural America, with high poverty which is reflected in higher mortality rates for children, higher unemployment, and declining populations.[1] Since the beginning of the economic slowdown, rural residents have experienced a greater decline in real income compared to other parts of the Nation due to lower rural educational attainment, less competition for workers among rural employers, and fewer highly skilled jobs in the rural occupational mix.[2] Rural electric cooperatives have far less revenue than the other electricity sectors, but support a greater share of the distribution infrastructure. The challenge of providing affordable electricity is critical when you consider that the average household income in most of our service territories is 14 percent below the national average. I enclose State demographic data for all committee members with rural electric cooperative consumers, as compiled by NRECA, as Exhibit 1.

Electric Cooperative Employees

Electric cooperatives are defined by their dedicated employees, who are committed to providing safe, reliable and affordable electricity to their consumer-owners. Like police, fire and other emergency service personnel, electric co-op employees frequently confront life-threatening situations and selflessly put themselves at great personal risk. Amidst the day to day dangers associated with the delivery of safe, reliable and affordable electricity—often during or in the immediate aftermath of hurricanes, floods, tornados and other natural disasters—many co-op employees continuously go above and beyond the call of duty:

• During the January ice storm in Greenfield, IA, Farmers Electric Cooperative had 18 of their linemen, led by Nick Kintigh, Doak Grantham, Paul Weber, Pat Held, Dennis Frank and Pat Armstrong, plus 44 linemen and two retired linemen from other co-ops in Iowa, Missouri, and Kansas reported for emergency duty. Even before the storm ended, crews were out to get as many of the 211 poles downed during the storm back up and working to keep the lights on.

• On the evening of June 6, the North Platte River uprooted a tree that took out transmission lines on an island in the middle of the river operated by Carbon Power & Light Cooperative, based in Saratoga, WY. With the river 10 percent above flood stage, water ran over the broken live lines with the poles still attached. Carbon's Operations Manager, Dave Cutbirth, who lives about 50 miles from Saratoga, turned around and went back to join Tom Westring, Nick Carey, Jeff McCarther, Bryn Hinz, John Saier, Kelly Lang and Bill Dahlke who, with the assistance of the local fire and rescue team, were boarding rafts in wetsuits in the raging river to get to the downed lines. Even more linemen were on either side of the river posi-

[1] Statement by USDA Secretary Thomas Vilsack before the Subcommittee on Agriculture, Rural Development, Food and Drug Administration, and Related Agencies, U.S. Senate, March 2, 2010.

[2] *Id.*

tioning the raft and moving equipment into place. At the same time, WY National Guardsmen positioned themselves down river to catch any "floaters". This was the first time anything like this had happened, so the crew was working on pure instinct. This quick thinking and bravery resolved the outage in 4½ hours, that would otherwise have left Saratoga and Encampment, WY in the dark for days if they had waited for the water to recede.

I could go on and on for hours with stories like these from every State over the years, not to mention the employees who lost their homes during Hurricane Katrina, or more recently from tornadoes in Alabama and Oklahoma, who stayed on the job for days before even attempting to rebuild their lives.

Electric Cooperatives Role in Our Communities

Since our humble beginnings in the mid-1930s, electric cooperatives' long-term business plan has been to provide safe, affordable and reliable electricity for our consumer-owners. A critical component of this commitment is to eliminate volatility and unpredictability in their annual budgets, and ultimately electricity rates. On average, 60 to 80 percent of a distribution electric cooperative's annual budget will be the cost of wholesale power, distantly followed by salaries and benefits. To prevent sharp spikes in electric bills, our power-producing Generation & Transmission (G&T) co-ops work day-in and day-out to avoid unpredictable and highly volatile wholesale electricity prices for our distribution systems that would make electricity unaffordable for their consumer-owners.

These same principles—to eliminate volatility and unpredictability—are also critically important to all companies like electric cooperatives that sponsor defined-benefit pension plans.

Co-op Commitment to Employees—Retirement Savings Plans

Economic security in retirement is a leading concern for all Americans, including electric cooperative employees. NRECA members are committed to preserving and enhancing the voluntary employer-sponsored retirement system and the tax policies that support it. NRECA is proud that the vast majority of its members offer comprehensive retirement benefits to their committed employees through a traditional defined-benefit plan (the NRECA Retirement Security Plan) and a defined-contribution plan (the NRECA 401(k) Plan). These "multiple-employer" retirement benefit plans (under § 413(c) of the Internal Revenue Code) are operated to maximize retirement savings for employees, retirees and their families and provide each co-op employee the financial means to enjoy a comfortable and secure retirement.[3]

The NRECA Retirement Security Plan

The NRECA Retirement Security Plan (the "Plan") provides comprehensive, guaranteed retirement benefits to over 63,000 employees and retirees throughout the United States. Our 900+ members have as few as four employees, with a median payroll of 48 employees. Our "multiple-employer" defined-benefit pension plan provides cooperatives with a convenient and affordable mechanism to pool resources, maximize group purchasing power and leverage economies of scale that would otherwise be unavailable to small businesses like cooperatives. In fact, that is why NRECA created the Plan in 1948—our members could not afford all of the administrative expenses to set up and operate a plan on their own, and financial institutions were not interested in employers of our size.

When defined-benefit plans were first created, Federal pension policies acknowledged that all business activities were cyclical. That is, Congress recognized that every sector of the economy had good times and bad times, which made defined-benefit plans enormously popular as a recruitment and retention tool to reward long-service employees through the 1980s. Until Congress amended the "full funding limit" rules (effective in 1988), the tax code allowed employers to contribute more

[3] This permits electric cooperatives to pool experience and expenses while being controlled by a single Plan Document with limited optional plan features for each employer that is not administered subject to a collective bargaining agreement—which differentiates us from "union multiemployer plans." The Plan annually files one Form 5500 with the U.S. Department of Labor. Each participating employer must execute an adoption agreement that binds them to the plan terms. For this reason we operate as a type of single-employer plan for some legal and administrative requirements, but each participating employer must meet other requirements, such as IRS nondiscrimination requirements, individually. Contributions to the Plan are pooled in a single trust and (unlike Master Prototype Plans) are available to pay benefits to employees of any of the participating organizations. Also, for funding purposes, the Plan is treated as one plan, rather than as a collection of single-employer plans, pursuant to Code section 413(c)(4)(B). This funding regime is very important to us, as it allows us to deal with funding issues with one overall approach, instead of some 900 different approaches.

to their retirement plans in good times, and less in bad times, recognizing the need for more capital in bad times. For the next 12 years, the Plan was so overfunded under these rules that electric cooperatives were prevented from making any additional contributions at all (1988–1993), or at best only permitted partial funding (1994–99). Since then, our members have funded the Plan as responsibly as possible, but policies like these and others that require more funding by companies during down financial markets make funding these plans extremely difficult. It is critical to remember that defined-benefit plans are invested for the long-term with liabilities extending out for decades, so Federal policies should be carefully crafted to balance the need to properly fund plans today, while ensuring that companies can weather cyclical financial storms to remain in business for the long term.

PPA codified the core, fundamental principle that a promise made is a promise kept. That is, it sought to strengthen the private retirement plan system with substantially increased funding requirements and improved disclosure to participants so that long service employees were more able to count on a secure, financial retirement. And, while the PPA has already been a success in many respects, the economic calamity that followed its passage in 2008 and 2009 with extraordinary investment losses for all employer-sponsored retirement savings vehicles demonstrated that even very good legislation may need to be refined to recognize new, unforeseen economic challenges.

Economic Downturn Impact on the Plan and Employees

While PPA recognized that by design, NRECA's "multiple-employer" defined-benefit plan posed no risk of default to the PBGC and delayed implementation of many provisions until 2017, electric co-ops were not immune from the unprecedented market losses of 2008 and early 2009. In real dollars, the Plan's assets were valued at $3.5 billion on December 31, 2008, a 30 percent ($1.5 billion dollars) drop from the previous year. On December 31, 2009, it had gained back some but not all of the previous year's losses. As a result, average Plan contributions in 2010 were 35 percent higher than in 2009, dramatically increasing short-term liabilities that forced some co-ops to make the difficult choice of increasing electricity rates, reducing or eliminating retirement benefits all together, or even laying off quality employees to pay for these increased liabilities. As a result, co-ops now, on average, contribute 23 percent of payroll to the Plan, making it an even larger part of total compensation.

In both good times and in bad times, electric co-ops have kept their promises to their employees and retirees, which has not always been easy. Congress specifically recognized the challenges faced by plan sponsors during the economic downturn. As a result, it passed legislation (Pub. L. 111–192) that directly permitted plan sponsors to implement a "2 plus 7" or 15-year extended amortization schedule for funding shortfalls. This was supported by nearly every employer and labor union that sponsors a plan (including NRECA) because it gave all parties more time to make up for the losses of 2008 and early 2009. NRECA applauds your efforts to enact this legislation last year.

We believe providing an employee with a secure retirement is critical to reward their commitment to providing our consumer-owners with safe, reliable and affordable electricity.

DB Plans Work for Electric Cooperatives, But Financial Challenges are Growing

As you know, keeping rural America's best and brightest "at home" has become an increasingly difficult task, with so many young people going to more urban areas for other employment and educational opportunities. The strongest recruitment and retention tool for electric cooperatives continues to be their employee-benefits programs—particularly their defined-benefit pension plans. As a consumer-owned business, each electric cooperative is focused on serving its community though its workforce. While many publicly traded, international companies see 20 to 30 percent or more annual employee turnover, electric cooperatives see less than a 5 percent annual employee turnover, with more than ⅔ of cooperative employees spending their entire working careers within the cooperative family. Our members understand the very real recruiting, training, and development costs for new hires are 1.0 to 2.0 times annual pay. As such, our defined-benefit plan rewards long service employees, and allows our members to invest in these key employees without having to face these substantial replacement costs.

Each co-op plan has a uniform benefit formula that treats all employees the same regardless of pay—from the CEO to the apprentice lineman. Over time, employees are able to accumulate substantial benefits for retirement security. This guaranteed security, however, has become much more difficult to sustain in recent years be-

cause of volatility in the financial markets, which leads to economic uncertainty and volatility for all businesses that sponsor defined benefit plans.

We are looking toward the future, working with our members to maintain our Plan going forward. Cost uncertainty is anathema to any business, let alone one that sponsors an increasingly complex and expensive defined-benefit plan. This is especially true for companies that run "at cost" like electric cooperatives. Policies that increase volatility in contribution rates and require more funding by companies during down financial markets has created a trend over the last decade for employers to freeze or completely eliminate defined-benefit plans. As such, electric cooperatives sometimes ask us: "If everyone else is cutting their defined benefit plans; why aren't we?" Thankfully for rural America that has not happened, largely due to our business model and the unique multiple-employer plan design that reduces complexity, and maximizes group purchasing power that would otherwise be unavailable while allowing cooperatives to tailor benefits to meet their needs. Many in the defined-benefit plan industry are aware that the multiple-employer plan model may be one of the best ways to encourage employers nationwide to reestablish traditional retirement plans. Congress should continually examine new and innovative policies to encourage current plan sponsors to remain "in the game" and should reject policies that leave companies no choice but to abandon the system.

Current Policies and Proposals Raise Concerns, Opportunities

PBGC Premiums—In his 2012 Budget Request to Congress, the President proposed giving PBGC the authority to set its own premiums, to utilize a company's "credit rating" in determining such premiums, and estimates premium increases of $16 billion over 10 years to alleviate the PBGC's alleged deficit. NRECA strongly believes that Congress should not, under any circumstances, cede its taxing authority to the Administration or allow PBGC to set its own premiums. Further, the idea of using "credit rating" or some other creditworthiness proxy has been specifically rejected by Congress—the latest time was during consideration of PPA. This role for a government agency would be inappropriate, especially for private companies and non-for-profit entities like electric cooperatives—or even NRECA as a trade association—that are not credit rated. PBGC has also stated that their $16 billion increase would be focused on "at-risk" companies only, and the PBGC has further stated that 20 percent of the 100 largest defined benefit plans are maintained by companies that are below investment grade. For companies already facing financial difficulties, massive premium increases would force those employers to discontinue providing retirement benefits altogether. We do not believe there is any way for PBGC to assess all or even most of this premium increase on just 20 percent of defined benefit plan sponsors, which is why even "healthy" companies are opposing this proposal. And finally, there are very serious questions about the size of the PBGC's deficit; and, by PBGC's own statements, there is no demonstrated basis for the drastic measures being considered. The PBGC states in its 2010 annual report that "[s]ince our obligations are paid out over decades, we have more than sufficient funds to pay benefits for the foreseeable future." Since there is no immediate crisis, Congress should not rush to relinquish its authority to establish appropriate premium requirements, or to raise them unnecessarily. Raising PBGC premiums, without any hearings or analysis of the value of the coverage received by the plan sponsors amounts to a tax on employers that have voluntarily decided to maintain defined benefit plans.

IRS Regulation Prevents Co-ops from Keeping their Promises to Employees—Electric cooperatives understand the realities of the tight market for skilled labor in rural America, and value long service employees. To prevent co-ops from losing their most valuable employees to retirement from these physically demanding jobs, the Plan permits employees to "quasi-retire"—that is, receive "in service" distributions at the Plan's NRA—including 30 years of benefit service. Without this feature, many needed employees would be forced to retire in order to obtain the Plan's most valuable benefit. This feature is a win-win for cooperatives and employees, *and has been a part of the Plan for 25 years*. While targeting a new "Cash Balance Plan" technique, the IRS published an immediately effective final regulation on May 21, 2007 (72 Fed. Reg. 28604, et. seq. (2007)) that could unfairly prevent employees with 30 years of benefit service who wish to continue working from receiving their benefits. Legislation has been introduced in the two preceding Congresses—the "Incentives for Older Workers Act of 2010" (S. 4012) in the 111th, and the "Aging Workforce Flexibility Act of 2007" (S. 2933) in the 110th—to prevent this from happening. We urge Congress to include this legislation in any pension bill before the end of this year, as some 500 employees at 188 co-ops who have been making life-changing financial decisions could be prevented from receiving their earned benefits in 2011 alone; *over 2,100 employees at 291 co-ops could be impacted over the next 5 years* because of this rule intended to address a completely different issue.

Eliminating/Limiting Retirement Savings Tax Policies—Congress and the Administration are focused on reducing budget deficits and the national debt, and are considering changes to the deferred tax treatment of defined-benefit plans, defined-contribution plans and other retirement savings vehicles that provide the economic and social safety net for a secure retirement to generate revenue for the Treasury. Eliminating or diminishing the current tax treatment of employer-sponsored retirement plans like the NRECA Retirement Security Plan or 401 (k) Plan will jeopardize the retirement security of tens of millions of American workers, impact the role of retirement assets in the capital markets, and create challenges in maintaining the quality of life for future generations of retirees. While we work to enhance the current retirement system and reduce the deficit, policymakers must not eliminate one of the central foundations—the tax treatment of retirement savings—upon which today' s successful system is built. As you consider comprehensive tax reform and deficit reduction, we urge you to preserve these provisions that both encourage employers to offer and workers to contribute to retirement plans, and prevent these critical plans from becoming "Piggy Banks" for the Federal Government.

CONCLUSION

NRECA strongly believes that any reforms to the retirement savings system should continue to encourage workers to provide for their own economic security, while encouraging employers to continue sponsoring benefit plans. Going forward, we need to restore a critical, very logical element from the period when defined benefit plans were most popular: funding rules that allow companies to contribute more during good economic times, and less during bad times. The current system often works the opposite way. We hope to continue our work with the committee to address the challenges of administering and participating in a defined-benefit pension plan, particularly "multiple-employer" plans like NRECA, so they remain a viable vehicle in the future for companies trying to do the right thing—providing meaningful retirement benefits to their employees. I look forward to answering your questions.

EXHIBITS

Alaska

Electric Cooperative Consumers

Legislative Profile

Demographics

Income	Co-op:	State	US:	Co-op vs. State $ Diff:	Co-op vs. State % Diff:	Co-op vs. US $ Diff:	Co-op vs. US % Diff:
Average Household	$77,573	$76.856	$71.212	$717	0 9%	$6.361	8.9%
Per Capita	$28,466	$28.166	$27.620	$300	1.1%	$846	3.1%

Race	Co-op:	State	US:
White	70.1%	66.2%	72.9%
Black	3.0%	3.6%	12.1%
Asian	4.2%	4.9%	4.4%
Other	22.7%	25.3%	10.7%
Total	100%	100%	100%
Hispanic	4.8%	5.4%	15.2%

Residential Market Share		
Co-op HHs	State HHs	Co-op %
199,905	251,866	79.4%

Education	Co-op:	State	US:
No High School	9.5%	9.9%	17.0%
College Degree	26.6%	26.2%	26.3%

Housing	Co-op:	State	US:
Own	71.5%	65.7%	68.7%
Rent	28.5%	34.3%	31.3%
Total	100%	100%	100%
Mobile Home	6.8%	7.2%	7.7%

Utility Comparisons

	Co-op:	IOU:	Municipal:	State Average:
Consumers per Mile	21.4	40.0	84.4	38.4
Revenue per Mile	$51,944	$70,454	$199,569	$90.154
Distribution Investment per Customer	$3.618	$2,459	$4,114	$3,800

	Co-op:		State Avg. All Utilities:	
	Rate	% of Sales	Rate	% of Sales
Residential	15.7 ¢	38%	15.2 ¢	33%
Commercial	14.3 ¢	33%	12.2 ¢	45%
Industrial	12.7 ¢	29%	12.6 ¢	22%
Avg Monthly Res Bill	$105		$101	

Data Sources: 2008 EASI Analytics, RUS, Platts, LDS, EIA

NRECA Strategic Analysis

9/3/2009

Arizona

Electric Cooperative Consumers

Legislative Profile

Demographics

Income	Co-op:	State	US:	Co-op vs. State $ Diff:	Co-op vs. State % Diff:	Co-op vs. US $ Diff:	Co-op vs. US % Diff:
Average Household	$52,396	$67,656	$71,212	($15,260)	-22.6%	($18,816)	-26.4%
Per Capita	$19,328	$25,690	$27,620	($6,362)	-24.8%	($8,292)	-30.0%

Race	Co-op:	State	US:
White	66.0%	72.6%	72.9%
Black	1.7%	3.2%	12.1%
Asian	1.1%	2.4%	4.4%
Other	31.2%	21.8%	10.7%
Total	100%	100%	100%
Hispanic	20.7%	29.1%	15.2%

Residential Market Share

Co-op HHs	State HHs	Co-op %
183,004	2,441,699	7.5%

Education	Co-op:	State	US:
No High School	18.5%	16.3%	17.0%
College Degree	17.8%	25.4%	26.3%

Housing	Co-op:	State	US:
Own	75.4%	71.3%	68.7%
Rent	24.6%	28.7%	31.3%
Total	100%	100%	100%
Mobile Home	32.1%	12.6%	7.7%

Utility Comparisons

	Co-op:	IOU:	Municipal:	State Average:
Consumers per Mile	10.4	29.9	33.9	30.4
Revenue per Mile	$14,566	$59,377	$66,734	$59,862
Distribution Investment per Customer	$2,805	$3,045	$2,533	$2,832

	Co-op: Rate	Co-op: % of Sales	State Avg. All Utilities: Rate	State Avg. All Utilities: % of Sales
Residential	11.4 ¢	52%	9.7 ¢	45%
Commercial	10.0 ¢	35%	8.3 ¢	39%
Industrial	7.4 ¢	12%	6.0 ¢	16%
Avg Monthly Res. Bill	$91		$110	

Data Sources: 2008 EASI Analytics, RUS, Platts, LDS, EIA

NRECA Strategic Analysis

9/3/2009

Colorado

Electric Cooperative Consumers

Legislative Profile

Demographics

Income	Co-op:	State	US:	Co-op vs. State $ Diff:	Co-op vs. State % Diff:	Co-op vs. US $ Diff:	Co-op vs. US % Diff:
Average Household	$82,842	$77,479	$71,212	$5,363	6.9%	$11,630	16.3%
Per Capita	$31,589	$30,612	$27,620	$977	3.2%	$3,969	14.4%

Race	Co-op:	State	US:
White	86.9%	79.6%	72.9%
Black	1.0%	4.0%	12.1%
Asian	1.4%	2.9%	4.4%
Other	10.6%	13.6%	10.7%
Total	100%	100%	100%
Hispanic	14.6%	19.9%	15.2%

Residential Market Share

Co-op HHs	State HHs	Co-op %
504,766	1,936,438	26.1%

Education	Co-op:	State	US:
No High School	9.6%	11.0%	17.0%
College Degree	34.6%	34.8%	26.3%

Housing	Co-op:	State	US:
Own	78.4%	70.1%	68.7%
Rent	21.6%	29.9%	31.3%
Total	100%	100%	100%
Mobile Home	11.7%	6.1%	7.7%

Utility Comparisons

	Co-op:	IOU:	Municipal:	State Average:
Consumers per Mile	7.8	67.0	69.7	54.2
Revenue per Mile	$11,399	$93,740	$81,908	$73,211
Distribution Investment per Customer	$3,114	$1,937	$2,418	$2,286

	Co-op: Rate	Co-op: % of Sales	State Avg. All Utilities: Rate	State Avg. All Utilities: % of Sales
Residential	10.2 ¢	42%	9.3 ¢	35%
Commercial	9.1 ¢	26%	7.6 ¢	40%
Industrial	6.9 ¢	32%	6.0 ¢	25%
Avg Monthly Res Bill	$88		$66	

Data Sources: 2008 EASI Analytics, RUS, Platts, LDS, EIA

NRECA Strategic Analysis

9/3/2009

Georgia

Electric Cooperative Consumers

Legislative Profile

Demographics

Income	Co-op:	State	US:	Co-op vs. State $ Diff:	Co-op vs. State % Diff:	Co-op vs. US $ Diff:	Co-op vs. US % Diff:
Average Household	$71,472	$72,423	$71,212	($951)	-1.3%	$260	0.4%
Per Capita	$26,363	$27,451	$27,620	($1,088)	-4.0%	($1,257)	-4.6%

Race	Co-op:	State	US:
White	74.8%	64.4%	72.9%
Black	18.7%	27.9%	12.1%
Asian	2.1%	2.7%	4.4%
Other	4.4%	5.1%	10.7%
Total	100%	100%	100%
Hispanic	5.8%	6.8%	15.2%

Residential Market Share

Co-op HHs	State HHs	Co-op %
1,703,000	3,653,200	46.6%

Education	Co-op:	State	US:
No High School	18.9%	18.3%	17.0%
College Degree	23.6%	26.5%	26.3%

Housing	Co-op:	State	US:
Own	79.0%	70.4%	68.7%
Rent	21.0%	29.6%	31.3%
Total	100%	100%	100%
Mobile Home	16.4%	11.8%	7.7%

Utility Comparisons

	Co-op:	IOU:	Municipal:	State Average:
Consumers per Mile	10.5	34.9	46.3	29.5
Revenue per Mile	$15,484	$74,540	$103,615	$61,495
Distribution Investment per Customer	$2,441	$2,727	$1,526	$2,539

	Co-op: Rate	Co-op: % of Sales	State Avg. All Utilities: Rate	State Avg. All Utilities: % of Sales
Residential	9.2 ¢	66%	9.1 ¢	41%
Commercial	8.9 ¢	21%	8.1 ¢	34%
Industrial	5.6 ¢	13%	5.5 ¢	25%
Avg Monthly Res. Bill	$116		$106	

Data Sources: 2008 EASI Analytics, RUS, Platts, LDS, EIA

NRECA Strategic Analysis

9/3/2009

Illinois

Electric Cooperative Consumers

Legislative Profile

Demographics

Income	Co-op:	State	US:	Co-op vs. State $ Diff:	Co-op vs. State % Diff:	Co-op vs. US $ Diff:	Co-op vs. US % Diff:
Average Household	$58,539	$77,878	$71,212	($19,339)	-24.8%	($12,673)	-17.8%
Per Capita	$24,483	$29,715	$27,620	($5,232)	-17.6%	($3,137)	-11.4%

Race	Co-op:	State	US:
White	95.1%	72.1%	72.9%
Black	2.4%	14.2%	12.1%
Asian	0.7%	4.2%	4.4%
Other	1.8%	9.5%	10.7%
Total	100%	100%	100%
Hispanic	2.1%	14.5%	15.2%

Education	Co-op:	State	US:
No High School	15.4%	15.9%	17.0%
College Degree	18.1%	28.2%	26.3%

Residential Market Share

Co-op HHs	State HHs	Co-op %
260,119	4,915,785	5.3%

Housing	Co-op:	State	US:
Own	79.7%	70.0%	68.7%
Rent	20.3%	30.0%	31.3%
Total	100%	100%	100%
Mobile Home	11.8%	3.2%	7.7%

Utility Comparisons

	Co-op:	IOU:	Municipal:	State Average:
Consumers per Mile	4.8	41.0	54.6	40.3
Revenue per Mile	$7,877	$64,863	$93,273	$64,173
Distribution Investment per Customer	$3,533	$2,680	$3,085	$2,737

	Co-op: Rate	Co-op: % of Sales	State Avg. All Utilities: Rate	State Avg. All Utilities: % of Sales
Residential	10.5 ¢	62%	10.1 ¢	33%
Commercial	8.5 ¢	19%	8.6 ¢	36%
Industrial	6.2 ¢	19%	6.6 ¢	31%
Avg Monthly Res. Bill	$118		$80	

Data Sources: 2008 EASI Analytics, RUS, Platts, LDS, EIA

NRECA Strategic Analysis

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Iowa

Electric Cooperative Consumers

Legislative Profile

Demographics

Income	Co-op:	State	US:	Co-op vs. State $ Diff:	Co-op vs. State % Diff:	Co-op vs. US $ Diff:	Co-op vs. US % Diff:
Average Household	$58,674	$62,796	$71,212	($4,122)	-6.6%	($12,538)	-17.6%
Per Capita	$24,115	$26,046	$27,620	($1,931)	-7.4%	($3,505)	-12.7%

Race	Co-op:	State	US:
White	96.5%	92.8%	72.9%
Black	0.6%	2.2%	12.1%
Asian	0.7%	1.6%	4.4%
Other	2.2%	3.4%	10.7%
Total	100%	100%	100%
Hispanic	2.8%	3.9%	15.2%

Residential Market Share		
Co-op HHs	State HHs	Co-op %
198,595	1,241,996	16.0%

Education	Co-op:	State	US:
No High School	12.4%	11.8%	17.0%
College Degree	18.3%	23.4%	26.3%

Housing	Co-op:	State	US:
Own	79.1%	74.6%	68.7%
Rent	20.9%	25.4%	31.3%
Total	100%	100%	100%
Mobile Home	6.5%	5.4%	7.7%

Utility Comparisons

	Co-op:	IOU:	Municipal:	State Average:
Consumers per Mile	3.4	25.8	47.1	25.5
Revenue per Mile	$6,058	$43,693	$59,286	$42,057
Distribution Investment per Customer	$3,680	$2,533	$2,290	$2,648

	Co-op:		State Avg. All Utilities:	
	Rate	% of Sales	Rate	% of Sales
Residential	10.1 ¢	54%	9.4 ¢	31%
Commercial	7.6 ¢	20%	7.2 ¢	26%
Industrial	5.4 ¢	27%	4.7 ¢	43%
Avg Monthly Res. Bill	$128		$84	

Data Sources: 2008 EASI Analytics, RUS, Platts, LDS, EIA

NRECA Strategic Analysis

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Kansas

Electric Cooperative Consumers

Legislative Profile

Demographics

Income	Co-op:	State	US:	Co-op vs. State $ Diff:	Co-op vs. State % Diff:	Co-op vs. US $ Diff:	Co-op vs. US % Diff:
Average Household	$55,404	$67,271	$71,212	($11,867)	-17.6%	($15,808)	-22.2%
Per Capita	$22,318	$27,158	$27,620	($4,840)	-17.8%	($5,302)	-19.2%

Race	Co-op:	State	US:
White	89.7%	84.3%	72.9%
Black	1.2%	5.7%	12.1%
Asian	0.7%	2.3%	4.4%
Other	8.4%	7.8%	10.7%
Total	100%	100%	100%
Hispanic	10.1%	8.5%	15.2%

Residential Market Share		
Co-op HHs	State HHs	Co-op %
192,582	1,123,595	17.1%

Education	Co-op:	State	US:
No High School	14.6%	11.6%	17.0%
College Degree	19.4%	28.7%	26.3%

Housing	Co-op:	State	US:
Own	77.6%	71.9%	68.7%
Rent	22.4%	28.1%	31.3%
Total	100%	100%	100%
Mobile Home	10.7%	6.2%	7.7%

Utility Comparisons

	Co-op:	IOU:	Municipal:	State Average:
Consumers per Mile	3.0	18.2	34.1	19.4
Revenue per Mile	$5,128	$28,898	$61,165	$32,058
Distribution Investment per Customer	$3,727	$2,163	$2,670	$2,419

	Co-op: Rate	Co-op: % of Sales	State Avg. All Utilities: Rate	State Avg. All Utilities: % of Sales
Residential	10.5 ¢	36%	8.2 ¢	34%
Commercial	9.1 ¢	39%	6.8 ¢	38%
Industrial	6.9 ¢	25%	5.1 ¢	27%
Avg Monthly Res Bill	$92		$75	

Data Sources: 2008 EASI Analytics, RUS, Platts, LDS, EIA

NRECA Strategic Analysis

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Kentucky

Electric Cooperative Consumers

Legislative Profile

Demographics

Income	Co-op:	State	US:	Co-op vs. State $ Diff:	Co-op vs. State % Diff:	Co-op vs. US $ Diff:	Co-op vs. US % Diff:
Average Household	$51,368	$58,129	$71,212	($6,761)	-11 6%	($19,844)	-27 9%
Per Capita	$20,559	$23,775	$27,620	($3,216)	-13 5%	($7,061)	-25 6%

Race	Co-op:	State	US:
White	94 0%	89 3%	72 9%
Black	3 5%	7 4%	12 1%
Asian	0 5%	1 0%	4 4%
Other	2 0%	2 4%	10.7%
Total	100%	100%	100%
Hispanic	2.0%	2 4%	15.2%

Residential Market Share		
Co-op HHs	State HHs	Co-op %
712,581	1,741,434	40 9%

Education	Co-op:	State	US:
No High School	27 2%	22 7%	17 0%
College Degree	13 5%	19 0%	26 3%

Housing	Co-op:	State	US:
Own	78 7%	73.3%	68.7%
Rent	21 3%	26.7%	31 3%
Total	100%	100%	100%
Mobile Home	20.6%	13.8%	7.7%

Utility Comparisons

	Co-op:	IOU:	Municipal:	State Average:
Consumers per Mile	8 8	36 8	47.2	28.1
Revenue per Mile	$14,806	$56,285	$81,189	$44,267
Distribution Investment per Customer	$2,423	$1,937	$1,702	$2,083

	Co-op:		State Avg. All Utilities:	
	Rate	% of Sales	Rate	% of Sales
Residential	8.3 ¢	40%	7.3 ¢	30%
Commercial	8.2 ¢	12%	6.8 ¢	22%
Industrial	4 3 ¢	48%	4 5 ¢	48%
Avg Monthly Res Bill	$104		$89	

Data Sources: 2008 EASI Analytics, RUS, Platts. LDS. EIA

NRECA Strategic Analysis

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Maryland

Electric Cooperative Consumers

Legislative Profile

Demographics

Income	Co-op:	State	US:	Co-op vs. State $ Diff:	Co-op vs. State % Diff:	Co-op vs. US $ Diff:	Co-op vs. US % Diff:
Average Household	$80,587	$85,404	$71,212	($4,817)	-5.6%	$9,375	13.2%
Per Capita	$29,485	$32,904	$27,620	($3,419)	-10.4%	$1,865	6.8%

Race	Co-op:	State	US:
White	73.4%	62.0%	72.9%
Black	21.4%	28.1%	12.1%
Asian	1.8%	4.9%	4.4%
Other	3.4%	5.0%	10.7%
Total	100%	100%	100%
Hispanic	2.8%	5.5%	15.2%

Residential Market Share		
Co-op HHs	State HHs	Co-op %
177,761	2,171,505	8.2%

Education	Co-op:	State	US:
No High School	13.7%	13.8%	17.0%
College Degree	22.7%	33.6%	26.3%

Housing	Co-op:	State	US:
Own	80.3%	69.8%	68.7%
Rent	19.7%	30.2%	31.3%
Total	100%	100%	100%
Mobile Home	5.6%	1.9%	7.7%

Utility Comparisons

	Co-op:	IOU:	Municipal:	State Average:
Consumers per Mile	12.4	43.9	57.6	42.0
Revenue per Mile	$20,026	$81,161	$86,669	$77,274
Distribution Investment per Customer	$2,544	$2,996	$1,924	$2,954

	Co-op:		State Avg. All Utilities:	
	Rate	% of Sales	Rate	% of Sales
Residential	12.9 ¢	64%	11.9 ¢	43%
Commercial	11.5 ¢	34%	11.6 ¢	47%
Industrial	8.7 ¢	2%	9.4 ¢	9%
Avg Monthly Res. Bill	$171		$129	

Data Sources: 2008 EASI Analytics. RUS. Platts, LDS, EIA

NRECA Strategic Analysis

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Minnesota

Electric Cooperative Consumers

Legislative Profile

Demographics

Income	Co-op:	State	US:	Co-op vs. State $ Diff:	Co-op vs. State % Diff:	Co-op vs. US $ Diff:	Co-op vs. US % Diff:
Average Household	$70,740	$75.123	$71,212	($4,383)	-5 8%	($472)	-0 7%
Per Capita	$27,050	$29,853	$27.620	($2,803)	-9 4%	($570)	-2 1%

Race	Co-op:	State	US:
White	93 4%	88.1%	72.9%
Black	0 9%	3 5%	12.1%
Asian	1 5%	3 4%	4 4%
Other	4 3%	5 1%	10.7%
Total	100%	100%	100%
Hispanic	2 4%	3 9%	15 2%

Residential Market Share		
Co-op HHs	State HHs	Co-op %
687,237	2,073,551	33 1%

Education	Co-op:	State	US:
No High School	10 9%	10 2%	17 0%
College Degree	23 2%	29 2%	26 3%

Housing	Co-op:	State	US:
Own	85.0%	76 5%	68 7%
Rent	15.0%	23 5%	31 3%
Total	100%	100%	100%
Mobile Home	7 6%	4.2%	7 7%

Utility Comparisons

	Co-op:	IOU:	Municipal:	State Average:
Consumers per Mile	5 9	40 2	47 3	34.6
Revenue per Mile	$7.489	$67,679	$77,762	$57.653
Distribution Investment per Customer	$2,699	$1,899	$1,928	$2.057

	Co-op:		State Avg. All Utilities:	
	Rate	% of Sales	Rate	% of Sales
Residential	8 8 ¢	63%	9 2 ¢	33%
Commercial	7 1 ¢	22%	7 5 ¢	33%
Industrial	5 5 ¢	15%	5 7 ¢	34%
Avg Monthly Res Bill	$94		$76	

Data Sources: 2008 EASI Analytics, RUS, Platts, LDS, EIA

NRECA Strategic Analysis

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New Mexico

Electric Cooperative Consumers

Legislative Profile

Demographics

Income	Co-op:	State	US:	Co-op vs. State $ Diff:	Co-op vs. State % Diff:	Co-op vs. US $ Diff:	Co-op vs. US % Diff:
Average Household	$43,949	$56,224	$71,212	($12,275)	-21.8%	($27,263)	-38.3%
Per Capita	$16,180	$21,328	$27,620	($5,148)	-24.1%	($11,440)	-41.4%

Race	Co-op:	State	US:
White	52.0%	61.8%	72.9%
Black	0.8%	2.0%	12.1%
Asian	0.5%	1.4%	4.4%
Other	46.7%	34.9%	10.7%
Total	100%	100%	100%
Hispanic	47.7%	49.5%	15.2%

Residential Market Share		
Co-op HHs	State HHs	Co-op %
179,811	752,064	23.9%

Education	Co-op:	State	US:
No High School	22.3%	18.5%	17.0%
College Degree	19.0%	25.3%	26.3%

Housing	Co-op:	State	US:
Own	79.6%	72.9%	68.7%
Rent	20.4%	27.1%	31.3%
Total	100%	100%	100%
Mobile Home	31.5%	19.4%	7.7%

Utility Comparisons

	Co-op:	IOU:	Municipal:	State Average:
Consumers per Mile	4.8	48.5	27.4	36.3
Revenue per Mile	$6,895	$69,214	$53,751	$53,476
Distribution Investment per Customer	$2,886	$1,789	$1,813	$2,039

	Co-op:		State Avg. All Utilities:	
	Rate	% of Sales	Rate	% of Sales
Residential	11.3 ¢	25%	9.1 ¢	29%
Commercial	9.5 ¢	25%	7.7 ¢	40%
Industrial	6.1 ¢	49%	5.6 ¢	31%
Avg Monthly Res. Bill	$65		$58	

Data Sources: 2008 EASI Analytics, RUS, Platts, LDS, EIA

NRECA Strategic Analysis

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North Carolina

Electric Cooperative Consumers

Legislative Profile

Demographics

Income	Co-op:	State	US:	Co-op vs. State $ Diff:	Co-op vs. State % Diff:	Co-op vs. US $ Diff:	Co-op vs. US % Diff:
Average Household	$57,475	$65,726	$71,212	($8,251)	-12.6%	($13,737)	-19.3%
Per Capita	$23,240	$26,624	$27,620	($3,384)	-12.7%	($4,380)	-15.9%

Race	Co-op:	State	US:
White	74.8%	70.6%	72.9%
Black	18.0%	21.7%	12.1%
Asian	0.9%	1.9%	4.4%
Other	6.3%	5.9%	10.7%
Total	100%	100%	100%
Hispanic	5.5%	6.1%	15.2%

Residential Market Share

Co-op HHs	State HHs	Co-op %
900,339	3,702,712	24.3%

Education	Co-op:	State	US:
No High School	21.8%	18.5%	17.0%
College Degree	17.8%	25.0%	26.3%

Housing	Co-op:	State	US:
Own	77.6%	72.3%	68.7%
Rent	22.4%	27.7%	31.3%
Total	100%	100%	100%
Mobile Home	24.8%	16.4%	7.7%

Utility Comparisons

	Co-op:	IOU:	Municipal:	State Average:
Consumers per Mile	9.5	26.5	41.8	26.3
Revenue per Mile	$13,547	$54,524	$90,925	$54,000
Distribution Investment per Customer	$2,719	$2,767	$2,066	$2,676

	Co-op: Rate	Co-op: % of Sales	State Avg. All Utilities: Rate	State Avg. All Utilities: % of Sales
Residential	10.9 ¢	74%	9.4 ¢	43%
Commercial	9.1 ¢	19%	7.4 ¢	35%
Industrial	5.8 ¢	7%	5.5 ¢	22%
Avg Monthly Res. Bill	$125		$107	

Data Sources: 2008 EASI Analytics, RUS, Platts, LDS, EIA

NRECA Strategic Analysis

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Oregon

Electric Cooperative Consumers

Legislative Profile

Demographics

Income	Co-op:	State	US:	Co-op vs. State $ Diff:	Co-op vs. State % Diff:	Co-op vs. US $ Diff:	Co-op vs. US % Diff:
Average Household	$57,585	$65.690	$71.212	($8,105)	-12.3%	($13,627)	-19 1%
Per Capita	$23.242	$26.232	$27,620	($2,990)	-11.4%	($4,378)	-15 9%

Race	Co-op:	State	US:
White	88.6%	83.3%	72 9%
Black	0 4%	1.7%	12.1%
Asian	1 3%	4.0%	4 4%
Other	9 8%	11.0%	10 7%
Total	100%	100%	100%
Hispanic	8 3%	10 1%	15 2%

Residential Market Share

Co-op HHs	State HHs	Co-op %
177.776	1,506,661	11 8%

Education	Co-op:	State	US:
No High School	14 3%	12.8%	17 0%
College Degree	21.4%	26.5%	26 3%

Housing	Co-op:	State	US:
Own	73.2%	66 5%	68.7%
Rent	26.8%	33 5%	31 3%
Total	100%	100%	100%
Mobile Home	19 6%	10 8%	7 7%

Utility Comparisons

	Co-op:	IOU:	Municipal:	State Average:
Consumers per Mile	6 8	32 9	30.2	29 7
Revenue per Mile	$11,222	$53.923	$51,045	$49.079
Distribution Investment per Customer	$3,661	$2.440	$2,220	$2,523

	Co-op:		State Avg. All Utilities:	
	Rate	% of Sales	Rate	% of Sales
Residential	7.6 ¢	51%	8.2 ¢	40%
Commercial	6.6 ¢	22%	7.2 ¢	33%
Industrial	5.0 ¢	27%	5.1 ¢	27%
Avg Monthly Res. Bill	$90		$83	

Data Sources: 2008 EASI Analytics, RUS, Platts, LDS. EIA

NRECA Strategic Analysis

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Pennsylvania

Electric Cooperative Consumers

Legislative Profile

Demographics

Income	Co-op:	State	US:	Co-op vs. State $ Diff:	Co-op vs. State % Diff:	Co-op vs. US $ Diff:	Co-op vs. US % Diff:
Average Household	$53,164	$67,241	$71,212	($14,077)	-20.9%	($18,048)	-25.3%
Per Capita	$21,422	$27,484	$27,620	($6,062)	-22.1%	($6,198)	-22.4%

Race	Co-op:	State	US:
White	97.4%	84.8%	72.9%
Black	1.0%	9.6%	12.1%
Asian	0.4%	2.2%	4.4%
Other	1.3%	3.4%	10.7%
Total	100%	100%	100%
Hispanic	1.5%	4.3%	15.2%

Residential Market Share		
Co-op HHs	State HHs	Co-op %
197,349	5,088,719	3.9%

Education	Co-op:	State	US:
No High School	17.7%	15.8%	17.0%
College Degree	14.3%	24.4%	26.3%

Housing	Co-op:	State	US:
Own	81.1%	73.8%	68.7%
Rent	18.9%	26.2%	31.3%
Total	100%	100%	100%
Mobile Home	15.2%	5.0%	7.7%

Utility Comparisons

	Co-op:	IOU:	Municipal:	State Average:
Consumers per Mile	7.4	34.5	43.8	34.1
Revenue per Mile	$8,999	$64,750	$62,083	$63,686
Distribution Investment per Customer	$2,814	$2,224	$2,192	$2,235

	Co-op:		State Avg. All Utilities:	
	Rate	% of Sales	Rate	% of Sales
Residential	10.9 ¢	74%	10.9 ¢	36%
Commercial	9.8 ¢	18%	9.2 ¢	31%
Industrial	7.6 ¢	8%	6.9 ¢	32%
Avg Monthly Res. Bill	$89		$96	

Data Sources: 2008 EASI Analytics, RUS, Platts, LDS, EIA

NRECA Strategic Analysis

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Tennessee

Electric Cooperative Consumers

Legislative Profile

Demographics

Income	Co-op:	State	US:	Co-op vs. State $ Diff:	Co-op vs. State % Diff:	Co-op vs. US $ Diff:	Co-op vs. US % Diff:
Average Household	$57,823	$62,531	$71,212	($4,708)	-7.5%	($13,389)	-18.8%
Per Capita	$22,791	$25,334	$27,620	($2,543)	-10.0%	($4,829)	-17.5%

Race	Co-op:	State	US:
White	90.8%	80.0%	72.9%
Black	6.1%	15.7%	12.1%
Asian	0.6%	1.3%	4.4%
Other	2.5%	3.0%	10.7%
Total	100%	100%	100%
Hispanic	2.7%	3.1%	15.2%

Residential Market Share

Co-op HHs	State HHs	Co-op %
823,782	2,508,789	32.8%

Education	Co-op:	State	US:
No High School	25.1%	20.8%	17.0%
College Degree	15.8%	21.6%	26.3%

Housing	Co-op:	State	US:
Own	79.9%	72.7%	68.7%
Rent	20.1%	27.3%	31.3%
Total	100%	100%	100%
Mobile Home	18.0%	11.2%	7.7%

Utility Comparisons

	Co-op:	IOU:	Municipal:	State Average:
Consumers per Mile	11.5	30.8	32.5	27.8
Revenue per Mile	$17,556	$57,423	$65,406	$54,597
Distribution Investment per Customer	$2,033	$1,774	$1,963	$1,974

	Co-op: Rate	Co-op: % of Sales	State Avg. All Utilities: Rate	State Avg. All Utilities: % of Sales
Residential	8.0 ¢	60%	7.8 ¢	40%
Commercial	8.7 ¢	24%	8.1 ¢	28%
Industrial	5.9 ¢	16%	5.2 ¢	31%
Avg Monthly Res. Bill	$114		$105	

Data Sources: 2008 EASI Analytics, RUS, Platts, LDS, EIA

NRECA Strategic Analysis

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Utah

Electric Cooperative Consumers

Legislative Profile

Demographics

Income	Co-op:	State	US:	Co-op vs. State $ Diff:	Co-op vs. State % Diff:	Co-op vs. US $ Diff:	Co-op vs. US % Diff:
Average Household	$52,695	$71,449	$71,212	($18,754)	-26.2%	($18,517)	-26.0%
Per Capita	$17,849	$22,755	$27,620	($4,906)	-21.6%	($9,771)	-35.4%

Race	Co-op:	State	US:
White	86.0%	87.1%	72.9%
Black	0.1%	0.8%	12.1%
Asian	0.6%	2.7%	4.4%
Other	13.3%	9.3%	10.7%
Total	100%	100%	100%
Hispanic	4.9%	10.9%	15.2%

Residential Market Share

Co-op HHs	State HHs	Co-op %
34,216	851,676	4.0%

Education	Co-op:	State	US:
No High School	14.0%	10.3%	17.0%
College Degree	19.5%	27.5%	28.3%

Housing	Co-op:	State	US:
Own	81.6%	74.2%	68.7%
Rent	18.4%	25.8%	31.3%
Total	100%	100%	100%
Mobile Home	16.6%	4.9%	7.7%

Utility Comparisons

	Co-op:	IOU:	Municipal:	State Average:
Consumers per Mile	5.5	28.1	71.3	34.3
Revenue per Mile	$11,052	$43,323	$102,639	$51,831
Distribution Investment per Customer	$3,210	$2,603	$1,354	$2,422

	Co-op: Rate	Co-op: % of Sales	State Avg. All Utilities: Rate	State Avg. All Utilities: % of Sales
Residential	6.5 ¢	40%	8.2 ¢	31%
Commercial	6.8 ¢	43%	6.5 ¢	37%
Industrial	5.9 ¢	18%	4.5 ¢	32%
Avg Monthly Res. Bill	$63		$65	

Data Sources: 2008 EASI Analytics, RUS, Platts, LDS, EIA

NRECA Strategic Analysis

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Vermont

Electric Cooperative Consumers

Legislative Profile

Demographics

Income	Co-op:	State	US:	Co-op vs. State $ Diff:	Co-op vs. State % Diff:	Co-op vs. US $ Diff:	Co-op vs. US % Diff:
Average Household	$63,304	$65,192	$71,212	($1,888)	-2.9%	($7,908)	-11.1%
Per Capita	$25,327	$27,097	$27,620	($1,770)	-6.5%	($2,293)	-8.3%

Race	Co-op:	State	US:
White	96.5%	96.0%	72.9%
Black	0.3%	0.5%	12.1%
Asian	0.5%	1.0%	4.4%
Other	2.7%	2.4%	10.7%
Total	100%	100%	100%
Hispanic	1.6%	1.6%	15.2%

Education	Co-op:	State	US:
No High School	12.1%	11.7%	17.0%
College Degree	30.6%	31.5%	26.3%

Residential Market Share	Co-op HHs	State HHs	Co-op %
	47,749	258,583	18.5%

Housing	Co-op:	State	US:
Own	81.5%	73.3%	68.7%
Rent	18.5%	26.7%	31.3%
Total	100%	100%	100%
Mobile Home	11.7%	8.8%	7.7%

Utility Comparisons

	Co-op:	IOU:	Municipal:	State Average:
Consumers per Mile	9.3	22.9	25.5	22.8
Revenue per Mile	$10,960	$44,606	$39,174	$42,350
Distribution Investment per Customer	$3,015	$1,769	$1,768	$1,822

	Co-op: Rate	Co-op: % of Sales	State Avg. All Utilities: Rate	State Avg. All Utilities: % of Sales
Residential	16.4 ¢	55%	14.1 ¢	37%
Commercial	13.1 ¢	24%	12.3 ¢	35%
Industrial	9.4 ¢	20%	8.9 ¢	28%
Avg Monthly Res. Bill	$90		$84	

Data Sources: 2008 EASI Analytics, RUS, Platts, LDS, EIA

NRECA Strategic Analysis

9/3/2009

Washington

Electric Cooperative Consumers

Legislative Profile

Demographics

Income	Co-op:	State	US:	Co-op vs. State $ Diff:	Co-op vs. State % Diff:	Co-op vs. US $ Diff:	Co-op vs. US % Diff:
Average Household	$65,121	$72,608	$71,212	($7,487)	-10.3%	($6,091)	-8.6%
Per Capita	$25,207	$28,706	$27,620	($3,499)	-12.2%	($2,413)	-8.7%

Race	Co-op:	State	US:
White	80.7%	78.4%	72.9%
Black	3.0%	3.3%	12.1%
Asian	3.6%	6.9%	4.4%
Other	12.7%	11.3%	10.7%
Total	100%	100%	100%
Hispanic	10.1%	9.4%	15.2%

Residential Market Share		
Co-op HHs	State HHs	Co-op %
143,665	2,574,701	5.6%

Education	Co-op:	State	US:
No High School	12.6%	11.1%	17.0%
College Degree	23.4%	29.1%	26.3%

Housing	Co-op:	State	US:
Own	73.4%	66.9%	68.7%
Rent	26.6%	33.1%	31.3%
Total	100%	100%	100%
Mobile Home	16.3%	9.0%	7.7%

Utility Comparisons

	Co-op:	IOU:	Municipal:	State Average:
Consumers per Mile	7.8	39.7	44.8	40.8
Revenue per Mile	$10,719	$54,579	$72,091	$61,970
Distribution Investment per Customer	$3,564	$2,557	$2,969	$2,843

	Co-op:		State Avg. All Utilities:	
	Rate	% of Sales	Rate	% of Sales
Residential	6.7 ¢	56%	7.3 ¢	41%
Commercial	5.5 ¢	31%	6.6 ¢	35%
Industrial	4.7 ¢	13%	4.6 ¢	24%
Avg Monthly Res Bill	$90		$78	

Data Sources: 2008 EASI Analytics, RUS, Platts, LDS, EIA

NRECA Strategic Analysis

9/3/2009

Wyoming

Electric Cooperative Consumers

Legislative Profile

Demographics

Income	Co-op:	State	US:	Co-op vs. State $ Diff:	Co-op vs. State % Diff:	Co-op vs. US $ Diff:	Co-op vs. US % Diff:
Average Household	$55,544	$60,143	$71,212	$5,401	9.0%	($5,668)	-8.0%
Per Capita	$26,236	$24,574	$27,620	$1,662	6.8%	($1,384)	-5.0%

Race	Co-op:	State	US:
White	89.1%	90.1%	72.9%
Black	0.2%	0.8%	12.1%
Asian	0.5%	0.7%	4.4%
Other	10.2%	8.4%	10.7%
Total	100%	100%	100%
Hispanic	5.9%	8.0%	15.2%

Residential Market Share	Co-op HHs	State HHs	Co-op %
	68,107	214,828	31.7%

Education	Co-op:	State	US:
No High School	10.1%	10.4%	17.0%
College Degree	25.1%	23.2%	26.3%

Housing	Co-op:	State	US:
Own	73.6%	72.7%	68.7%
Rent	26.4%	27.3%	31.3%
Total	100%	100%	100%
Mobile Home	17.6%	16.4%	7.7%

Utility Comparisons

	Co-op:	IOU:	Municipal:	State Average:
Consumers per Mile	3.3	29.4	65.4	23.5
Revenue per Mile	$7,145	$47,224	$67,287	$36,738
Distribution Investment per Customer	$4,045	$2,453	$2,704	$2,911

	Co-op: Rate	Co-op: % of Sales	State Avg. All Utilities: Rate	State Avg. All Utilities: % of Sales
Residential	7.6 ¢	19%	7.8 ¢	17%
Commercial	5.7 ¢	34%	6.2 ¢	27%
Industrial	4.0 ¢	47%	4.1 ¢	56%
Avg Monthly Res. Bill	$88		$68	

Data Sources: 2008 EASI Analytics, RUS, Platts. LDS. EIA

NRECA Strategic Analysis

9/3/2009

The CHAIRMAN. Thank you very much, Mr. Stephen.

Mr. Bertheaud. Bertheaud (Berthode) or Bertheaud (Berthoud)?

Mr. BERTHEAUD. Thank you. Bertheaud (Berthoud). Thank you.

The CHAIRMAN. Bertheaud. Thank you, Mr. Bertheaud. Please proceed.

STATEMENT OF EDMOND P. BERTHEAUD, JR., CHIEF ACTUARY AND DIRECTOR OF CORPORATE INSURANCE, THE DUPONT COMPANY, WILMINGTON, DE

Mr. BERTHEAUD. My name is Edmond Bertheaud. I'm the chief actuary and director of Corporate Insurance for the DuPont Company. I serve on the American Benefits Council board of directors, on whose behalf I testify today.

I thank Chairman Harkin, Ranking Member Enzi, and the members of the committee for the opportunity to be here today to discuss the role of the employer-sponsored defined benefit pension plan.

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

DuPont is a science-based products and services company founded in 1802. DuPont put science to work by creating sustainable solutions essential to a better, safer, healthier life for people everywhere. Operating in more than 90 countries, DuPont offers a wide range of innovative products and services for markets, including agriculture and food, building and construction, communications and transportation.

DuPont has operated a defined benefit pension plan for over 100 years. Beginning in 2007, DuPont chose to change its emphasis from defined benefit to defined contribution. The defined contribution plan now provides a 3 percent company contribution plus a full match of the employee contribution up to 6 percent of pay. New employees no longer participate in the defined benefit plan, but to help existing employees with the transition, accruals in that plan continue for those employees at one-third of their previous rate.

Defined benefit plans are an effective means of providing long service employees with a secure retirement. Such plans protect employees from investment risk and offer employees guaranteed income for life. In that regard, DuPont's defined benefit plan has never offered a lump-sum option and was designed to provide employees with a steady stream of retirement income.

As a matter of policy, we and many other Council members are supportive of the defined benefit system. However, the legal and competitive environments have caused many companies to move away from that system. We hope that a discussion of the reasons for this will be helpful to the committee.

In brief, here are our primary concerns, together with the concerns of other Council members.

First, publicly traded plan sponsors have financial reporting considerations. Under U.S. generally accepted accounting principles, defined benefit pension plan assets and liabilities are determined annually in a snapshot view. Such snapshots affect the sponsor's balance sheet immediately so that when a sudden shortfall arises as a result of a severe economic downturn such as we experienced in 2008 and 2009, or due to low spot interest rates, investors can become concerned.

Shortfalls also cause volatility in the sponsor's corporate income, and the rating agencies consider them in the same category as debt.

By contrast, the cost of defined contribution plans is stable as employee compensation, results in no long-term company liabilities, and require very little explanation to investors.

Second, defined benefit plan funding rules used to be structured to permit companies to contribute less during challenging economic times and more during favorable economic times. This made defined benefit plans very attractive to companies. Unfortunately, over the last 25 years, the pendulum has swung in the exact opposite direction. Now the rules are less flexible. Extremely large and potentially unfavorable contributions are required when times are toughest. Defined benefit funding has also become less predictable, which is inconsistent with business planning.

Third, it seems many employees do not value the promise of a lifetime income as much as they value retirement accounts. Without supportive accounting and funding rules, and with employee sentiment favoring defined contribution plans, employers are not in a position to educate employees about the value of a defined benefit pension plan.

Fourth, the significant increases in PBGC premiums that are being discussed, and the PBGC deficit itself upon which the increases are being justified, should be carefully examined by Congress so as to avoid burdensome and inappropriate increases. There are serious questions about the size and calculation of the PBGC's deficit that should be understood by Congress.

Fifth, the regulation of employee benefit plans has grown considerably, and the employee benefits field has become an area of the law that is well known for its complexity and burdensome regulatory regime. To be sure, plan sponsors appreciate the importance of rules that are appropriately protective of plan sponsors' and participants' interests. But those interest are not well served when requirements are unnecessarily broad, when there are conflicting rules from agencies, overlapping reporting, and communication requirements where the rules are very overly burdensome.

We look forward to working with the committee to find ways to improve the regulatory environment.

In closing, the employer-sponsored retirement system is important to the long-term retirement security of Americans. Its strength is dependent on a concerted effort amongst all stakeholders—government, employers, and employees. Attaining retirement security is dependent on developing consensus on policy, a strong and flexible legal and regulatory environment, and improved understanding among employees of the importance of retirement security and the value of benefits being offered.

We look forward to working with the committee as they delve into these issues. Thank you, and I'm happy to answer any questions.

[The prepared statement of Mr. Bertheaud follows:]

PREPARED STATEMENT OF EDMOND P. BERTHEAUD, JR.

My name is Edmond P. Bertheaud, Jr., and I am chief actuary and director of Corporate Insurance for the DuPont Company. I also serve on the Policy Board of Directors for the American Benefits Council (the "Council") for whom I am testifying

today. On behalf of DuPont and the Council, I want to thank the committee for holding this hearing on such a critical topic and for inviting us to testify.

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

DuPont is a science-based products and services company. Founded in 1802, DuPont puts science to work by creating sustainable solutions essential to a better, safer, healthier life for people everywhere. Operating in more than 90 countries, DuPont offers a wide range of innovative products and services for markets including agriculture and food; building and construction; communications; and transportation.

DuPont has operated a defined benefit pension plan for over 100 years. The plan pays monthly benefits based on years of service and average pay. The intent of the plan is to provide a retirement income stream. There has never been an option to receive pension benefits in a lump sum, except as required to preserve benefit forms after acquisitions.

Starting in the early 1970s, DuPont has operated a defined contribution plan in addition to the defined benefit plan. This plan provided the opportunity for employees to save by payroll deduction and was meant to supplement retirement income from the pension plan. For most of this plan's existence, the company matched half of the employee's contribution up to 6 percent of the employee's base pay.

Beginning in 2007, DuPont chose to change its emphasis from defined benefit to defined contribution. The defined contribution plan now provides a 3 percent company contribution plus a full match of the employee contributions up to 6 percent of pay. New employees no longer participate in the defined benefit plan, but to help existing employees with the transition, accruals in that plan continue at one-third of their previous rate.

VIEWS ON DEFINED BENEFIT PLANS

Defined benefit plans are an effective means of providing long-service employees with a secure retirement. Such plans protect employees from investment risk and offer employees guaranteed income for life. As a matter of policy, we and many other Council members are supportive of the defined benefit system. However, the legal and competitive environments have caused many companies to move away from the defined benefit system. We hope that a discussion of those reasons would be helpful to the committee.

In brief, here are our concerns together with concerns of other Council members:

(1) Defined benefit plan funding rules used to be structured to permit companies to contribute less during challenging economic times and more during favorable economic times. This made defined benefit plans very attractive to companies. Unfortunately, over the last 25 years, the pendulum has swung in the exact opposite direction. Now, the rules are less flexible. Extremely large and potentially unaffordable contributions can be required when times are toughest.

(2) Defined benefit funding used to be predictable. Now it is significantly unpredictable, which is inconsistent with business planning.

(3) Employees do not value the promise of lifetime income as much as they value retirement "accounts". Because of the other factors listed here, employers have less incentive to educate employees about the advantages of defined benefit plans.

(4) Publicly traded plans sponsors have financial reporting considerations. Under U.S. generally accepted accounting principles, defined benefit pension plan assets and liabilities are determined annually in a snapshot view. Such snapshots affect the sponsor's balance sheet immediately, so that when sudden shortfalls arise as a result of a severe economic downturn such as we experienced in 2008 and 2009, or due to low spot interest rates, investors can become concerned. Shortfalls can also cause volatility in the sponsor's corporate income and the rating agencies consider them in the same category as debt. By contrast, the cost for defined contribution plans is as stable as employee compensation, result in no long-term company liabilities and require very little explanation to investors.

(5) The PBGC has maintained a practice of intervening in the normal business transactions of defined benefit plan sponsors. This is true even when there is not increased risk to the PBGC.

(6) The Administration has proposed imposing a $16 billion tax on defined benefit plan sponsors through premium increases for an alleged PBGC deficit that plan sponsors generally did not create. PBGC premiums should be set only after exten-

sive consideration by Congress of the real risks posed to the PBGC by defined benefit pension plans.

(7) In recent years, the regulation of employee benefit plans has grown considerably, and the employee benefits field has become an area of the law that is well-known for its complexity and burdensome regulatory regime. To be sure, plan sponsors appreciate the importance of rules that are appropriately protective of sound objectives. But those interests are not well-served when requirements are unnecessarily broad and overly burdensome. Rather, the government should establish a coordinated legal and regulatory regime under which individual savers and employer plan sponsors can operate effectively.

DISCUSSION

Funding. Employers can provide substantial help to employees when it comes to retirement savings and income with respect to all types of retirement plans. Employers are in an excellent position to know the retirement needs of their employee populations and can tailor their retirement programs to these needs. The government is in a unique position to help employers in this regard through supportive public policy. Many employers have maintained defined benefit pension plans over the years because public policy supported employer actions that served employees' needs.

There has, however, been a steady trend away from defined benefit plans for some time now. One reason for this trend is a dramatic change in public policy regarding funding. Pursuant to that change, the largest, least manageable funding obligations arise during the hardest economic times.

We recognize the great strengths of the Pension Protection Act of 2006 ("PPA"). It was critical to establish the fundamental principle that a promise made is a promise kept. But it is also critical to learn from the economic downturn and refine the PPA in ways that respond to the lessons from the downturn. To help defined benefit plans, it is critical that plan sponsors have the flexibility to contribute less in the tough economic times.

In this respect, when many defined benefit plans were put in place, their sponsors considered them to be long-term commitments. Plan sponsors expected to fund the plans as needed, but had flexibility to do so in a measured way when cash was available. Over time, the focus of changes in funding rules has been to view the sponsor's responsibility less as a long-term commitment and more as a short-term requirement, with much of the flexibility removed. Restoration of this flexibility is critical.

ERISA section 4062(e). The PBGC recently proposed regulations regarding various corporate transactions, including the shutdown of operations. These proposed regulations would reverse longstanding PBGC written policy and would impose potentially enormous liabilities with respect to routine transactions that involve no layoffs or shutdowns and pose no threat to the PBGC. Companies will find it extremely difficult to continue sponsoring defined benefit pension plans if their routine business transactions trigger large liabilities unrelated to any risk to the PBGC. In our view, this regulatory project is a critical test of defined benefit plan public policy. Given the depth of our concerns, we were very encouraged when last fall PBGC Director Joshua Gotbaum recognized the importance of these proposed regulations and extended the comment period to receive further input. We thank the Chairman and Ranking Member of this committee for their leadership with respect to that extension. We further hope that this hearing will lead to an open dialogue among Congress, plan sponsors, and the PBGC so that the PBGC rules will encourage rather than discourage plan maintenance.

PBGC premiums. Recently there has been increased attention paid to the possibility of increasing premiums paid to the Pension Benefit Guaranty Corporation including the possibility of it being included in deficit reduction measures. The Pension Benefit Guaranty Corporation is charged with protecting the pension benefits of workers and retirees in the event a company sponsoring a defined benefit pension plan goes bankrupt. The PBGC is partially financed through premiums paid by the sponsors of defined benefit pension plans. We urge Congress to take the time to fully analyze the implications of proposals to increase the premiums.

Proponents of increasing PBGC premiums have often cited the PBGC's deficit and the need to ensure that companies sponsoring pension plans be responsible for that deficit. While many have tossed about the figure of $23 billion as PBGC's deficit, there are many serious questions about this number which should be critically examined by Congress. For example, the $23 billion number is based on a study of the cost of buying annuities to satisfy pension liabilities, despite the fact that the PBGC does not purchase annuities. This can have a very material effect on the size

of the deficit. The PBGC actually resembles an ongoing pension plan in that it pays out benefits over many years.

Moreover, PBGC's report states that almost 30 percent of its self-reported deficit is solely attributable to the drop in interest rates over 12 months. Interest rates have been low as part of a national strategy to address recent economic challenges. It would be inappropriate to raise premiums without examining the role interest rates play in the PBGC's deficit.

While we understand the pressures that Congress is facing to address budget deficits, significant increases in PBGC premiums must be carefully examined—and not adopted based on pressure to find revenue raisers.

Regulatory Burdens. Regulations should not conflict, go beyond the statute in interpretation, be overly broad or hastily implemented because that causes frustration, extra costs and confusion. President Obama acknowledged the critical importance of avoiding regulatory conflicts and burdens in his January 18, 2011, executive order on Improving Regulation and Regulatory Review.

One area of current concern is the use of swaps by pension plans. Pension plans use swaps to manage interest rate risks and other risks, and to reduce volatility with respect to funding obligations. If swaps were to become materially less available to plans, plan costs and funding volatility would rise sharply. This would undermine participants' retirement security and would force employers to reserve, in the aggregate, billions of additional dollars to address increased funding volatility. These reserves would have to be diverted from investments that create and retain jobs and that spur economic growth and recovery.

In enacting the Dodd-Frank Wall Street Reform and Consumer Protection Act, Congress adopted "business conduct" standards to help plans and other swap counterparties by ensuring that swap dealers and major swap participants (MSPs) deal fairly with plans and other counterparties. A conflict has grown out of the business conduct standards and the DOL proposed fiduciary definition so that compliance with the business conduct standards would create a prohibited transaction under ERISA. The interaction of the business conduct standards under the Dodd-Frank Act and the DOL's proposed fiduciary definition regulations should be publicly and formally resolved in a way that provides legal certainty that using swaps will not cause a violation of ERISA by the time the CFTC finalizes the business conduct standards.

Furthermore, under the proposed business conduct standards, if a swap dealer or MSP "functions as an advisor to a plan with respect to" a swap, the swap dealer or MSP must act "in the best interests" of the plan with respect to the swap. Under the proposed rules, many standard communications used by a swap dealer or an MSP in the selling process would cause the swap dealer or MSP to be treated as an advisor. This means that swap dealers or MSPs acting solely as counterparties would be required to also act in the best interests of the plan. A swap dealer or MSP as a party to a swap transaction cannot have a conflicting duty to act against its own interests and in the best interests of its counterparty with respect to the swap. If such a conflict were to be imposed on swap dealers and MSPs, all swaps with plans would cease.

If a swap dealer or MSP clearly communicates to a plan in writing that it is functioning solely as the plan's counterparty or potential counterparty, no communication by the swap dealer or MSP should be treated as a "recommendation".

Employers are committed to helping their employees save for retirement. However, the current defined benefit plan structure does not facilitate the creation or maintenance of pension plans. If Congress desires more defined benefit plans, significant changes may need to be made. The Council and its members look forward to working with this committee and Congress to find solutions.

I appreciate this opportunity to discuss pension issues with the committee. Thank you for your time. I would be happy to answer any questions.

SUPPLEMENTAL STATEMENT OF EDMOND BERTHEAUD

As mentioned in the full written testimony, in addition to a defined benefit pension plan that continues to accrue benefits for many of our employees, the DuPont Company defined contribution plan provides a 3 percent company contribution plus a full match of the employee contributions up to 6 percent of pay for a potential total contribution of 9 percent of compensation.

On behalf of the American Benefits Council and the DuPont Company, I would like to clarify two points that were raised at the July 12, 2011 hearing referenced above.

EMPLOYEE PREFERENCES

First, the question was raised as to whether there is any support for the proposition that employees prefer account-based plans over traditional pension plans. The answer is, yes. For example, a 2006 personal finance poll found that 79 percent of those surveyed preferred a defined contribution plan to a defined benefit plan. Wall Street Journal Online/Harris Interactive, "Vast Majority Say the Government Should Take Action to Ensure Americans Have Enough to Live on in Retirement," September 2006. In a 2002 survey, 73 percent preferred a plan with company matching contributions over a pension plan Transamerica Center for Retirement Studies, "Transamerica Small Business Retirement Survey." November 2002.

We are not suggesting that the literature on this issue is uniform. We are suggesting that there is a solid foundation for concluding that employees favor defined contribution plans over pension plans. Further support is found in the overwhelming shift to defined contributions over the last 25 years. It is not realistic to conclude that this shift did not reflect the demands of the workforce. Retirement plans of any kind are expensive; employers naturally desire to spend this money wisely so they are constantly seeking the best plan to recruit and retain employees.

In choosing the right plan for their workforce, employers are sensitive to the fact employees have become more mobile. The median job tenure—the number of years with a worker's current employer—is now 4.4 for individuals 16 years and older. Bureau of Labor Statistics, "Employer Tenure Summary," September 2010. The percentage of employed wage and salary workers age 25 with over 10 years or more of tenure with their current employer is only 33.1. Bureau of Labor Statistics, Employer Tenure Summary, September 2010. As employees have become more mobile, many employers have tried to respond to workforce requests for retirement plans that grow more evenly across careers by establishing or strengthening 401(k) plans that include defined contributions by the employer.

401(k) plans have been met with enormous popularity with employees. This is evidenced by the strong opposition employees have to changes to the defined contribution plan system and its tax benefits. Fully 88 percent of all U.S. households disagreed when asked whether the tax advantages of defined contribution accounts should be eliminated, while 82 percent opposed any reduction in account contribution limits. Nearly 90 percent of all U.S. households disagreed with the idea that individuals should not be permitted to make investment decisions in their defined contribution plan accounts. Ninety-six percent of all account-owning households agreed that it is important to have choice in, and control of, the investment options in their defined contribution plans. Investment Company Institute, *Commitment to Retirement Security: Investor Attitude and Actions*, January 27, 2011.

With the popularity of 401(k) plans, it is no wonder that many companies maintain very robust plans that include the use of automatic enrollment and automatic escalation as well as matching contributions. In the case of some of the more robust plans, additional contributions not contingent upon contributions made by employees are also made. The DuPont Company is one of these plans as was noted in the primary testimony.

DUPONT EDUCATIONAL INITIATIVES

I would also like to clarify a second point. DuPont has worked very hard to educate its employees about retirement planning, and how to achieve a secure retirement. In this regard, we are extremely proud of our record.

We do not provide information to employees about retirement plan designs that DuPont does not sponsor, nor are we aware of any company that does so or would consider doing so. As discussed below, we are dedicated to helping our employees use the very generous programs that we provide to attain retirement security.

We offer several retirement planning tools to our employees through our relationships with our Defined Contribution recordkeeper—Bank of America Merrill Lynch (BAML) and our Defined Benefit recordkeeper—Aon Hewitt. There is no additional cost to the employees to use these services.

Advice Access. Advice Access is a service which helps employees determine how much they need to save for retirement. Employees can use the tool through the BAML on-line Web site or by phone by talking with a BAML Participant Service Representative. The tool automatically factors in the employee's DuPont 401(k) and pension plan benefits. Employees can provide additional asset information (prior employer pension and savings plans benefits, other asset holdings, spouse asset holdings, etc.) as well as indicate various cash flow needs (college, weddings, second home, etc.) to be factored into the model at various retirement ages selected by the participant. The tool will then model expected needed savings both inside and outside—if necessary—of the 401(k) plan so that the participant can generate expected

cash flow needed at the retirement date. In addition, as part of the model, the tool makes recommendations for investment allocations across the various funds offered within the 401(k) plan.

Pre-Retirement Financial Planning. In addition to the above, we have piloted a program to a select group of individuals who may be within 5–7 years of retirement. Participants in the program are encouraged to complete a "Retirement Readiness" profile through their on-line account at BAML. The profile questionnaire asks questions which help the participant think about the things needed in preparation for retirement—estate planning, beneficiary elections, elder care, getting pension estimates, etc. In addition, on-site seminars have been offered at various DuPont locations. These seminars are run by the Financial Advisors (FA) in the BAML Retirement Education Services group along with DuPont Human Resources. Seminars provide an overview of the DuPont benefit plans and Social Security, and help employees think about how to plan regarding their DuPont benefits as it relates to retirement. Employees also have the option to sign up for a free one-time consultation with a BAML FA who will provide specific recommendations based on information the employee provides to the consultant.

The intent is to eventually offer this program to all employees—tailored to the needs of the various life cycles—young new hire, early family, mid-career new hire, mid-career family, and retirement eligible.

DuPont Connection. In addition to the two programs above, pension plan participants can ask for detailed projected defined benefit pension estimates through our pension recordkeeper—Aon Hewitt. The Hewitt Web site also allows for some do-it-yourself on-line retirement modeling for the DuPont pension and 401(k) plans at various retirement ages, pay assumptions, and savings rates and rates of return.

New Hires. Upon hire we provide a "Plan Highlights" brochure and "Investment Choices Guide" booklet which describe the 401(k) plan provisions as well as an overview of the funds offered. The "Plan Highlights" brochure describes: (1) the plan features (contributions, vesting, withdrawals, distributions, etc.), (2) how to enroll—including a description of our auto-enroll/auto-escalation feature if no action is taken by the employee, (3) how employees can access and monitor their accounts, and (4) the benefits of early participation in the plan through modeling.

The "Investment Choices Guide" describes the basic asset classes used by investors (including returns of these general asset classes over the past 10 years), discusses the risks and rewards of investing and the importance of diversification, and provides an overview of each of the funds offered in the plan along with the estimated fees and expenses of each fund. Detailed information for each of the funds can be found in our quarterly "Fund Fact Sheets" which are available on the BAML Web site.

The Advice Access tool is described in both of these packages.

The CHAIRMAN. Thank you very much, Mr. Bertheaud.

And now we'll wind up with Mr. Marchick.

STATEMENT OF DAVID M. MARCHICK, MANAGING DIRECTOR, CARLYLE GROUP, WASHINGTON, DC

Mr. MARCHICK. Thank you, sir. Mr. Chairman, members of the committee, Senator Enzi, thank you very much for the opportunity to testify before you today on this important subject.

I'd like to focus on four points. First, as you said, Mr. Chairman, pension funds provide essential liquidity that helps grease the U.S. economy. They're absolutely essential.

Second, as was stated earlier, defined benefit plans tend to outperform defined contribution plans, and therefore help to increase savings and consumer spending in the United States.

Third, pension funds are a critical driver of growth and equally importantly are one of the only sources of long-term patient capital in the United States.

And finally, pension funds provide the bulk of funding for venture capital, growth capital, private equity, and real estate funds, and those investments in turn create millions of jobs, more efficient companies, and drive innovation in the United States.

The bottom line is that private and public pension funds create jobs and drive economic growth in the United States at a time when we desperately need growth and higher levels of employment.

Defined benefit plans create wealth for the middle class, as was stated earlier. They out-perform other forms of savings. Two studies show that defined benefit plans out-perform defined contribution plans by about 1 percent a year. Now, that may sound trivial, but over a 35-year period where an individual contributes $3,000 a year, that person would have $200,000 more at the end of his or her period of employment. So the compounding is very significant.

And let me give you two examples of long-term patient investments that have and will continue to create jobs in the United States which would not have been possible without a robust defined benefit system. Our firm invests in small, medium, and large companies in the United States. We've invested in about 80 companies in the United States; 75 percent of them are small or medium-sized companies.

One example is an investment we made in 1999 in a company called Kuhlman Electric in Kentucky. Kuhlman made large transformers for the electric utility industry. And right after we made our investment, unfortunately, the entire market crashed, the California energy crisis, Enron, electric utilities cut capital spending, and we wrote down the investment to zero. Because this was long-term patient capital, pension funds had committed about 45 percent of the money to this particular fund and we had a 10-year investment horizon, we were able to weather the storm, put more capital up, and were able to ride out the cycle.

And at the end of our investment period, which is 10 years, jobs were up by 25 percent, sales were up, and we were able to survive the downturn, turn the company around, and the end result was very positive.

I'll give you another example, which is in Connecticut we have developed a partnership with the State of Connecticut to refurbish and revitalize the service centers where you stop for gas, food, and restrooms on the road on Highway 95. Now, these service plazas were built in the 1940s and 1950s, and had not been upgraded for 25 years. And obviously, as you all know, the State of Connecticut and other States are pressed for cash. So we basically structured a 35-year deal where we would put up the money, partner with the State of Connecticut. We would invest $178 million over 5 years and revitalize, refurbish, rebuild the service plazas, and then enter into a revenue-sharing agreement with the State which will produce a significant amount of revenue for both the State and for the pension funds that invested with us in this investment. This project alone will create 375 jobs.

We've partnered with the SEIU in the State to create good jobs, and the State will share about $500 million in revenue from the investment, and we have examples of this in virtually every State. In Iowa, for example, we have investments in six companies that have about 1,300 employees, and in Minnesota we have investments in 10 companies that have about 1,300 employees; North Carolina—Senator Hagan was here—15 companies with 3,700 employees.

State by State, and basically about 40 percent of the money that goes into venture capital, growth capital, real estate investing funds come from pension funds, and they would not be able to invest in long-term patient projects that can ride out the quarterly ups and downs over 5, 7, 10 years without the long-term investment horizon of pension funds.

And so we've heard from you, Mr. Chairman, about the benefits that they pay to individuals, and we've heard about the huge contributions that the payouts mean for the middle class. But the role of pension funds as a driver of liquidity in the U.S. economy is absolutely central to the growth and vibrancy of our economy. Thank you very much, Mr. Chairman.

[The prepared statement of Mr. Marchick follows:]

PREPARED STATEMENT OF DAVID MARCHICK, MANAGING DIRECTOR, THE CARLYLE GROUP

Mr. Chairman, Senator Enzi and members of the committee, thank you very much for the opportunity to testify on the very important subject of the role that pension funds play in the U.S. economy. I also want to thank the Chairman and Ranking Member for approaching this important subject in a bipartisan manner.

The Carlyle Group is a global alternative asset management firm with approximately $150 billion in assets under management. We care deeply about the subject of this hearing because our mandate as a firm is to generate attractive returns for our investors, the largest groups of which are public and private pension funds.

I would like to focus on four points today:

1. First, authoritative research demonstrates that pension funds provide essential liquidity that helps make U.S. financial markets function effectively and efficiently.

2. Second, defined benefit plans tend to out-perform defined contribution plans, particularly where individual, non-professional investors make investment decisions.

3. Third, pension funds are critical drivers of growth and economic activity in the United States because they are one of the only significant sources of long-term, patient capital. As such, they are able to invest in longer-term, less liquid asset classes, and those asset classes tend to create jobs and generate efficiencies in the U.S. economy.

4. Finally, pension funds provide the bulk of funding for venture and growth capital, real estate and private equity investments, and those investments in turn create millions of jobs, and more efficient companies, driving innovation in the U.S. economy.

The bottom line is that private and public pension funds create jobs and drive economic growth in the United States at a time when we desperately need more growth and lower unemployment.

1. PENSION FUNDS ARE AN IMPORTANT DRIVER OF LIQUIDITY IN THE U.S. ECONOMY

The size and scale of pension funds have helped to drive the development of the U.S. financial system. Defined benefit pension systems depend on asset accumulation to pay benefits, which increases demand for new investments and accelerates securities market development. World Bank researchers have established a causal relationship between pension funds' asset accumulation and stock market development in many countries.[1] In other words, the larger and more developed a country's pension funds, the larger and more developed a country's stock market. Stock market growth obviously creates growth in income and national wealth.

Pension funds also help stimulate the development of non-bank finance channels, including the issuance of corporate bonds and commercial paper that reduce businesses' external financing costs relative to bank loans.

At the end of the first quarter of 2011, U.S. private pensions held $6.27 trillion in total assets, while State and local government employee pension funds held more than $3.03 trillion in assets.[2] Of this $9 trillion of total assets, $4 trillion was invested directly in corporate equities, with an additional $2.4 trillion invested in mutual funds that invest in corporate securities. In total, private and public pension funds accounted for about one-third of the total market capitalization of domestic

[1] World Bank Policy Research Working Paper No. 2421.
[2] Federal Reserve, Flow of Funds, June 2011.

corporations, which the Fed estimates at $18.2 trillion. Pension funds play a key role providing liquidity for initial public offerings, private placements of equity and debt securities, and large block securities trades. Without a large and strong pension fund sector in the United States, the cost of capital to businesses would increase, slowing growth.

Defined benefit pension funds also provide large benefits to investors. By pooling savings and risks across beneficiaries, pension plans create economies of scale, which results in lower average costs for investors. These economies of scale also enable defined benefit funds to invest in large investment opportunities, including large-scale natural resource development and other types of project finance that would otherwise be unable to attract competitive financing.

2. DEFINED BENEFIT (DB) PLANS OUT-PERFORM DEFINED CONTRIBUTION (DC) PLANS

DB plans' economies of scale and wide range of investment opportunities translate directly to higher returns than other forms of savings, including DC plans and individual retirement accounts (IRAs). By out-performing other forms of savings, DB plans reduce the amount of resources that need to be set aside today to fund a given level of future retirement income. In other words, for the same level of savings today, DB plans can generate sufficient future investment balances to provide higher levels of retirement income. The economy benefits because higher returns create more consumer demand, which in turn creates more rapid economic growth.

Two authoritative studies published in the last 5 years show that DB plans achieved higher returns than both DC plans and IRAs. A 2006 paper published by the Center for Retirement Research at Boston College found that DB plans out-performed DC plans by 1 percent per year between 1988 and 2004. This finding was confirmed by research from Watson Wyatt, a leading retirement consulting firm. Watson Wyatt also observed a 1.09 percent per year return differential between 1995 and 2006. The Watson Wyatt study analyzed corporate DB plans and 401(k)s in both bull and bear markets and found that larger DB plans out performed 401(k)s in part because larger plans "generally have access to a wider variety of investment options and economies of scale and, in the case of DB plans, more investment expertise." That study concluded the following:

> "Trustees for DB plans have a fiduciary responsibility for investment performance. They or the professionals they hire also usually have considerable financial education, experience, discipline and access to sophisticated investment tools—advantages not typically shared by individual participants in 401(k) plans. These advantages help DB plan investors maximize their returns and maintain well-diversified portfolios, so they can generally ride out market fluctuations more smoothly than 401(k) plan participants."

Although one may question the benefit of a 1 percent differential, the results over time are significant. As shown in the hypothetical example below, an individual who made the median annual employee contribution of $3,000 for 35 years would realize a difference in the end-of-period balance of nearly $200,000 with just a 1 percent increase in annual returns.

Extrapolated Return Differentials

	Defined benefit	Defined contribution
Return	10.30 percent	9.21 percent
Years	35	35
Annual Contribution	$3,000	$3,000
Ending Balance	$871,256.12	$678,715.35

As a firm that invests in companies throughout the United States, we understand the challenges that companies face from a competitive position with respect to defined benefit plans. U.S. companies are facing huge competitive pressures, and the costs and uncertainties associated with escalating retirement and medical obligations have led to a trend by corporations away from DB toward DC plans. But this trend does not undermine the fact that from a macro-economic perspective, as mentioned above, DB plans make enormous contributions to the U.S. economy and tend to out-perform other forms of saving.

3. PENSION FUNDS ARE CRITICAL DRIVERS OF GROWTH AND ECONOMIC ACTIVITY IN THE UNITED STATES

Pension funds represent long-term, patient capital—one of the only significant sources of stable capital in the United States. This approach to long-term investing is necessarily driven by their structure: DB plans have liabilities that extend 20, 30 or even 40 years, and therefore need to invest in assets that will match their long-term obligations. While pursuing long-term investment strategies is directly in pension funds' self interest, their patient approach pays huge dividends for the economy. Pension funds allow firms to issue equity and longer-dated securities, which increases capital market development and lowers the cost of capital for American businesses.

The length of time until a liability comes due helps to determine the expected return and liquidity characteristics of the investment used to fund that obligation. For example, a household with surplus cash today will choose different investment options for that savings depending on how it is expected to be used. If the money will be devoted to next month's cable bill, the household would likely choose to put the money in a savings account and accept a lower expected return in exchange for less volatility. Conversely, if that money were intended for a college tuition payment in 8 years, the more appropriate investment would be one that accepts greater short-term volatility in exchange for higher expected returns. By nature of the longer time horizon, pension funds can accept less liquidity and more short-term volatility in exchange for higher expected returns.

It is widely understood that technological change drives long-term economic growth, productivity and improvement in living standards. Institutions that hold longer-dated assets are critical to financing technological change because the cash flow from new technologies is paid out in the distant future, well beyond the investment horizons of banks and other investors. For example, consider that the first microprocessor was introduced in 1971 with very uncertain commercial prospects. By 2010, computer technology had fundamentally transformed the economy and society and annual semiconductor sales had reached nearly $300 billion. Institutions unable to absorb short-term uncertainty and volatility cannot fund investments in transformative technologies that increase employment and living standards.

Consider the following: A large commercial construction project that takes 10 years to develop is not likely to be funded by an institution that might need to sell its stake 18 months after groundbreaking. Similarly, the investor base of a company seeking to commercialize a new technology is not likely to be concentrated among investors subject to overnight withdrawals that might need to sell their interest in the venture during the early development stages.

4. PENSION FUNDS PROVIDE THE BULK OF FUNDING FOR VENTURE AND GROWTH CAPITAL, REAL ESTATE FUNDS AND PRIVATE EQUITY, WHICH IN TURN CREATE MILLIONS OF JOBS IN THE UNITED STATES

Pension funds are also the largest source of funding for venture, private equity and real estate funds—all of which tend to have long-term investment horizons. More specifically, public and private pensions account for 42 percent of all investments in venture capital, real estate, infrastructure, and later stage corporate finance.[3] Based on a prorated allocation to current invested capital totals, pension funds provide financing for more than $100 billion in venture capital investments and more than $400 billion in growth capital and later stage corporate private equity investments. In addition, according to the Real Estate Roundtable, pension funds currently provide approximately $160 billion of needed equity capital to the commercial real estate industry in the United States at a time when the sector has been under great pressure.

These investments contribute to a larger economy and more jobs. According to research from the World Economic Forum, productivity growth at private equity-backed companies is 2 percentage points greater than at comparable businesses, translating directly to higher wages. Private equity investment supports more than 6 million jobs in the United States, according to 2009 data compiled by the Private Equity Growth Capital Council. An estimated 9 million jobs are generated or supported by real estate—jobs in construction, planning, architecture, environmental consultation and remediation, engineering, building maintenance and security, management, leasing, brokerage, investment and mortgage lending, accounting and legal services, interior design, landscaping, cleaning services and more. In 2010, according to the National Venture Capital Association, more than 1 in every 10 private sector

[3] Preqin, 2011 Global Private Equity Report.

workers in the United States was employed by a company that had received venture capital funding at one point.

A smaller DB defined benefit pension base would directly compromise the capital markets' ability to fund these types of investments. The investment opportunities and potential employment gains would still be there, but the lack of patient capital with a sufficiently long investment horizon would make financing these projects much more difficult.

The Carlyle Group invests in small, medium and large companies, real estate, infrastructure projects and financial services firms. Whether an investment is in a small, growing company, a large infrastructure project or a real estate asset, our strategy is the same: we seek to build long-term value in a company or asset through investments, improvements in management, and efficiency enhancements. Today, we have investments in approximately 80 companies based in the United States, 77 percent of which are small or medium-size businesses (fewer than 2,500 employees), as well as about 125 real estate projects, which include commercial, residential, and health care or data centers. Combined, these companies employ more than 216,000 people in the United States in all 50 States.

We invest in a variety of asset classes, most of which target long-term investments of 4 to 7 years. Some of our funds have investment horizons as long as 10 or 12 years, one of the longest investment horizons a pension fund can invest in outside of 30-year bonds.

My partners at Carlyle make the decisions when to invest, how much to invest, and how to manage the investment, but it is our investors' money, matched by a commitment of 3–5 percent of our own money, that makes an investment possible. In other words, without the long-term, patient capital provided by private and public pension funds, private equity investment would not be possible.

Allow me to give you a couple of examples of how long-term, patient capital from pension funds has helped to create jobs and economic activity in the United States.

One of Carlyle's earliest buyout funds, Carlyle Partners II, L.P., acquired Kuhlman Electric Corporation in October 1999. Public and private pension funds accounted for 45 percent of the capital committed to that fund. Kuhlman, which is based in Kentucky, was founded in 1894 and provides power transformers and related products to utility companies.

Carlyle managed our investment in Kuhlman through tough economic conditions resulting from California's energy deregulation initiative, the collapse of Enron, major reductions in customer capital spending, falling wholesale prices, and the sector's challenging credit crisis. As a result of these conditions, Carlyle valued the investment at zero.

However, Carlyle remained committed to Kuhlman. In fact, several investors and Carlyle employees personally invested additional capital to strengthen the company. Carlyle, together with management, helped turn the company around. Nearly 10 years later, in August 2008, Kuhlman was sold by Carlyle to ABB, the global power and automation technology group, earning our investors an attractive return. For the fiscal years 2005, 2006 and 2007, Kuhlman's revenue increased by approximately 26 percent, 26 percent and 45 percent, respectively. In 2007, Kuhlman experienced record results in all three of its operating divisions. In addition, Kuhlman's overall employment levels increased approximately 25 percent during Carlyle's ownership. At the time of the sale to ABB, the company had approximately 800 employees. During the downturn, Kuhlman maintained a positive relationship with its unionized workforce, and organized labor was an important part of the turnaround.

Another Carlyle fund that is focused on infrastructure investments has developed an innovative partnership with the State of Connecticut to redevelop, operate, and maintain Connecticut's 23 highway service areas across the State. Public and private pension funds contributed 42 percent of the $1.1 billion infrastructure fund that we manage.[4] In this case, Carlyle's infrastructure fund formed a 35-year public-private partnership with the State of Connecticut to finance the redevelopment and operations of highway service areas at a time when the State budget was under great stress. Carlyle and our partners plan to invest approximately $178 million in improvements and upgrades to the service areas over the next 5 years, investments that we estimate will create approximately 375 permanent and construction-related jobs—a 50 percent increase above the 750 jobs that support the service areas today.

[4] The actual amount that fund investors contribute to a particular transaction frequently varies from the level of commitment those fund investors have made to a particular fund. This differential stems from a number of factors, including the investments made by a management team or co-investors.

In total, the State is expected to receive nearly $500 million in economic benefit from the redevelopment effort.

Neither of these investments would have been possible without the commitment of long-term capital to Carlyle's funds by private and public pension funds in the United States. In both of these cases, private and public pension funds contributed capital for 10 years, and we are working hard to provide attractive returns to those investors who have entrusted their assets with us.

Thank you once again for the opportunity to testify.

The CHAIRMAN. Thank you, Mr. Marchick.

Thank you all very much. Very stimulating testimony. And, of course, last night I got to read your written testimony, and I think I'd like to start 5-minute rounds here.

First let me start with Mr. Bertheaud. I just remember reading it, and I think you mentioned it also, and someone else mentioned that we had a number of plans that had gone down. Oh, yes, Senator Enzi said that in the 1980s we had 112,000—I think that was right—defined benefit plans, and in 2008 we only had 27,000.

I keep asking, Why? What happened? Not just for you, but I'll start with you, Ms. Oakley. Why? Why did this happen? If it's a good driver in our economy, it's patient capital, everything I looked at said it's good investments, it's low cost. I forget who had the chart in here about the cost ratio between defined benefit and defined contribution, about half. So if you get the same benefit at half the cost, why did all these plans go by the wayside?

Ms. OAKLEY. Mr. Chairman——

The CHAIRMAN. I really want you to think about this because I think we have to come to grips with this.

Ms. OAKLEY. Senator Harkin, one of the things that's interesting in terms of the work that NIRS has done, we're very familiar with private and public sector plans. If you look at what's happened in the public sector, where defined benefit plans continue to cover 80-plus percent of the employees, a lot of it is their workforce values that plan.

It's also because the States have—they're not as regulated as the private sector because there's no PBGC, no government guarantee. And so the States really are responsible for making sure that they deliver those benefits to their employees, and they gradually, perhaps more gradually than what is currently allowed in the tax law for making contributions to pensions, they get to full funding. They get there a little slower, but they've gotten there and, again, they've gone through the same losses in the market.

What we've seen when we compare public and private that's the most startling is the percentage increase in contributions from a year-to-year basis. And the private sector contributions, the volatility of those contributions is things that we've also heard is very concerning, the unpredictability of the contributions, where everything else is predictable in the defined contribution—the defined benefit plan, and the defined contribution plan has a predictable contribution. That's something that's critically important, too, from what we understand, for private sector employers.

The CHAIRMAN. It still would seem to me that the business community wants more predictability, less volatility. So if there's more predictability and stability in defined benefit plans, why have we gone from—what did I say?—120,000 down to 27,000, 112,000 down to 27,000, and I think it was mentioned by someone that de-

fined benefit pension plans may be just going out the window. It may be the end of it.

Mr. Stephen, any thoughts on this? I'm trying to come to grips with why this is happening.

Mr. STEPHEN. I think from the employee side, Mr. Chairman, you're right, that it is a predictable, guaranteed retirement benefit that the employee or then eventually the retiree can't outlive. It's guaranteed income for life if they take the annuity stream.

However, from the employer's side, since the full funding limit rules came into effect in 1988, those really—it changed the dynamic that began in the 1940s after World War II when DB plans were at their most popular clip, because of the way that the funding rules worked at the time. Obviously, I wasn't there, but my history tells me that the way the funding rules worked is business cycle and pension funding cycle were on the same page.

Now we find ourselves 60 years later in a counter-cyclical market. So we have pension funding rules in a different cycle than business times, which makes you fund more in down markets when capital is at a premium, and doesn't let you fund as much in good times.

The CHAIRMAN. I've read that in more than one testimony that we've had here. When did that happen? When were those rules changed? In other words, it makes sense to me. It's just common sense.

Mr. STEPHEN. Sure.

The CHAIRMAN. I'm not an actuary or anything. If you in good times can pre-pay and put in more, then in bad times you put in less. Why was that changed? You or Mr. Bertheaud or Mr. Marchick.

Mr. STEPHEN. Why?, I can't answer. I can tell you when.

The CHAIRMAN. When? When?

[Laughter.]

Mr. STEPHEN. When? It was when the full funding limit rules became effective in 1988.

The CHAIRMAN. 1988.

Mr. STEPHEN. Yes, sir.

The CHAIRMAN. I've got to find out what that was all about. I was here at that time, but I was just a freshman Senator then. I just don't remember that.

Mr. STEPHEN. If it's any consolation, I was in high school.

[Laughter.]

The CHAIRMAN. Rub it in, rub it in.

[Laughter.]

Mr. Bertheaud, again, OK, is this one of the keys, then, that change that was made?

Mr. BERTHEAUD. Absolutely. That was one of the keys.

The CHAIRMAN. Wow.

Mr. BERTHEAUD. The concept of being able to fund more in good times and not to fund as much in bad times is a key for employers.

Another thing, though, was the adoption of the current pension accounting rules and their development over the last several years, several decades. And where the companies, as there are fluctuations in the markets and fluctuations in interest rates which affect the amount of pension liabilities, these things now appear directly

on the balance sheets of corporations, and corporations end up having to explain why do you have, why are you ending up with so much liabilities on your balance sheet, that kind of thing.

So it ends up being a financial concern to the management of corporations.

The CHAIRMAN. But it wasn't before 1988? I'm trying—I don't understand——

Mr. BERTHEAUD. It was earlier in the 1980s, actually. The accounting rules came in about the early to mid-1980s, and they have developed over time. And especially just in this past decade, when the accounting rules became even more stringent and required these liabilities to go immediately onto the balance sheet.

The CHAIRMAN. Mr. Marchick, I've gone over my time, but do you have a point of view on this?

Mr. MARCHICK. Nothing to add. They explained it quite well.

The CHAIRMAN. Senator Franken.

STATEMENT OF SENATOR FRANKEN

Senator FRANKEN. Thank you, Mr. Chairman, for calling this very important hearing, and thank you all for your testimony.

I'll followup on exactly what the Chairman was talking about later. I had just one bit of confusion in reading Mr. Bertheaud's testimony from yesterday. I'm sorry I came in late. I was at another meeting.

But you basically say that employees prefer defined contribution to defined benefit plans. That has not been my experience when I talk to people who work for a living and who would be the people who would choose between those. And Ms. Oakley said that, in her testimony, 75 percent of Americans think that the decline of pensions have made it harder to achieve the American dream. And also I've heard from experts in previous hearings that Americans have difficulty conceptualizing what a 401(k) account balance means in terms of monthly retirement income.

Can anyone respond to this, Mr. Bertheaud? Anybody else? You asserted this as a fact, and I'm wondering is it just your opinion? Is it based on something other than your opinion?

Mr. BERTHEAUD. It's been the experience of members of our association that many employees, especially younger employees, when you're going out to hire employees, that they expect to—they value more the account-based type, because they can watch it grow. They can watch their contributions go in, they can watch them grow. They can watch their company's contributions go in and grow, and they have value for it.

Traditional defined benefit plans, and there may be other designs that are available, but traditional defined benefit plans often are stated in terms of benefits at age 65, and it's hard for a younger employee in the early parts of their career to appreciate that as much as an account that they can watch grow.

Senator FRANKEN. Is it because people don't see their life at one company the way people used to? Is that part of it?

Mr. BERTHEAUD. That's quite a bit of it. And the traditional design, which is the plan that DuPont had sponsored for many years, if your career is broken at any point, even in two different employers, or maybe three different employers, often you leave a lot of

value behind in that kind of an arrangement. So that the portability of the defined contribution type plan has become something that people value.

Senator FRANKEN. Right. Ms. Oakley, did you have something to say about this?

Ms. OAKLEY. Yes, Senator. Senator, I think when we recently did some opinion surveys, and what we also found was that 8 out of 10 Americans think that everybody ought to have access to a traditional pension. We had to explain to some people what a traditional pension was because they didn't know about them. But when they heard what it was and what it delivered, I think especially in light of the last decade of investment returns, individuals really do value that type of lifelong income security that they can't outlive and a benefit that gives them a promise of a certain replacement of their income.

It is a difficult thing for some people when they're younger to understand that, but clearly I think as we've seen particularly in the public sector, where employees have a long career as a teacher, a police officer, a firefighter, they value those benefits.

Senator FRANKEN. Those are all sort of public sector jobs.

Ms. OAKLEY. Right.

Senator FRANKEN. And Mr. Bertheaud is the actuary at DuPont. So I think there's a difference. I mean, we kind of pinpointed some of this, which is that most people who work in the private sector, and even people who work in the public sector, don't expect necessarily to do that job for their whole life. A policeman or a firefighter probably does, a teacher might, but not necessarily someone who works at DuPont, someone who works at DuPont may see themselves changing jobs.

You're an actuary, right? So you deal with numbers, and you trust numbers. You have a lot of faith in numbers. You're an actuary. Did you have any numbers? Are there numbers? Did you do any, or is this anecdotal?

Mr. BERTHEAUD. I don't have numbers for you.

Senator FRANKEN. OK, because you made an assertion that was, I guess, based on your opinion, but you didn't state it as based on your opinion, and I find that troubling because as a Senator taking testimony, I'd really like to be able to understand what's fact versus opinion, especially coming from someone as distinguished as yourself.

I guess I'm out of time. OK, we'll do another round.

The CHAIRMAN. I want to pick up on Senator Franken. I can understand why a younger worker, if looking at a defined contribution plan and a standard defined benefit plan, would think to himself or herself, I like that defined contribution plan. I can understand that because I might leave DuPont. I might go someplace, and I take it with me. I can still remember in the 1980s, I was here. I was in the House at the time. I came over here in the mid-1980s.

But I remember, that was the big deal about defined contribution plans. You could move it with you. And because the workforce had changed, people don't work at one company. They change four, five, six, seven times. Now you had portability, and at any point in time you could go in and see how much you had.

That appeals to people. It appeals to me, and especially—well, maybe not at my age, but it appeals to younger people, I would think. So I can understand that a younger person presented with just this or that might say, "hmmm, I like that defined contribution." I don't have numbers, but I could just sense that that would be true, that they would like a defined contribution plan better.

I think the problem is, as somebody mentioned, education. How are they being educated about their lifespan and how long they can live and the difference between a defined contribution, defined benefit? Also, and this is what intrigues me, and I've been wrestling with since we started this set of hearings, isn't there some kind of a hybrid out there, something that you brilliant people could come up with that has the aspects of defined benefit but which you can take with you and move as you go from company to company?

Mr. Stephen, you have your plans in your rural electric cooperatives. You said employees tend to stay there, but what if they went from one rural electric to another, to another? Would they still have that same plan?

Mr. STEPHEN. In our plan, Mr. Harkin, in fact—I was going to jump in. In our plan, in the NRECA Retirement Security Plan, if you stay within the cooperative family and you go from one co-op to the other, and both co-ops have a retirement plan, you continue to accrue. So you still have that portability inside of our multiple employer plan.

Now, if you start working at a co-op and then you go work for DuPont, obviously that benefit is not portable from the co-op to DuPont. However, they would roll it over to an IRA and then take it eventually. But inside the cooperative multiple employer plan, if you go from a co-op in Iowa to a co-op in Wyoming, it's a portable benefit. It's a unique thing to our multiple employer plan.

The CHAIRMAN. Let's take that a step further.

Mr. STEPHEN. Sure.

The CHAIRMAN. This is what I'm wrestling with. So you've got small businesses.

Mr. STEPHEN. Yes.

The CHAIRMAN. Which employ most of the people in America.

Mr. STEPHEN. Yes.

The CHAIRMAN. Sorry, DuPont, but it's mostly small businesses out there. By the way, my brother worked all his life for DuPont, so I have very strong feelings about what a great company it is.

But small businesses, if they could join some kind of a cooperative—did you guys say that?—or something——

Mr. STEPHEN. We'd like for you to say that. Yes, sir.

[Laughter.]

The CHAIRMAN. Well, I don't know what it would be, but some kind of a network, because we all know insurance. Insurance, the broader the base, the cheaper it is for everybody, and the more stable it is.

Mr. STEPHEN. Correct.

The CHAIRMAN. And so if you had a system whereby small businesses could join in on defined benefit plans, so that if I worked for the ABC Company that had 10 employees, and then I went to work for the XYZ Company that had 30 employees and moved around like that, that each of them would have a stake in the de-

fined benefit plan and I would somehow take it with me. Is that impossible?

Mr. STEPHEN. I would just answer and say nothing is impossible, but it's going to be inherently difficult because of the myriad of existing regulations on——

The CHAIRMAN. Well, if nothing else has come out of these hearings it's that we've got to look at these regulations. What you all have brought up here I've heard before, and something has got to be done about this. So we're going to zero in on that.

I keep thinking that defined benefit plans aren't really dead. Sure, there's been this big cutback, but now what we're seeing are the fruits of that. People now are retiring without enough money to last them, one out of four without any assets at all in terms of retirement. The retirement stool was built on three legs, right? There's Social Security, a pension, and savings. So now we're down to two, down to Social Security and savings, savings being the defined contribution plan. So we've pulled one leg of that stool out from underneath it, and I want to know is there any way of reversing it.

Ms. OAKLEY. Senator Harkin, there is a model too in small communities. For example, we just at NIRS did a study on six case studies of well-funded plans that survived the financial market meltdown. One of those plans was a plan in the State of Illinois, and many people might say that they'd be surprised that Illinois has a well-funded public pension, but this municipal plan which enables small communities in Illinois, small cities, towns to come into a larger plan that then provides benefits for all of their employees in a defined benefit structure is one of the best funded plans in the country.

And so there are models out there that do work and provide that.

The CHAIRMAN. I just asked him to get me all the data he could on that.

I'm sorry. Senator Franken.

Senator FRANKEN. Well, again, Ms. Oakley, that again is for public employees, and I think we have to make the distinction. I mean, I have a defined benefit plan from being a member of a union where we had multiple employees, where I wrote for NBC, I wrote for Paramount, I wrote for on and on. But they paid into the Writer's Guild for me, and I have a defined benefit plan there. So that's a common defined benefit plan, right?

Mr. STEPHEN. Just to clarify, yes, it is, Senator, in answer to your question, but there is a huge difference. And I know it's a term of art between multiemployer plan, which you're talking about.

Senator FRANKEN. Yes.

Mr. STEPHEN. Which is subject to a collective bargaining agreement.

Senator FRANKEN. Right.

Mr. STEPHEN. And a multiple employer plan like ours, which is not. We're under the single employer rules for all of our funding and reporting obligations.

Senator FRANKEN. OK.

Mr. STEPHEN. But we do have multiple employers with a common employment bond in our plan. For example, we're all electric cooperatives.

Senator FRANKEN. Right. And I love electric cooperatives.

Mr. STEPHEN. And we appreciate that.

Senator FRANKEN. We have a great electric cooperative in Minnesota, and I'm for increasing RUS loans, and I'm big on rural electric co-ops. Great.

Mr. STEPHEN. And we thank you.

Senator FRANKEN. Absolutely. You're welcome.

[Laughter.]

OK. Now, on the regulation that we were talking about, Mr. Bertheaud, you talked to a number of these things, and Mr. Stephen, you talked to this, too, about the requirements at a down period to put in a lot of money when that isn't a good time to do it, and at a high point that your contributions are actually capped. Is that right, Mr. Bertheaud?

Mr. BERTHEAUD. Yes. I think those caps, when it came about in 1988 and caused quite a bit less funding I think at that time, those caps have been relaxed somewhat by PPA in some of the more recent legislation, and that has allowed employers to contribute more when times are good. But it's still—the problem is that the requirements when times are bad can be so harsh——

Senator FRANKEN. Right.

Mr. BERTHEAUD [continuing]. That it causes a lot of trouble for employers.

Senator FRANKEN. Did Congress do anything in the wake of this last downturn, the meltdown especially, to alleviate that at all?

Mr. BERTHEAUD. Yes.

Senator FRANKEN. And what were those measures?

Mr. BERTHEAUD. Yes. There was some relief given, and the idea in the PPA which passed in 2006, that any shortfalls needed to be funded over 7 years, amortized over 7 years. What the funding relief allowed was to amortize that just for a couple of years, not forever but just for a couple of years of shortfalls, to amortize it over 15 years or interest only for 2 years and then over 7 years after that.

Senator FRANKEN. A longer period.

Mr. BERTHEAUD. Right.

Senator FRANKEN. Let me ask you this, because the Chairman spoke to this and about education, and I think you kind of talked to it, about your employees wanting to have the defined contribution rather than defined benefit.

Do you make an effort? Do you make an effort to educate your employees about what a defined benefit is and what the advantages are? I mean, we've had testimony on what the advantages are to the company and society in terms of patient capital. And I think everyone should understand that that's patient, like I have a lot of patience, as opposed to a doctor having a lot of patients, but patient, like long-term capital, and it's a good thing, right? As opposed to someone who is in a defined contribution plan and is jumping their investments all over the place.

So do you educate your employees?

Mr. BERTHEAUD. And I would say, the employers in our organization, the defined benefit rules and the contribution rules and the accounting rules that have kind of put a burden on us from that standpoint have really not put us in a position to educate our employees that defined benefit is the way to go because it presents such a burden for us as a corporation.

Senator FRANKEN. So you feel it's not in your interest to educate them, or it's not in their interest, or both?

Mr. BERTHEAUD. That's——

Senator FRANKEN. I'm running out of time.

[Laughter.]

Mr. BERTHEAUD. I'm sorry, I'm sorry.

Senator FRANKEN. No, I'm sorry. I was kidding. You take your time on that one.

[Laughter.]

Mr. BERTHEAUD. I guess, I'm not sure that employers who are burdened by the regulation, etc, accounting rules, really find that it would make sense for them to be convincing people a defined benefit is the way to go when it presents such a burden to the corporation.

Senator FRANKEN. OK. Thanks for your honest answer. And I know, Mr. Chairman, if it's OK, Ms. Oakley seemed to want to respond as well.

The CHAIRMAN. Please.

Ms. OAKLEY. I did want to say, Senator Franken, one of the things that NIRS asked employees when we did this nationwide survey of people, both in defined benefit, defined contribution public/private, we said should the government make it easier for employers to offer defined benefit plans, and 50 percent of the people we surveyed who responded strongly agreed with that statement. Eight out of ten people agreed with it. So I think, again, there is a perceived value. Perhaps it's because they see the pension their parents have, the pension their grandparents have, and how it's enabled them to sort of get through the financial crunch, and they wonder about themselves not having a pension and wanting to have that flexibility.

Senator FRANKEN. Thank you.

Mr. STEPHEN. Mr. Chairman, may I have one moment to——

The CHAIRMAN. Sure, sure.

Mr. STEPHEN. To Senator Franken, to your point on education, we actually have a total—and lawyers shouldn't use numbers, but we have 349 full-time employees between our Arlington headquarters and our Lincoln services operation that have something to do with administering our three benefit plans, our DB, our 401(k), and our group benefits trust. Of that number, we have 39 full-time people in our investments department, a subset of which, I believe it's a number of 10, that are personal investment retirement counselors, that are all about investment education on a one-on-one basis, on a group basis, and on a co-op basis. So we do retirement plans, asset allocation, long-term savings strategies and how to save to augment those three benefits together. And if you're a participant in one of the plans, you have a right to that for free.

In addition, we have just under 20 what we call relationship managers. They are field reps inside of different regions of the

State. For example, Karen Alexander is our representative in Minnesota. She has Minnesota and Wisconsin, doing employee meetings, retirement planning 10 years out, 5 years out, one-on-one, as well as group settings, to try and prepare people, even in their 20s, on the value of retirement savings.

Senator FRANKEN. So that seems like a stark difference between you and DuPont. And thank you, Mr. Bertheaud, for your really honest response to that, which is that DuPont kind of feels it's not in its interests because of what you feel is the regulatory impediments to do this. So I thank you all for your testimony.

Mr. BERTHEAUD. And, Senator Franken, understand that I'm also speaking not just for DuPont but for the American Benefits Council.

Senator FRANKEN. Oh, yes. I'm sorry.

Mr. BERTHEAUD. I'm involved in that.

Senator FRANKEN. Thank you.

The CHAIRMAN. Well, again, Mr. Bertheaud, going over your written testimony, you said DuPont has operated a defined benefit pension plan for over 100 years, and there's never been an option to receive pension benefits in a lump sum. Then starting in the early 1970s, DuPont started a defined contribution plan in addition to the defined benefit plan. So you have both now at DuPont.

Mr. BERTHEAUD. We do have both now.

The CHAIRMAN. And then, let's see, you match up to 6 percent on the defined contribution, up to that.

Mr. BERTHEAUD. Yes, plus a 3 percent contribution that does not require the employees to contribute.

The CHAIRMAN. Oh, you put in. So if I work for DuPont and I want to have a defined contribution plan, if I didn't put in anything, you'd still put in 3 percent.

Mr. BERTHEAUD. Yes, sir. Yes.

The CHAIRMAN. And then how much would you put into the defined contribution plan? Then 3 percent?

Mr. BERTHEAUD. Well, that is the defined contribution. We put 3 percent in——

The CHAIRMAN. I mean defined benefit.

Mr. BERTHEAUD. OK. The defined benefit plan right now is continuing only for existing employees.

The CHAIRMAN. New employees don't get into it.

Mr. BERTHEAUD. New employees do not get into the defined contribution plan.

The CHAIRMAN. So you said that started in the 1970s. They offered it in addition to the defined benefit. When did you stop offering a defined benefit plan?

Mr. BERTHEAUD. In 2007.

The CHAIRMAN. Wow, just recently.

Mr. BERTHEAUD. To new employees.

The CHAIRMAN. Oh, I see. You said beginning in 2007, DuPont chose to change its emphasis from defined benefit to defined contribution. They didn't change emphasis, they changed the whole thing.

Mr. BERTHEAUD. For new employees, yes. Current employees continue to accrue a portion of their benefits.

The CHAIRMAN. So again, why in 2007 would DuPont end something they've done seemingly quite well for 100 years? Why would they end that in 2007?

Mr. BERTHEAUD. It gets back to the burdens that we've talked about, the way the accounting rules end up putting the volatility of markets and the volatility of discount rates right on our balance sheet of corporations, and that combined with the funding rules that have become difficult for corporations to manage the fluctuations and having to contribute in down times, and these various reasons have caused employers to look more toward the defined contribution environment.

The CHAIRMAN. Could you help us out a little bit more than that and maybe in writing or something?

Mr. BERTHEAUD. We'd be happy to—the ABC staff would be happy to follow up with your staff, absolutely.

The CHAIRMAN. A little bit more detail on that.

Mr. BERTHEAUD. Absolutely.

The CHAIRMAN. I'm still trying to get to why—OK, I understand the rules on pre-paying more and not paying. I get that.

Mr. BERTHEAUD. Right.

The CHAIRMAN. I get maybe some of the other reporting requirements. I don't understand completely some of the IRS problems there, but we ought to look at that, too.

Is it in your opinion, Mr. Bertheaud, now not as DuPont but now wearing your other hat, the American Benefits Council, is it worth us to really look at how we can save and maybe re-grow a defined benefit plan in America for the reasons that Mr. Marchick talked about in terms of patient capital, long-term investment, stability? Is it worth it? And assuming that we can look at some of the rules changes, IRS changes, regulatory changes, to make them better and to figure out some way of making them portable, is it worth it?

Mr. BERTHEAUD. I think it is worth it.

The CHAIRMAN. Well, we'd like to do that. That's what we're trying to get our hands on. Like I told you at the beginning, I said I don't have the answers.

Mr. BERTHEAUD. Right.

The CHAIRMAN. But it seems to me everything that we've heard, not only from here but in previous sessions we've had, is that there is something good for the long-term interests of our country in terms of the long-term interests of the middle class of America, in terms of retirement, that other leg of that stool, that really is very compelling for a defined benefit program. So then I keep thinking, well, if that's the case, why are we losing them all? So that's what I want to try to figure out. As the Chairman of this committee, and I hope I speak for other members of the committee on both sides, that we try to figure that out and see if there's a path forward, if you believe they're really worth saving.

Do you believe they're worth saving, Mr. Marchick, I mean defined benefit plans?

Mr. MARCHICK. I think the idea that you've articulated is one that is well worth exploring. I understand the pressures from the business side as a company that invests in business, and we hear from management about these pressures all the time. But if you

can take the individual flexibility of a defined contribution plan where people can take it with them, it's portable, they can make choices, combined with the benefits of a defined benefit plan where you have large pools of savings, professional management, and a very long-term investment horizon, that's a very attractive option.

I don't know how you structure that from new legislation requirements, but if you could do that, that would be very, very attractive, and I think that would be a wonderful thing to do on a bipartisan basis because it takes the ideas that many on the Republican side advocate in terms of individual choice and individual flexibility, individual mobility, with the ideas of many on the Democratic side in terms of pooled savings, and it would be a very, very creative bipartisan approach to pursue that strategy for the benefit of the country.

The CHAIRMAN. Mr. Stephen.

Mr. STEPHEN. Mr. Chairman, I wouldn't say it's important that we do what we can, I'd say it's critical that we do what we can. And I think that with your leadership in this committee, with your dedication to this, we can come up with something that makes sense for business and ultimately for employees, which is the whole point.

I would say that when you're looking at DB funding, we were trying to figure out what happened. Well, if you look at it from a company standpoint, you're looking at a long-term unfunded liability with unpredictable contribution rates year by year that are dependent on returns in the equity market, the financial market, and interest rates on the DB side.

When you look at the DC side, at 401(k)s, I can look at my payroll for this year, know that I'm going to make a 1 percent negative election or a 1 percent base contribution or a 4 percent match, and I know exactly what my number is going to be every year within a percentage point or two. I can budget for it. It's sure, it's predictable, and it's easy to follow.

DB funding is completely different. It's an unfunded long-term liability that the company now—if a company is now starting, if you're starting a small business, to your point, if we're in Iowa starting a small business, once I get past all of the FICA taxes and unemployment and everything that I'm doing to get my start-up company done, why am I going to have this new unfunded liability that I'm going to have no idea what my costs are going to be in 3 years, let alone I'm trying to survive to the next quarter?

So it's a difference in the world marketplace where, to Senator Franken's point, when you look at anecdotal data, of course, but real data shows—the Department of Labor—that an average American will change jobs seven to eight times in their working career. Without that portability on the DB side, someone who works for a company for a year-and-a-half doesn't accumulate much, and the compliance costs and the start-up costs for that company to get that account set up for that person for a year-and-a-half there is upside-down, under water—use the analogy you want.

So when you're looking at it that way, there's a difference between long-term employees with very low turnover where a long kind of legacy plan, if you will—I know that's a bad word sometimes when you're talking about pension plans—makes sense. For

us, it makes sense. For a very different market, for example, I know of a company that has several gas station convenience stores, I believe their annual turnover is 166 percent a year. They pay folks with no-fee debit cards. Those aren't the kind of people that should be having a DB plan. It makes no sense. They come and work for 2 weeks and then they don't show up again.

So it's different depending on your market, depending on your business, and depending on your long-term goal.

The CHAIRMAN. That's very good, very good.

Yes, Ms. Oakley.

Ms. OAKLEY. Senator Harkin, I think one of the other interesting things to look at and maybe learn a little bit from what happens in the public sector. A lot of people aren't aware that public sector employees make a significant contribution toward their defined benefit plans, just as sometimes happens in the multiemployer side. They do that, and it does help. It helps reduce the cost for the employer directly. It gives some predictability to the funding.

It also gives the employees a stake in the game. That forced savings helps them get that ownership and start to value that defined benefit plan. So that even today as we're seeing a lot of reforms around the State, increased employee contributions, quite often that's done in an environment legislatively where there's discussion back and forth, or it's done on collective bargaining situations where employees agree willingly to contribute more because they value those defined benefit plans.

So I think there are ways. And, in fact, I believe that one small piece of the Pension Protection Act that really hasn't gotten off fully was something called the DBK, which was a way of combining a defined benefit plan with 401(k) plans. And maybe there's some hope to go back and look at the DBK where you get that tax benefit for the employees and still have a defined benefit plan that's there to provide a benefit for the employees in the private sector.

The CHAIRMAN. Very good.

Senator Franken.

Senator FRANKEN. Well, I'm going to go look back at the DBK.

Who, Mr. Bertheaud, makes up the American Benefits Council?

Mr. BERTHEAUD. It's principally Fortune 500 companies and other organizations that assist employers in providing benefits to employees.

Senator FRANKEN. OK, because it seems to me here that we're talking about a whole bunch of different things that are happening all at once, different factors, one of which—and you talked about all the different uncertainty that faces a company, and Mr. Stephen talked to that a little bit. And talking about start-ups, DuPont, obviously, is not a start-up. Probably many of the Fortune 500 companies aren't start-ups, almost by definition.

So what it seems to me is that what we're talking about here is a shift of the uncertainty from the corporation, from the business to the employee. And because this has happened over the last 20, 30 years, we're seeing—this is part of the middle class squeeze, if you will, or just another part of it, which is a shift of the burden from corporate America to people who are working and to the middle class. And that's why I was wondering whether you did education about the benefits of this.

I want to ask Mr. Marchick a question just so that he can speak to the benefits, because you spoke to investments. How does a shift from defined benefit plans to defined contribution plans affect entrepreneurs and their access to capital, and could that shift have larger effects on the economy as a whole?

Mr. MARCHICK. That's a great question. One of the key distinctions between investments in a typical DC plan versus a DB plan is that the DB plan can invest in long-term illiquid assets, a very long-term corporate investment, a long-term real estate investment, a long-term infrastructure investment, 10, 20, 30 years.

A defined contribution plan has to be liquid. And so therefore with liquidity, it's typically going to larger, publicly traded companies that are large enough to be on a stock market. So that money is not going into small and medium-sized companies typically because they're not large enough to have liquidity.

And so one of the benefits of a defined benefit plan is they support venture capital investments. They support real estate investments. They support growth investments, which are investments in companies that may or may not make it, but the ones that make it grow so much faster than the ones that don't make it that there's a risk/reward ratio that overall benefits the United States and benefits our economy and makes it the most dynamic economy in the world.

And so creating pools of capital that can fund those long-term riskier investments is essential for the vibrancy of our economy.

Senator FRANKEN. So the vitality, the dynamic nature of our economy is helped by defined benefits.

Mr. MARCHICK. By large pools of savings that can invest in the whole range of assets, some liquid, some illiquid, some short-term, some long-term, that can create the most balanced portfolio to not only create attractive investments but also create better returns for those beneficiaries.

Senator FRANKEN. And is it in the interest of large corporations perhaps not to have that dynamism in the short term?

Mr. MARCHICK. I think for large corporations—and again, we invest in small, medium and large. We see the pressures from the corporate side. Many large corporations, the uncertainty and the costs, the liability costs associated with long-term health care, long-term retirement obligations are very, very significant, particularly in the up and down of a market. And so there are pros and cons for large corporations.

Obviously, large corporations want a dynamic U.S. economy. They want people to have as much money as they can that drives consumer demand. But the costs on their balance sheet, as Mr. Bertheaud said, are very, very high. And so in a highly competitive economic environment, there are very, very strong competitive pressures on large U.S. companies that have driven many of those companies to move toward defined contribution plans.

Senator FRANKEN. What about all this money that we hear that is being sat on, this $2 trillion? I just want to ask you, Mr. Marchick, why is that not being invested?

Mr. MARCHICK. I think a lot of it is not being invested because of lack of confidence about the future, that companies, investment firms make investments if they believe that the long-term return

on that investment will be attractive. And in a very uncertain economic environment, it's very hard to make those investment decisions if you don't have confidence about the future in terms of your ability to sell a product, sell a new service, provide new opportunities for the consumers, either individual consumers or business consumers of a particular product, because many investments take 3, 5, 7, 10 years to pay off, and if you're uncertain about the future of the economy, you sit on cash.

Senator FRANKEN. OK. Well, my time is up. But it seems to me that we're in a bit of a vicious cycle here. I don't think that's a new observation.

So thank you, Mr. Chairman.

The CHAIRMAN. Senator Franken, in just talking about risk, I couldn't help but think—my staff always carries it for me—about shifting risk, The Great Risk Shift by Jacob Hacker. It talks exactly about this, about shifting risk, and I think that's all right. In some circumstances that's OK.

But in terms of something that's so important to our country as retirement because we're living longer, we wish people would save more money, but they don't. And in tough times, it's hard for a family making $45,000 a year and they've got two or three kids, it's hard to save any money on that kind of an income.

So it seems to me that if we make a decision that defined benefit plans are worth saving, worth re-growing, not just sort of stabilizing but actually growing it, and that it's good for the long-term interests of our Nation to do that, then maybe we ought to re-think perhaps the structure of defined benefits. Ms. Oakley talked about that.

For example, for defined benefit plans, the employer puts in all the money. The employee doesn't put in anything. So an employee says, not bad, they put it all in, I don't have to worry about it. Of course, now it's not portable. If I leave the company, I don't get it. So that makes a defined contribution look better to me.

On a defined contribution, the employee puts in the money, and the employer may or may not contribute to it, may or may not.

But what if you had a defined benefit plan where employees had to contribute? Just like they do with a defined contribution plan now. We talked about someone who went to work for a couple of weeks and then moved on. Well, they got a paycheck. But if some of that had to be sliced off to go to a DB plan which would be there no matter where they went, it would seem to me that if you could work something out like that, that that would be in the long-term best interests for our country.

Why can't employees contribute to a defined benefit plan? Is there something, maybe a law against it?

Mr. BERTHEAUD. No. Certainly, it's not necessarily typical, but certainly it's permissible.

The CHAIRMAN. It is.

Mr. BERTHEAUD. Employees can contribute to a defined benefit plan.

Mr. MARCHICK. On an after-tax basis.

Mr. BERTHEAUD. On an after-tax basis.

The CHAIRMAN. On what? Oh, after-tax basis.

Mr. BERTHEAUD. Right, after-tax basis. But this kind of creative thinking is the kind of thing I think that we need to try to at least take a step toward reviving the defined benefit system.

The CHAIRMAN. Well, I need more information.

Ms. OAKLEY. Yes, Senator. One of the things I think, just sitting here on the panel listening, public and private plans are definitely different, but there's a lot to be learned from public plans understanding what the private sector does, and private sector plans understanding how the public sector plans work. And I think you've done so much today in this hearing to bring light to that.

In the private sector, they said employees can contribute, but it's with after-tax dollars, and 401(k) plans highlight if you can do it with before-tax dollars, maybe that makes it easier for many people to do it.

The CHAIRMAN. So 401(k) plans is before-tax dollars.

Ms. OAKLEY. Exactly.

The CHAIRMAN. Defined benefit, as the public employees put in, that's after-tax dollars.

Ms. OAKLEY. Well, actually, there's a provision—this gets into where the tax code goes through these numbers and letters all the time. There's another provision in the tax code that allows something called an employer pick-up for public employees so that that money is treated as before-tax dollars. So public employees can contribute to their employer's pension with before-tax dollars, and that does make an incentive. It makes it more palatable for those contributions.

The CHAIRMAN. That's Federal tax dollars.

Ms. OAKLEY. Federal.

The CHAIRMAN. Is that true all over the country? If so, then that's true for everyone, right?

Ms. OAKLEY. It's available to everyone.

The CHAIRMAN. So it's really not after-tax dollars. It's before-tax dollars.

Ms. OAKLEY. In the public sector, by and large, it's probably before-tax dollars.

The CHAIRMAN. But in the private sector, it would be after-tax dollars.

Ms. OAKLEY. Right.

Mr. BERTHEAUD. That's correct.

The CHAIRMAN. Well, now, that's interesting. We'll have to think about that one.

Ms. OAKLEY. And that's what the DBK proposal was going to try to address. It would let you put the before-tax dollars——

The CHAIRMAN. I'll ask Michael about that. He said they still haven't got rules out on that. What did you say?

Ms. OAKLEY. Haven't issued rules.

The CHAIRMAN. They're still working on it. Well, that's who we ought to—let's get them up here sometime, find out where they are on that.

Mr. STEPHEN. Can we submit questions for the record on that?

The CHAIRMAN. Absolutely. Yes, I could use some questions, absolutely. In fact, I invite that. If you've got questions that we need to be asking them, I'd invite that to come to this committee. Please submit them to this committee, absolutely. As I said, I don't have

any set idea on what to do. I just have this sense from your testimony and others that the defined benefit plans really do have a value, a great value to our country, and it's a shame to see them going down and almost being done away with.

Now, if the consensus was that everybody said, "no, they're not worth a darn or valueless, they don't do the good things you talked about," well, OK, fine, let them go.

But that's not what I've heard here. I haven't heard this today, and I haven't heard it in the other two or three hearings that we've had on this. But it seems like they're dwindling and going away because no one is paying attention to it or no one is doing anything about it. And that's what I want this committee to focus on.

So I don't know if I have any more questions. You've all been very forthright in your testimony, and I thank you for that. I would just ask you if you have some questions you'd like us to submit to get more of what IRS is up to; second, Mr. Bertheaud, you were going to give me some information, too. What was it I asked for? Now I can't remember. I asked you to give me something here for the committee. I'm sorry; what was that?

Mr. BERTHEAUD. It was information about the regulation that changed the system back in the 1980s.

The CHAIRMAN. Thank you. Yes, I need that kind of background stuff, and any advice and suggestions that each of you have on how we change the regulatory structure. You all outlined them in your testimonies, that there's a problem there. I'm sorry to say, I don't see any solutions in here, OK? So I need you to, if you've got some ideas on how we change it, I really invite you to submit that to the committee.

Mr. BERTHEAUD. We will. Mr. Chairman, the American Benefits Council would be happy to work with the committee on this.

The CHAIRMAN. That would be wonderful. I'd appreciate it.

Mr. STEPHEN. The NRECA will continue to work with you.

The CHAIRMAN. I would appreciate that.

Ms. OAKLEY. We'll be happy to do that as well, sir.

The CHAIRMAN. Thank you.

Mr. Marchick.

Mr. MARCHICK. I'm in.

The CHAIRMAN. You're in? OK, good. Thank you.

[Laughter.]

Anything else for the record that anybody would like to bring up? Something we might have missed, we overlooked?

[No response.]

No. Well, listen, you've been a great panel. You obviously all really know the system well, and we thank you so much for this. And help us try to work through this to see where we can move ahead in the future, OK?

Thank you all very much.

Mr. BERTHEAUD. Thank you, Mr. Chairman.

Ms. OAKLEY. Thank you, Mr. Chairman.

The CHAIRMAN. The committee stands adjourned.

[Additional material follows.]

ADDITIONAL MATERIAL

PREPARED STATEMENT OF HAROLD A. SCHAITBERGER, GENERAL PRESIDENT, INTERNATIONAL ASSOCIATION OF FIRE FIGHTERS

Chairman Harkin, Ranking Member Enzi, and distinguished members of the HELP Committee, I thank you for holding today's critically important hearing on "The Power of Pensions: Building a Strong Middle Class and Strong Economy." As the General President of the International Association of Fire Fighters (IAFF), I have the honor of representing nearly 300,000 men and women who risk their lives daily to provide fire, rescue and emergency medical services protection to over 85 percent of our Nation's population. It is on behalf of these dedicated Americans that I wish to offer my thoughts on retirement security.

In addition to speaking on behalf of IAFF members in all 50 States, I also speak as someone who has spent the better part of his professional life focusing on retirement security issues for first responders and other public employees. After serving as a Lieutenant in the Fairfax County Fire Department, I served as a public member of the County's pension board. Upon my arrival in Washington, DC, I served as Counsel to both the National Conference on Public Employee Retirement Systems and the National Association of Government Deferred Compensation Administrators. And as President of the IAFF, I have greatly expanded our organization's emphasis on retirement issues, creating a new Pension Department. In total, I have spent the better part of four decades championing retirement security for working Americans.

It is from this background that I have come to fully appreciate the essential role that defined benefit pensions play both in our economy and in the everyday lives of retired Americans. I don't believe it is hyperbole to say that defined benefit pension plans were one of the reasons why our parents' generation retired with dignity. Unfortunately, the increasing absence of DB plans in compensation packages is a critical threat to the retirement security of both our generation, Mr. Chairman, and our children and grandchildren's generations.

For emergency responders in particular, defined benefit pension plans are simply irreplaceable. Any movement away from them—and you only have to pick up the newspaper to see that our pension plans are under attack in State capitals and city halls across America—would decimate the retirement security of fire fighters and their families.

As a matter of public policy, State and local governments have adopted earlier retirement ages for public safety officers than other occupations. Many jurisdictions have mandatory retirement ages which require fire fighters and law enforcement officers to leave their job at a certain age. Working together with management and legislators, IAFF Locals have helped structure defined benefit pension plans that reflect these public safety realities. Defined contribution plans, which are dependent solely on the amount of money contributed rather than a benefit formula, undermine the policy goal of having a younger, more physically fit, public safety workforce. We do not believe it is wise public policy to force a fire fighter to remain on the job after they are no longer capable of performing their duties solely because a market downturn robbed their DC plan of the funds they needed to retire.

Our DB plans also address the high rates of disability in public safety occupations by providing a secure retirement even for those who suffer a career-ending injury early in their careers. And our plans provide for the survivors of fire fighters who make the ultimate sacrifice in the line of duty. 401(k)-style defined contribution plans offer no such security for those who place their lives on the line each day to protect their neighbors, and who all too often pay a huge price for their service.

The advantages of DB plans, however, are not limited to fire fighters and other public safety officers. In an apples-to-apples comparison, DB plans simply beat DC plans in several ways. Perhaps the most important way is in actual plan performance. In a Watson Towers study that compared DB and DC investment returns between 1995 and 2007, the study found that DB plans outperformed DC plans by 1 percentage point per year. And 1 percentage point does not amount to pocket change. With a $5,000 annual contribution spanning 40 years, a difference between an 8 percent return and a 7 percent return is over $330,000.

DB plans are also cheaper to run. Administration and investment costs for DC plans can cost as much as four times what a DB plan would cost. And who bears the full brunt of these additional costs? The employee. Again, these additional costs equal real money. According to the Illinois Municipal Retirement Fund, the administrative and investment costs associated with switching to a DC plan could cost them up to $250 million more than what they currently pay with their DB plan.

DC plans also punish people who are unable to put as much into their retirement accounts as they would like. Many people are unable to contribute to DC plans because a family member has high medical bills or other circumstances beyond their control. DB plans provide a secure retirement to workers regardless of other expenses the worker has to meet.

But even those who conscientiously make maximum annual payments to their defined contribution plans do far better under a defined benefit scheme. A fire fighter who works for 30 years, starting at age 25 earning $30,000, would have to contribute more than $1,000 every month to even come close to providing the retirement income offered by a typical DB plan. It is simply not reasonable to assume that a family making $30,000 can devote 40 percent of their income toward retirement.

And then there is the predictability and security of knowing that in retirement, you will get a check every month to cover your expenses, or cover your spouse's expenses should you pass away. As the saying goes, that kind of peace of mind is truly priceless. That's why retirement annuities that take your 401(k) nest egg and convert them to a steady income stream are on the rise. People are scared that they will outlive their savings, so they are willing to pay extra fees in order to convert them to fixed annuities that act as *de facto* pension plans.

Wouldn't it have been better to have just had a DB plan in the first place, so these hard working Americans could have taken advantage of the higher investment returns and lower administrative costs of a DB plan over their lifetime, and cut out the middle-men at the brokerage firms collecting their commissions and fees?

Those of us in occupations that are still covered by defined benefit plans are often asked why we should continue to enjoy the benefits of these plans when so many others have lost them in the recent migration to defined contribution plans. But this question suggests that there should be a race to the bottom in retirement planning. Rather than promoting a race to the bottom, the IAFF believes that our Nation should be exploring ways to ensure that all hardworking Americans can retire with dignity. Instead of pension envy, we should be fostering pension pride.

That's why I commend you, Chairman Harkin, for trying to find ways to increase defined benefit pension plans in the private sector as well as being a true champion of DB plans in the public workforce. I look forward to working with you and the members of this distinguished committee to find ways to foster pension pride for all Americans.

PREPARED STATEMENT OF JACK VANDERHEI, PH.D., RESEARCH DIRECTOR, EMPLOYEE BENEFIT RESEARCH INSTITUTE (EBRI)*

INTRODUCTION

According to EBRI estimates,[1] the percentage of private-sector workers participating in an employment-based defined benefit plan decreased from 38 percent in 1979 to 15 percent in 2008. Although much of this decrease took place by 1997,[2] there have been a number of recent developments[3] that have made defined benefit sponsors in the private sector re-examine the costs and benefits of providing retirement benefits through the form of a qualified defined benefit plan.[4] However, these plans still cover millions of U.S. workers and have long been valued as an integral component of retirement income adequacy for their households. In this testimony, we make use of an EBRI simulation project that has been ongoing for more than 10 years to evaluate the importance of defined benefit plans for households assuming they retire at age 65.

In 2010, EBRI updated its Retirement Security Projection Model[5] (RSPM) and determined that the overall retirement income adequacy for households currently ages 36–62 had substantially improved since 2003 (VanDerhei and Copeland, 2010). Almost one-half of Baby Boomers and Gen Xers were determined to be at risk of not having sufficient retirement income to cover even basic expenses and uninsured health care costs. The results, not surprisingly, were even worse for low-income households, as 70 percent of households in the lowest one-third when ranked by pre-retirement income were classified as "at risk." Moreover, 41 percent of those in the lowest pre-retirement income quartile are predicted to run short of money within 10 years of retirement.

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*The views expressed in this statement are solely those of Jack VanDerhei and should not be attributed to the Employee Benefit Research Institute (EBRI), the EBRI Education and Research Fund, any of its programs, officers, trustees, sponsors, or other staff. The Employee Benefit Research Institute is a nonprofit, nonpartisan, education and research organization established in Washington, DC, in 1978. EBRI does not take policy positions, nor does it lobby, advocate specific policy recommendations, or receive Federal funding.

Although the 2010 version of RSPM assumed all households retired at age 65, the model was updated in 2011 to allow retirement income adequacy simulations for deferred retirement ages through age 84 (VanDerhei and Copeland, 2011). The percentage of households with adequate retirement income at a 50, 70 or 80 percent probability level obviously increased as the deferral period beyond age 65 increased but the results cast suspicions on the conventional wisdom that merely working a few more years beyond age 65 would be adequate for all retirees (especially for those in the lowest-income quartile).

EBRI received several requests to focus on what the average present values of retirement income deficits would be for various cohorts of future retirees, and what the aggregate value of those deficits are likely to be in current dollars. The 2010 Retirement Savings Shortfalls (RSS) were determined as a present value of retirement deficits at age 65 for the same three age cohorts in VanDerhei (September 2010):

- Early Boomers (born between 1948–54, now ages 56–62).
- Late Boomers (born between 1955–64, now ages 46–55).
- Generation Xers (born between 1965–74, now ages 36–45).

The aggregate RSS for these age cohorts expressed in 2010 dollars is $4.55 trillion, for an overall average of $47,732 per individual[6] still assumed to be alive at age 65.[7] Figure 1 in VanDerhei (October 2010a) shows that the average RSS varies by age cohort as well as gender and marital status. The RSS per individual is always lowest for households (varying from $29,467 for Early Boomers to $32,098 for Gen Xers), somewhat higher for single males (19–34 percent depending on age cohort), and more than twice as large for single females (110–135 percent depending on age cohort). Even though the present values are defined in constant dollars, the RSS for any gender/marital status combination increases for younger cohorts. This is largely due to the impact of assuming health care-related costs will increase faster than the general inflation rate.

In testimony before this committee last year (VanDerhei, October 2010b), we used this model to demonstrate the importance of Social Security retirement benefits. We estimated that if those benefits were to be eliminated, the aggregate deficit would jump to $8.5 trillion and the average would increase to approximately $89,000.

THE IMPORTANCE OF DEFINED BENEFIT PLANS FOR RETIREMENT INCOME ADEQUACY

Previous EBRI studies were able to document the degree to which eligibility for participation in defined contribution plans matters with respect to "at-risk" status. For example, the at-risk probability for Gen Xers varies from 60 percent for those with no future years of eligibility in a defined contribution plan to 20 percent for those with 20 or more years. However, RSPM had never been used in the past to quantify the importance of accruals in defined benefit plans.[8] For purposes of this testimony, we assumed that all households retire when the oldest wage earner reaches age 65.[9] We bifurcated each household in terms of whether it had a defined benefit accrual at age 65[10] to assess the impact of these benefits on retirement income adequacy.[11] We then ran the results for all Baby Boom and Gen Xer households and found that *overall the presence of a defined benefit accrual at age 65 reduces the at-risk percentage by 11.6 percentage points*.

Figure 1 shows the impact of a defined benefit accrual at age 65 on at-risk probabilities by age cohort. The greatest impact is on the early boomers as the percentage of households without any defined benefit accruals considered to be at risk of insufficient retirement income is 67 percent compared with only 41 percent for their counterparts with some defined benefit accruals. As expected, the defined benefit advantage (as measured by the gap between the two at-risk percentages) narrows for younger cohorts. For late boomers the at-risk percentage is 59 percent for those with no defined benefit accruals versus 38 percent for those with some defined benefit accrual. The gap narrows even more for the Gen Xers: 55 percent for those with no defined benefit accruals versus 38 percent for those with some defined benefit accrual.

Figure 2 provides similar information to Figure 1 although this time the impact is displayed as a function of pre-retirement income level.[12] The greatest defined benefit advantage (as measured by the gap between the two at-risk percentages) is for the lowest-income quartile: the percentage of households without any defined benefit accruals considered to be at risk of insufficient retirement income is 86 percent compared with only 68 percent for their counterparts with some defined benefit accruals. The absolute value of the differences decrease as the relative pre-retirement income quartiles increase (10.3 percentage points for the second income quartile, 9.0 percentage points for the third-income quartile and 8.7 percentage points for the

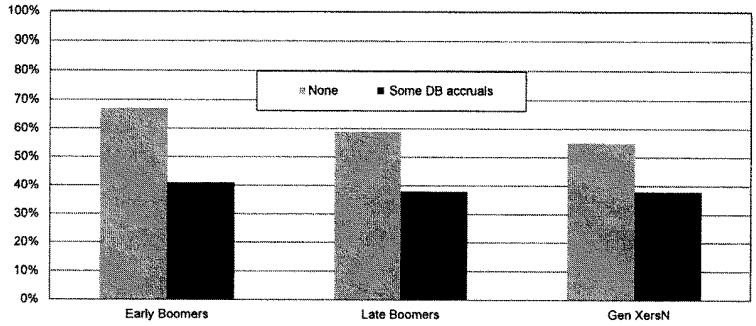
highest income quartile); however, the relative value (when compared with the at-risk levels for those without defined benefit accruals) remain quite high.[13]

Figure 3 shows the impact of a defined benefit accrual at age 65 on at-risk probabilities by age cohort and pre-retirement income level. In each case the greatest defined benefit advantage (as measured by the gap between the two at-risk percentages) is for the lowest-income quartile. The absolute difference for the lowest income quartile is 20.0 percentage points for Early Boomers and 20.7 percentage points for the Late Boomers. It decreases somewhat for Gen Xers but still decreases the at-risk rating for the lowest-income quartile in that cohort by 15.8 percentage points.

Figure 1

Impact of Age and Presence of Defined Benefit Accrual at Retirement Age on At-Risk* Probabilities

Percentage of population "at risk" for inadequate retirement income, by age cohort, and future years eligible for participation

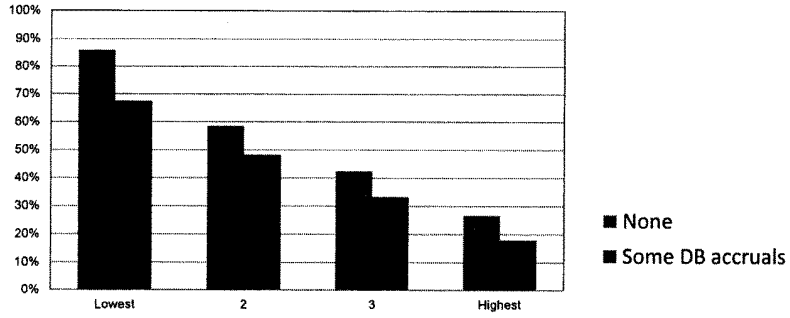


Source: EBRI/ERF Retirement Security Projection Model® version 110714e.
* An individual or family is considered to be "at risk" in this version of the model if their aggregate resources in retirement are not sufficient to meet aggregate minimum retirement expenditures defined as a combination of deterministic expenses from the Consumer Expenditure Survey (as a function of income) and some health insurance and out-of-pocket health-related expenses, plus stochastic expenses from nursing home and home health care expenses (at least until the point they are picked up by Medicaid). The resources in retirement will consist of Social Security (either status quo or one of the specified reform alternatives), account balances from defined contribution plans, IRAs and/or cash balance plans, annuities from defined benefit plans (unless the lump-sum distribution scenario is chosen), and (in some cases) net housing equity (either in the form of an annuity or as a lump-sum distribution). This version of the model is constructed to simulate "basic" retirement income adequacy; however, alternative versions of the model allow similar analysis for replacement rates, standard-of-living, and other ad hoc thresholds.

Figure 2

Impact of Income and Presence of Defined Benefit Accrual at Retirement Age on At-Risk* Probabilities

Percentage of population "at risk" for inadequate retirement income, by age-specific remaining career income quartiles (baseline assumptions)



Source: EBRI/ERF Retirement Security Projection Model ™ version 100504e.
* An individual or family is considered to be "at risk" in this version of the model if their aggregate resources in retirement are not sufficient to meet aggregate minimum retirement expenditures defined as a combination of deterministic expenses from the Consumer Expenditure Survey (as a function of income) and some health insurance and out-of-pocket health-related expenses, plus stochastic expenses from nursing home and home health care expenses (at least until the point they are picked up by Medicaid). The resources in retirement will consist of Social Security (either status quo or one of the specified reform alternatives), account balances from defined contribution plans, IRAs and/or cash balance plans, annuities from defined benefit plans (unless the lump-sum distribution scenario is chosen), and (in some cases) net housing equity (either in the form of an annuity or as a lump-sum distribution). This version of the model is constructed to simulate "basic" retirement income adequacy; however, alternative versions of the model allow similar analysis for replacement rates, standard-of-living, and other ad hoc thresholds.

Even though the overall finding that the presence of a defined benefit accrual at age 65 reduces the at-risk percentage by 11.6 percentage points is quite impressive, this impact is undoubtedly muted to some extent by the interaction of defined contribution plan accumulations. Although the greater heterogeneity produced by defined contribution plans precludes a simple bifurcation of whether or not a plan balance exists at age 65, we are able to distinguish the overall impact of eligibility in a defined contribution plan by tracking the number of future years of simulated eligibility and displaying the impact of the presence of a defined benefit accrual in one of four categories:

- Zero future years of eligible participation.
- 1–9 future years of eligible participation.
- 10–19 future years of eligible participation.
- 20 or more future years of eligible participation.

Figure 4 provides the results for this analysis. As expected, the overall impact of a defined benefit accrual at age 65 is much larger for those households with no future years of eligible participation in a defined contribution plan (23.6 percentage points) and decreases as the future years of defined contribution eligibility increases (11.3 percentage points for 1–9 years, 8.5 percentage points for 10–19 years and 6.4 percentage points for those with 20 or more years).

SUMMARY

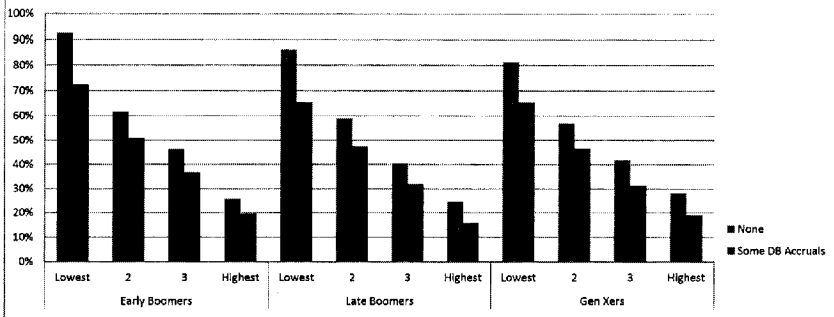
The analysis performed for this testimony shows the tremendous importance of defined benefit plans in achieving retirement income adequacy for Baby Boomers and Gen Xers. Overall, the presence of a defined benefit accrual at age 65 reduces the "at-risk" percentage by 11.6 percentage points. The defined benefit plan advantage (as measured by the gap between the two at-risk percentages) is particularly valuable for the lowest-income quartile but also has a strong impact on the middle class (the reduction in the at-risk percentage for the second and third income quartiles combined is 9.7 percentage points which corresponds to a 19.5 percent relative reduction).

It should be noted that this analysis does NOT attempt to do a comparison between the relative effectiveness of defined benefit vs. defined contribution plans in providing retirement income adequacy; however, it does show that when the value of a defined benefit plan is analyzed for those without any future eligibility in a defined contribution plan, the impact on the at-risk ratings increases to 23.6 percentage points. In other words, for those households without future years of defined contribution eligibility, the presence of a defined benefit accrual at age 65 is sufficient to save nearly 1 out of 4 of these households in the Baby Boomer and Gen Xer cohorts from becoming "at risk" of running short of money in retirement for basic expenses and uninsured medical expenses.

Figure 3

Impact of Age and Income and Presence of Defined Benefit Accrual at Retirement Age on At-Risk* Probabilities

Percentage of population "at risk" for inadequate retirement income, by age and age-specific remaining career income quartiles (baseline assumptions)



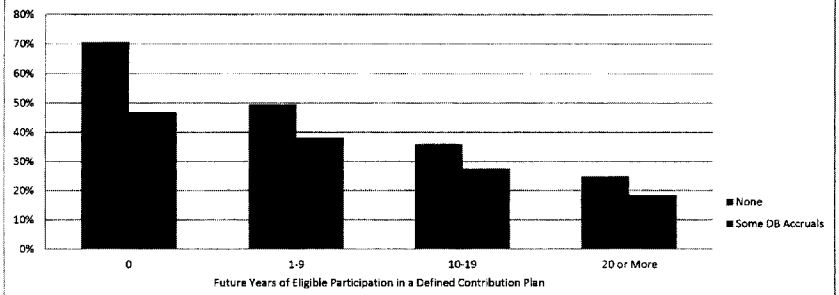
Source: EBRI/ERF Retirement Security Projection Model® version 110714e.

* An individual or family is considered to be "at risk" in this version of the model if their aggregate resources in retirement are not sufficient to meet aggregate minimum retirement expenditures defined as a combination of deterministic expenses from the Consumer Expenditure Survey (as a function of income) and some health insurance and out-of-pocket health-related expenses, plus stochastic expenses from nursing home and home health care expenses (at least until the point they are picked up by Medicaid). The resources in retirement will consist of Social Security (either status quo or one of the specified reform alternatives), account balances from defined contribution plans, IRAs and/or cash balance plans, annuities from defined benefit plans (unless the lump-sum distribution scenario is chosen), and (in some cases) net housing equity (either in the form of an annuity or as a lump-sum distribution). This version of the model is constructed to simulate "basic" retirement income adequacy; however, alternative versions of the model allow similar analysis for replacement rates, standard-of-living, and other ad hoc thresholds.

Figure 4

Impact of Presence of Defined Benefit Accrual at Retirement Age and Future Years of Eligibility for Participation in a Defined Contribution Plan on At-Risk* Probabilities

Percentage of population "at risk" for inadequate retirement income, by Future Years of Eligible Participation in a Defined Contribution Plan (baseline assumptions)



Source: EBRI/ERF Retirement Security Projection Model® version 110714e.

* An individual or family is considered to be "at risk" in this version of the model if their aggregate resources in retirement are not sufficient to meet aggregate minimum retirement expenditures defined as a combination of deterministic expenses from the Consumer Expenditure Survey (as a function of income) and some health insurance and out-of-pocket health-related expenses, plus stochastic expenses from nursing home and home health care expenses (at least until the point they are picked up by Medicaid). The resources in retirement will consist of Social Security (either status quo or one of the specified reform alternatives), account balances from defined contribution plans, IRAs and/or cash balance plans, annuities from defined benefit plans (unless the lump-sum distribution scenario is chosen), and (in some cases) net housing equity (either in the form of an annuity or as a lump-sum distribution). This version of the model is constructed to simulate "basic" retirement income adequacy; however, alternative versions of the model allow similar analysis for replacement rates, standard-of-living, and other ad hoc thresholds.

APPENDIX

BRIEF CHRONOLOGY OF RSPM

The original version of Retirement Security Projection Model® (RSPM) was used to analyze the future economic well-being of the retired population at the State level. The Employee Benefit Research Institute and the Milbank Memorial Fund, working with the governor of Oregon, set out to see if this situation could be addressed for Oregon. The analysis [14] focused primarily on simulated retirement wealth with a comparison to ad hoc thresholds for retirement expenditures, but the results made it clear that major decisions lie ahead if the State's population is to have adequate resources in retirement.

Subsequent to the release of the Oregon study, it was decided that the approach could be carried to other States as well. Kansas and Massachusetts were chosen as the next States for analysis. Results of the Kansas study were presented to the State's Long-Term Care Services Task Force on July 11, 2002,[15] and the results of the Massachusetts study were presented on December 1, 2002.[16] With the assistance of the Kansas Insurance Department, EBRI was able to create Retirement Readiness Ratings based on a full stochastic accumulation model that took into account the household's longevity risk, post-retirement investment risk, and exposure to potentially catastrophic nursing home and home health care risks. This was followed by the expansion of RSPM, as well as the Retirement Readiness Ratings produced by it, to a national model and the presentation of the first micro-simulation retirement income adequacy model built in part from administrative 401(k) data at the EBRI December 2003 policy forum.[17] The basic model was then modified for Senate Aging testimony in 2004 to quantify the beneficial impact of a mandatory contribution of 5 percent of compensation.[18]

The first major modification of the model occurred for the EBRI May 2004 policy forum. In an analysis to determine the impact of annuitizing defined contribution and IRA balances at retirement age, VanDerhei and Copeland (2004) were able to demonstrate that for a household seeking a 75 percent probability of retirement income adequacy, the additional savings that would otherwise need to be set aside each year until retirement to achieve this objective would decrease by a median amount of 30 percent. Additional refinements were introduced in 2005 to evaluate the impact of purchasing long-term care insurance on retirement income adequacy.[19]

The model was next used in March 2006 to evaluate the impact of defined benefit freezes on participants by simulating the minimum employer contribution rate that would be needed to financially indemnify the employees for the reduction in their *expected* retirement income under various rate-of-return assumptions.[20] Later that year, an updated version of the model was developed to enhance the EBRI interactive Ballpark E$timater® worksheet by providing Monte Carlo simulations of the necessary replacement rates needed for specific probabilities of retirement income adequacy under alternative risk management treatments.[21]

RSPM was significantly enhanced for the May 2008 EBRI policy forum by allowing automatic enrollment of 401(k) participants with the potential for automatic escalation of contributions to be included.[22] Additional modifications were added in 2009 for a Pension Research Council presentation that involved a winners/losers analysis of defined benefit freezes and the enhanced defined contribution employer contributions provided as a quid pro quo.[23]

A new subroutine was added to the model to allow simulations of various styles of target-date funds for a comparison with participant-directed investments in 2009.[24] In April 2010, the model was completely re-parameterized with 401(k) plan design parameters for sponsors that have adopted automatic enrollment provisions.[25] A completely updated version of the national model was produced for the May 2010 EBRI policy forum and used in the July 2010 *Issue Brief*.[26]

The new model was used to analyze how eligibility for participation in a defined contribution plan impacts retirement income adequacy in September 2010.[27] It was also used to compute Retirement Savings Shortfalls for Boomers and Gen Xers in October 2010.[28]

In October 2010 testimony before the Senate Health, Education, Labor, and Pensions Committee, on "The Wobbly Stool: Retirement (In)security in America," the model was used to analyze the relative importance of employer-provided retirement benefits and Social Security.[29]

In February 2011, the model was used to analyze the impact of the 2008/9 crisis in the financial and real estate markets on retirement income adequacy.[30]

Finally, an April 2011 article introduced a new method of analyzing the results from the RSPM.[31] Instead of simply computing an overall percentage of the simu-

lated life paths in a particular cohort that will not have sufficient retirement income to pay for the simulated expenses, the new method computes what percentage of the households will meet that requirement more than a specified percentage of times in the simulation.

RETIREMENT INCOME AND WEALTH ASSUMPTIONS

RSPM is based in part on a 13-year time series of administrative data from several million 401(k) participants and tens of thousands of 401(k) plans,[32] as well as a time series of several hundred plan descriptions used to provide a sample of the various defined benefit and defined contribution plan provisions applicable to plan participants. In addition, several public surveys based on participants' self-reported answers (the Survey of Consumer Finances [SCF], the Current Population Survey [CPS], and the Survey of Income and Program Participation [SIPP]) were used to model participation, wages, and initial account balance information.

This information is combined to model participation and initial account balance information for all defined contribution participants, as well as contribution behavior for non-401(k) defined contribution plans. Asset allocation information is based on previously published results of the EBRI/ICI Participant-Directed Retirement Plan Data Collection Project, and employee contribution behavior to 401(k) plans is provided by an expansion of a method developed in VanDerhei and Copeland (2008) and further refined in VanDerhei (2010).

A combination of Form 5500 data and self-reported results was also used to estimate defined benefit participation models; however, it appears information in the latter is rather unreliable with respect to estimating current and/or future accrued benefits. Therefore, a database of defined benefit plan provisions for salary-related plans was constructed to estimate benefit accruals.

Combinations of self-reported results were used to initialize IRA accounts. Future IRA contributions were modeled from SIPP data, while future rollover activity was assumed to flow from future separation from employment in those cases in which the employee was participating in a defined contribution plan sponsored by the previous employer. Industry data are used to estimate the relative likelihood that the balances are rolled over to an IRA, left with the previous employer, transferred to a new employer, or used for other purposes.

DEFINED BENEFIT PLANS

A stochastic job duration algorithm was estimated and applied to each individual in RSPM to predict the number of jobs held and age at each job change. Each time the individual starts a new job, RSPM simulates whether or not it will result in coverage in a defined benefit plan, a defined contribution plan, both, or neither. If coverage in a defined benefit plan is predicted, time series information from the Bureau of Labor Statistics (BLS) is used to predict what type of plan it will be.[33]

While the BLS information provides significant detail on the generosity parameters for defined benefit plans, preliminary analysis indicated that several of these provisions were likely to be highly correlated (especially for integrated plans). Therefore, a time series of several hundred defined benefit plans per year was coded to allow for assignment to the individuals in RSPM.[34]

Although the Tax Reform Act of 1986 at least partially modified the constraints on integrated pension plans by adding Sec. 401(l) to the Internal Revenue Code, it would appear that a significant percentage of defined benefit sponsors have retained Primary Insurance Amount (PIA)-offset plans. In order to estimate the offset provided under the plan formulas, RSPM computes the employee's Average Indexed Monthly Earnings, Primary Insurance Amount, and covered compensation values for the birth cohort.

DEFINED CONTRIBUTION PLANS

Previous studies on the EBRI/ICI Participant-Directed Retirement Plan Data Collection Project have analyzed the average account balances for 401(k) participants by age and tenure. Recently published results (VanDerhei, Holden and Alonso, 2009) show that the year-end 2008 average balance ranged from $3,237 for participants in their 20s with less than 3 years of tenure with their current employer to $172,555 for participants in their 60s who have been with the current employer for at least 30 years (thereby effectively eliminating any capability for IRA rollovers).

Unfortunately, the EBRI/ICI database does not currently provide detailed information on other types of defined contribution plans, nor does it allow analysis of defined contribution balances that may have been left with previous employers. RSPM uses self-reported responses for whether an individual has a defined con-

tribution balance to estimate a participation model and the reported value is modeled as a function of age and tenure.

The procedure for modeling participation and contribution behavior and asset allocation for defined contribution plans that have not adopted automatic enrollment is described in VanDerhei and Copeland (2008). The procedure for modeling contribution behavior (with and without automatic escalation of contributions) for 401(k) plans is described in VanDerhei (2010). Asset allocation for automatic enrollment plans is assumed to follow average age-appropriate target-date funds as described in VanDerhei (2009). Investment returns are based on those used in Park (2009).

SOCIAL SECURITY BENEFITS

Social Security's current-law benefits are assumed to be paid and received by those qualifying for the benefits under the baseline scenario. This funding could either be from an increase in the payroll tax or from a general revenue transfer. The benefits are projected for each cohort assuming the intermediate assumptions within the 2009 OASDI Trustee's Report. A second alternative is used where all recipients' benefits are cut 24 percent on the date that the OASDI Trust Fund is depleted (2037).

EXPENDITURE ASSUMPTIONS

The expenditures used in the model for the elderly consist of two components—deterministic and stochastic expenses. The deterministic expenses include those expenses that the elderly incur in their basic daily life, while the stochastic expenses in this model are exclusively health-event related—such as an admission to a nursing home or the commencement of an episode of home health care—that occur only for a portion of retirement (if ever), not on an annual or certain basis.

DETERMINISTIC EXPENSES

The deterministic expenses are broken down into seven categories—food, apparel and services (dry cleaning, haircuts), transportation, entertainment, reading and education, housing, and basic health expenditures. Each of these expenses is estimated for the elderly (65 or older) by family size (single or couple) and family income (less than $20,000, $20,000–$39,999, and $40,000 or more in 2008 dollars) of the family/individual.

The estimates are derived from the 2008 Consumer Expenditure Survey (CES) conducted by the Bureau of Labor Statistics of the U.S. Department of Labor. The survey targets the total noninstitutionalized population (urban and rural) of the United States and is the basic source of data for revising the items and weights in the market basket of consumer purchases to be priced for the Consumer Price Index. Therefore, an expense value is calculated using actual experience of the elderly for each family size and income level by averaging the observed expenses for the elderly within each category meeting the above criteria. The basic health expenditure category has additional data needs besides just the CES.

HEALTH

The basic health expenditures are estimated using a somewhat different technique and are comprised of two parts. The first part uses the CES as above to estimate the elderly's annual health expenditures that are paid out-of-pocket or are not fully reimbursed (or not covered) by Medicare and/or private Medigap health insurance.

The second part contains insurance premium estimates, including Medicare Part B and Part D premiums. All of the elderly are assumed to participate in Part B and Part D, and the premium is determined annually by the Medicare program and is the same nationally with an increasing contribution from the individual/family on the basis of their income. For the Medigap insurance premium, it is assumed all of the elderly purchase a Medigap policy. A national estimate is derived from a 2005 survey done by Thestreet.com that received average quotes for Plan F in 47 States and the District. The estimates are calculated based on a 65-year-old female. The 2005 premium level is the average of the 47 State average quotes. The 2010 premium level was estimated by applying the annual growth rates in the Part B premiums from 2006 through 2010 to the average 2005 premium.

This approach is taken for two reasons. First, sufficient quality data do not exist for the matching of retiree medical care (as well as the generosity of and cost of the coverage) and Medigap policy use to various characteristics of the elderly. Second, the health status of the elderly at the age of 65 is not known, let alone over the entire course of their remaining life. Thus, by assuming everyone one has a

standard level of coverage eliminates trying to differentiate among all possible coverage types as well as determining whether the sick or healthy have the coverage. Therefore, averaging of the expenses over the entire population should have offsetting effects in the aggregate.

The total deterministic expenses for the elderly individual or family are then the sum of the values in all the expense categories for family size and family income level of the individual or family. These expenses make up the basic annual (recurring) expenses for the individual or family. However, if the individual or family meet the income and asset tests for Medicaid, Medicaid is assumed to cover the basic health care expenses (both parts), not the individual or family. Furthermore, Part D and Part B premium relief for the low-income elderly (not qualifying for Medicaid) is also incorporated.

STOCHASTIC EXPENSES

The second component of health expenditures is the result of simulated health events that would require longterm care in a nursing home or home-based setting for the elderly. Neither of these simulated types of care would be reimbursed by Medicare because they would be for custodial (not rehabilitative) care. The incidence of the nursing home and home health care and the resulting expenditures on the care are estimated from the 1999 and 2004 National Nursing Home Survey (NNHS) and the 2000 and 2007 National Home and Hospice Care Survey (NHHCS). NNHS is a nationwide sample survey of nursing homes, their current residents and discharges that was conducted by the National Center for Health Statistics from July through December 1999 and 2004. The NHHCS is a nationwide sample survey of home health and hospice care agencies, their current and discharge patients, that was conducted by the National Center for Health Statistics from August 2000 through December 2000 and from August 2007 through February 2008.

For determining whether an individual has these expenses, the following process is undertaken. An individual reaching the Social Security normal retirement age has a probability of being in one of four possible assumed "health" statuses: Not receiving either home health or nursing home care; Home health care patient; Nursing home care patient; and Death, based upon the estimates of the use of each type of care from the surveys above and mortality. The individual is randomly assigned to each of these four categories with the likelihood of falling into one of the four categories based upon the estimated probabilities of each event. If the individual does not need long-term care, no stochastic expenses are incurred. Each year, the individual will again face these probabilities (the probabilities of being in the different statuses will change as the individual becomes older after reaching age 75 then again at age 85) of being in each of the four statuses. This continues until death or the need for longterm care.

For those who have a resulting status of home health care or nursing home care, their duration of care is simulated based upon the distribution of the durations of care found in the NNHS and NHHCS. After the duration of care for a nursing home stay or episode of home health care, the individual will have a probability of being discharged to one of the other three statuses based upon the discharge estimates from NNHS and NHHCS, respectively. The stochastic expenses incurred are then determined by the length of the stay/number of days of care times the per diem charge estimated for the nursing home care and home health care, respectively.

For any person without the need for long-term care, this process repeats annually. The process repeats for individuals receiving home health care or nursing home care at the end of their duration of stay/care and subsequently if not receiving the specialized care again at their next birthday. Those who are simulated to die, of course, are not further simulated.

As with the basic health care expenses, the qualification of Medicaid by income and asset levels is considered to see how much of the stochastic expenses must be covered by the individual to determine the individual's final expenditures for the care. Only those expenditures attributable to the individual—not the Medicaid program—are considered as expenses to the individual and as a result in any of the "deficit" calculations.

TOTAL EXPENDITURES

The elderly individuals' or families' expenses are then the sum of their assumed deterministic expenses based upon their retirement income plus any simulated stochastic expenses that they may have incurred. In each subsequent year of life, the total expenditures are again calculated in this manner. The base year's expenditure value estimates excluding the health care expenses, are adjusted annually using the assumed general inflation rate of 2.8 percent from the 2009 OASDI Trust-

ees Report, while the health care expenses are adjusted annually using the 4.0 percent medical consumer price index that corresponds to the average annual level from 2004–9.[35]

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ENDNOTES

1. *www.ebri.org/publications/benfaq/index.cfm?fa=retfaq14*, last accessed July 26, 2011.
2. For a historical review of causes of this decline see Olsen and VanDerhei (1997).
3. See VanDerhei (2007) for a summary of the responses of defined benefit sponsors to the implementation of the new funding requirements under the Pension Protection Act of 2006 as well as the potential pension expense volatility under new FASB requirements.
4. This does not necessarily imply that many existing defined benefit sponsors have or will terminate their existing defined benefit plans. Instead the process of freezing these plans for current and/or new workers has increased substantially in recent years. For more information on the impact of plan freezes on workers see VanDerhei (March 2006). For an analysis of whether "frozen" workers have been financially indemnified via enhanced employer contribution to defined contribution plans, see Copeland and VanDerhei (2010).
5. A brief description of RSPM is included in the appendix.
6. Household deficits for married couples are divided equally between the two spouses.
7. Boston College's Center for Retirement Research has recently estimated a figure of $6.6 trillion in retirement income deficits or "about $90,000 per household if you count all 72 million households ages 32 to 64" (Coombes, 2010). The proper interpretation of this number is somewhat problematic in that it appears that they are assuming virtually none of the 72.6 million households in that age range in the 2007 Survey of Consumer Finances die prior to age 65.
8. This was primarily due to the increased likelihood of future eligibility in a defined contribution plan relative to a defined benefit plan.
9. This assumption will be relaxed in a later study.
10. The term "accrual at age 65" does not denote that an employee age 65 accrued a benefit in that year. Instead, it is meant to indicate that they had a previously accrued benefit that has not been cashed out prior to age 65.
11. It is important to note that this is not the same as assessing the importance of all defined benefit plan accruals. Whenever an employee is assumed to leave a job in RSPM, the present value of the vested defined benefit accrual from the current job is compared with the year-specific involuntary cash-out threshold and converted to a terminated vested status if greater. Any present values less than the threshold are assumed to be cashed out.
12. Specifically, each household is placed into one of four quartiles based on age-specific remaining career income.
13. The value of the absolute difference divided by the at-risk percentage without defined benefit accruals is 21 percent for the lowest-income quartile, 18 percent for the second-income quartile, 21 percent for the third-income quartile and 33 percent for the highest-income quartile.
14. VanDerhei and Copeland (2001).
15. VanDerhei and Copeland (July 2002).
16. VanDerhei and Copeland (December 2002).
17. VanDerhei and Copeland (2003).
18. VanDerhei (January 2004).
19. VanDerhei (2005).
20. VanDerhei (March 2006).

21. VanDerhei (September 2006).
22. VanDerhei and Copeland (2008).
23. Copeland and VanDerhei (2010).
24. VanDerhei (2009).
25. VanDerhei (April 2010).
26. VanDerhei and Copeland (2010).
27. VanDerhei (September 2010).
28. VanDerhei (October 2010a).
29. VanDerhei (October 2010b).
30. VanDerhei (February 2011).
31. VanDerhei (April 2011).
32. The EBRI/ICI Participant-Directed Retirement Plan Data Collection Project is the largest, most representative repository of information about individual 401(k) plan participant accounts. As of December 31, 2009, the database included statistical information about:

- 20.7 million 401(k) plan participants, in
- 51,852 employer-sponsored 401(k) plans, holding
- $1.21 trillion in assets.

The EBRI/ICI project is unique because it includes data provided by a wide variety of plan recordkeepers and, therefore, portrays the activity of participants in 401(k) plans of varying sizes—from very large corporations to small businesses—with a variety of investment options.

33. The model is currently programmed to allow the employee to participate in a nonintegrated career average plan; an integrated career average plan; a 5-year final average plan without integration; a 3-year final average plan without integration; a 5-year final average plan with covered compensation as the integration level; a 3-year final average plan with covered compensation as the integration level; a 5-year final average plan with a PIA offset; a 3-year final average plan with a PIA offset; a cash balance plan, or a flat benefit plan.

34. BLS information was utilized to code the distribution of generosity parameters for flat benefit plans.

35. While the medical consumer price index only accounts for the increases in prices of the health care services, it does not account for the changes in the number and/or intensity of services obtained. Thus, with increased longevity, the rate of health care expenditure growth will be significantly higher than the 4.0 percent medical inflation rate, as has been the case in recent years.

PREPARED STATEMENT OF THE AMERICAN COUNCIL OF LIFE INSURERS (ACLI)

The American Council of Life Insurers (ACLI) commends this committee for holding hearings on the growing retirement security crisis. We applaud Chairman Harkin (D–IA) and Ranking Member Enzi (R–WY) for holding this particular hearing because of its focus on the benefits of retirees receiving lifetime income. ACLI believes that individuals should convert some of their savings to lifetime income at retirement to cover anticipated expenses in retirement. A number of studies demonstrate that retirees receiving lifetime income felt the most secure in their retirement.[1]

The American Council of Life Insurers is a national trade organization with over 300 members that represent more than 90 percent of the assets and premiums of the U.S. life insurance and annuity industry. ACLI member companies offer insurance contracts and investment products and services to qualified retirement plans, including defined benefit pension, 401(k), 403(b) and 457 arrangements and to individuals through individual retirement arrangements (IRAs) or on a non-qualified basis. ACLI member companies' also are employer sponsors of retirement plans for their employees. As service and product providers, as well as employers, we believe that saving for retirement and managing assets throughout retirement are critical economic issues facing individuals and our Nation.

Lifetime income products are a vital piece of the retirement income security puzzle. The General Accounting Office (GAO) released a report on June 7, 2011, titled "Retirement Income: Ensuring Income throughout Retirement Requires Difficult Choices," noting that

> "Experts we interviewed tended to recommend that retirees draw down their savings strategically and systemically and that they convert a portion of their savings into an income annuity to cover necessary expenses or opt for the annu-

[1] EBRI, May 2011 Issue Brief, "Retirement Income Adequacy with Immediate and Longevity Annuities." EBRI, 2011 Retirement Confidence Survey Fact Sheet.

ity provided by an employer-sponsored DB pension, rather than take a lump sum."

Many current retirees are fortunate in that they are receiving lifetime monthly income from both Social Security and an employer-provided defined benefit (DB) pension. That situation is rapidly changing. Today, more workers have retirement savings in defined contribution plans, which generally do not offer the option to elect a stream of guaranteed lifetime income. This change leads to questions of how individuals will manage their savings to last throughout their lifetime. Attached as an addendum to this statement, ACLI has outlined a number of legislative and regulatory initiatives that can help employers assist their employees in obtaining guaranteed lifetime income in the same way they have assisted employees in obtaining life insurance, disability insurance, and other financial protection products. A number of these initiatives were included in the recently issued GAO report.

In addition to employers offering lifetime income options to their workers, workers need to understand the value of their retirement savings as a source of guaranteed lifetime income. The "Lifetime Income Disclosure Act," which is co-sponsored by Senators Bingaman, Isakson and Kohl, will help workers think of their defined contribution plan savings as not only a lump sum balance, but also as a source of guaranteed lifetime income. The legislation would provide every worker with a lifetime income illustration directly on their 401(k) statements. The Federal Thrift Savings Plan has successfully incorporated this feature on Federal workers' statements this year. With this additional information, workers will receive a ball park estimate, which, when coupled with their Social Security statement, visually displays how much monthly income they could potentially receive in retirement based on their current savings. Workers can better decide whether to increase their savings, adjust their 401(k) investments or reconsider their retirement date, if necessary, to assure the quality of life they expect in retirement.

Last, about one-half of workers are not covered by an employer-provided retirement savings plan, so they need to be disciplined to save for their own retirement. For these individuals, nonqualified ("individual") annuities continue to play an important role in their retirement planning. Individuals can contribute to their individual annuities during their working years and convert some of their savings at retirement into lifetime income. Last year, legislation was passed which included a provision to more easily allow individuals to partially convert their annuity savings into a lifetime income stream. However, more can be done. ACLI supports the implementation of a national strategy for financial literacy and education that helps Americans recognize the importance of retirement savings, managing these savings to last a lifetime and how insurance products help families manage risk and protect savings.

Over the long-term, the Nation will benefit because people who address their long-term financial security needs today are less likely to need public assistance tomorrow. Government policies that encourage prudent behavior, such as long-term savings, should not only be maintained, they should be enhanced. Therefore, ACLI continues to urge lawmakers to maintain the availability of annuities and other financial protection products for all Americans and their families by rejecting proposals that would make these products more expensive.

In conclusion, lifetime income products play a vital role in any retirement income security plan. Middle class families feel the most secure in their retirements when they are receiving lifetime income. ACLI has outlined a number of initiatives that would help facilitate the securement of lifetime income. ACLI looks forward to working with the committee in taking these important steps today to help address tomorrow's retirement income security crisis.

ADDENDUM

New laws and regulations can help employers assist their employees in obtaining guaranteed lifetime income in the same way they have assisted employees in obtaining life insurance, disability insurance, and other financial protection products. New laws and regulations can also create an incentive to use guaranteed lifetime income as part of an employee's overall retirement income plan.

Recommendations to Encourage Employers to Offer Annuities

1. Provide Employers with Guidance on Lifetime Income and Education. The ACLI urges the DOL to revise and extend Interpretive Bulletin 96–1 beyond guidance on investment education to include guidance on the provision of education regarding lifetime income and other distribution options, both "in-plan" and outside the plan, to assist participants and beneficiaries in making informed decisions regarding their distribution choices.

2. Help Employers Select an Annuity Provider. The DOL took an important step by changing the so-called "safest annuity standard" in Interpretive Bulletin 95–1 by adopting a safe harbor for the selection of annuity providers for individual account plans. While this regulation provided some helpful guideposts, it contains a requirement that the fiduciary "conclude that the annuity provider is financially able to make all future payments." This standard is difficult to meet, in part because it is hard to know how to draw this conclusion. While it is part of a "safe harbor," this prong makes it difficult to use the safe harbor and thus is an impediment to the offer of annuities in defined contribution plans. ACLI believes that changes can be made to these rules which will make it easier for employers to meet their duties while at the same time ensuring a prudent selection. We plan to work with the Department of Labor to simplify this requirement so that an employer can more easily and objectively evaluate the financial stability of the annuity provider.

3. Annuity Administration. Employers take on a number of duties in administering a retirement plan, and the administration of an annuity option would increase those duties. The qualified joint and survivor annuity ("QJSA") rules provide important spousal protections. The notice and consent requirements provide spouses with an opportunity to consider the survivor benefits available under a joint and survivor annuity. However, these rules add an additional layer of administrative complexity as well as technical compliance issues that most plan sponsors choose to avoid by excluding annuities from their plans.

There are a number of ways that the rules can be modified to make it easier for employers to administer this important requirement while protecting survivors, including:

- model plan amendments for employers to add guaranteed lifetime income options;
- simplify QJSA notice requirements; and
- the use of electronic signatures, widely accepted in financial transactions today.

ACLI proposes allowing those employers who choose to do so to transfer the duties and liabilities of administering qualified joint and survivor annuity rules to an annuity administrator. Also, employers need guidance that confirms that a participant's purchase of incremental deferred payout annuities should not be subject to the QJSA rules until the participant has elected to take the annuity payout.

4. Partial Annuitization Option. Some employers view annuitization as an "all-or-nothing" distribution offering. In our RFI submission, we asked the Departments to provide guidance making clear that plans may provide retirees with the option to use a portion of the account value to purchase guaranteed lifetime income, including model amendments to simplify the adoption of such provision.

Recommendations to Encourage Workers to Elect Annuities

1. Illustration. To reframe retirement savings as a source of lifetime income, ACLI supports legislative proposals to include an illustration of participant accumulations as monthly guaranteed lifetime income on defined contribution plan benefit statements. ACLI thanks Senators Kohl, Bingaman and Isakson for their bipartisan sponsorship of S. 2832, the Lifetime Income Disclosure Act, in the 111th Congress. This bill would help workers understand how their retirement savings might translate into guaranteed lifetime income.

2. Information. The ACLI has asked the Treasury Department to modify the 402(f) rollover notice requirements and the safe harbor notice to include information on guaranteed lifetime income, including the importance of income protections and the availability of lifetime income plan distribution options, if any, as well as lifetime income options available outside the plan.

ATTACHMENTS

February 2009

ENCOURAGE ANNUITY OPTIONS FOR DEFINED CONTRIBUTION PLANS

Problem: Currently, about one-half of employees' retirement savings is in defined contribution plans. Most defined contribution plans do not contain guaranteed lifetime income (annuity) distribution options notwithstanding that annuitization of account balances on retirement is the best way of assuring that retirement funds will not be exhausted during the participant's life. Early exhaustion of account balances may also adversely affect surviving spouses.

A major reason that defined contribution plans do not provide guaranteed lifetime income options is that, if they do so, the plan must then comply with burdensome

statutory requirements relating to joint and survivor annuities. The J & S rules impose costly and burdensome administrative requirements involving notifications to spouses, waivers by spouses, and prescribe the form and amount of spousal benefits. A major reason for the shift to defined contribution plans is a desire by employers to avoid the administrative cost and complexity associated with defined benefit plans, including compliance with joint and survivor annuity requirements.

A potential solution to this problem would be for the plan sponsor to outsource the administration of the joint and survivor annuity rules to the annuity provider. However, in the event of a failure of the annuity provider to properly administer the rules, the plan and plan sponsor would still be liable for a claim for benefits under Section 502 of ERISA.

Solution: Where the plan sponsor and the annuity provider have agreed that the annuity provider will be responsible for administration of the joint and survivor annuity rules, provide that enforcement actions for failure to comply with the joint and survivor annuity rules may only be maintained against the annuity provider, provided that the plan sponsor or administrator has prudently selected and retained selection of the annuity provider. Make this provision applicable only to administration of the joint and survivor annuity rules under defined contribution plans. The electronic delivery rules should be modified to allow greater use of electronic means for administration of the J & S rules.

Rationale: The ability to shift responsibility for the administration of the joint and survivor annuity rules would make guaranteed lifetime income (annuity) options more attractive to plan sponsors and could result in significantly wider availability of such annuity payment options under defined contribution plans. While this approach would retain the cost and complexity of the annuity rules, it would preserve spousal protections and would permit the plan and plan sponsor to shift responsibility to an experienced third party annuity provider. This provider would be an insurance company with experience in annuity administration and a secure financial ability to pay annuities. These factors makes shifting responsibility to annuity issuers more beneficial to and protective of plan participants, beneficiaries (including surviving spouses) and the plan sponsor than leaving responsibility with the plan and plan sponsor.

Electronic administration is more cost efficient and has become more widely used. DOL has indicated that they are modifying their regulation on electronic delivery, although it is not known whether the modification will cover the QJSA rules.

SECTION__

(a) AMENDMENTS TO THE EMPLOYEE RETIREMENT INCOME SECURITY ACT OF 1974.—

(I) IN GENERAL—Section 402(c) of the Employee Retirement Income Security Act of 1974 (29 U.S.C. 1102(c)) is amended—

(A) in paragraph (2) by striking "or" at the end;

(B) in paragraph (3) by striking the period at the end and inserting "; or"; and

(C) by adding at the end the following new paragraph:

"(4) that a named fiduciary, or a fiduciary designated by a named fiduciary pursuant to a plan procedure described in section 405(e), may appoint an annuity administrator or administrators with responsibility for administration of an individual account plan in accordance with the requirements of Section 205 and payment of any annuity required thereunder."

(2) Section 405 (29 U.S.C. 1105) is amended by adding at the end the following new subsection:

"(e) Annuity Administrator

If an annuity administrator or administrators have been appointed under section 402(c)(4), then neither the named fiduciary nor any appointing fiduciary shall be liable for any act or omission of the annuity administrator except to the extent that——

(1) the fiduciary violated section 404(a)(l)—

(i) with respect to such allocation or designation, or

(ii) in continuing the allocation or designation; or

(2) the fiduciary would otherwise be liable in accordance with subsection (a)."

(3) Section 205(b) (29 U.S.C. 1055) is amended by adding at the end the following new sentence:

"Clause (ii) of subparagraph (C) shall not apply if an annuity administrator or administrators have been appointed under section 402(c)(4)."

(b) AMENDMENTS TO THE INTERNAL REVENUE CODE OF 1986—

(1) IN GENERAL—Section 401(a)(11) of the Internal Revenue Code of 1986 (relating to requirements of joint and survivor annuities and preretirement survivor annuities) is amended by adding at the end the following new sentence:

"Clause (iii) (II) shall not apply if an annuity administrator or administrators have been appointed under section 402(c)(4) of the Employee Retirement Income Security Act of 1974."

(c) ELECTRONIC DELIVERY

(I) IN GENERAL—The Secretary of the Department of Labor shall modify the regulations under section 104 or section 205 of the Employee Retirement Income Security Act of 1974 to provide a broad ability to administer the requirements of section 205 of the Employee Retirement Income Security Act of 1974 by electronic means.

"ACLI Retirement Choices Study," by Mathew Greenwald & Associates, Inc, April 2010. (*see http://www.acli.com/Issues/Documents/f3ce56cc76ca4060a5cb9fae03ce5f96Report__ACLIRetirementChoicesStudy.pdf)*

[Editor's Note: Due to the high cost of printing, previously published materials are not reprinted.]

THE AMERICAN SOCIETY OF PENSION PROFESSIONALS & ACTUARIES (ASPPA)*

COMMENTS ON PROPOSED ADDITIONAL RULES REGARDING HYBRID RETIREMENT PLANS

The American Society of Pension Professionals & Actuaries (ASPPA) appreciates this opportunity to comment on the proposed additional rules regarding hybrid retirement plans as issued by the IRS and Treasury on October 19, 2010 (REG–132554–08).

ASPPA is a national organization of more than 7,500 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, investment professionals, administrators, actuaries, accountants and attorneys. Our large and broad-based membership gives ASPPA unique insight into current practical applications of 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 employer-sponsored retirement plan system. All credentialed actuarial members of ASPPA are members of the ASPPA College of Pension Actuaries (ASPPA COPA), which has primary responsibility for the content of comment letters that involve actuarial issues.

References are to the Internal Revenue Code of 1986 and Treasury regulations unless otherwise specified.

SUMMARY OF RECOMMENDATIONS

The following is a summary of ASPPA COPA's recommendations which are described in greater detail in the Discussion of Issue section.

I. Final regulations should provide § 411(d)(6) relief for changing the method of calculating immediate annuity options.

II. Final regulations should provide a safe harbor definition of "reasonable assumptions".

III. Final regulations should provide additional guidance about statutory hybrid plans and § 411(a)(9).

IV. Final regulations should include a "set and forget" conversion rule.

V. Final regulations should make it clear that general testing rules are not available to show compliance with § 411 if the market rate of return and preservation of capital rules are not satisfied.

VI. Final regulations should clarify that a plan using segment rates can reference either current or prior stability period rates to determine the current stability period interest credit.

VII. Final regulations should clarify that partial interest credits are permitted on amounts distributed between interest crediting dates.

VIII. Final regulations should allow for the use of an interest crediting rate based on an index.

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* Department of Treasury, Internal Revenue Service (26 CFR Part 1 [REG–132554–08])

IX. Final regulations should provide that when certain events occur a plan would be permitted to substitute a comparable RIC or index based on the stated investment objectives of the original RIC, without concern for protected benefit rights under § 411(d)(6).

X. Final regulations should clarify that, for plans that use a crediting rate equal to the trust's actual rate of return, changes in actual investments do not present issues under the § 411(d)(6) anti-cutback rules.

XI. Final regulations should clarify that the annuity conversion rates for a terminated plan applicable at normal retirement also apply at a participants early retirement date.

XII. Final regulations should provide additional § 411(d)(6) relief and guidance for changes to interest crediting rates.

XIII. Final regulations should provide additional guidance on how the accrual rules apply to a floor offset arrangement that includes a cash balance plan.

XIV. Final regulations should provide guidance on the application of nondiscrimination, coverage, participation, accrual and maximum benefit rules when a plan uses a variable rate.

XV. If participant choice is permitted, regulations should provide new safeguards to participants in exchange for workable rules for plan sponsors.

DISCUSSION OF ISSUES

I. **Early retirement benefit conversion options.** Based on prior IRS requirements that the accrued benefit be stated solely as the monthly annuity payable at normal retirement age, and the § 411(a) requirement that all optional forms be at least actuarially equivalent to the normal retirement benefit (on the basis of reasonable actuarial assumptions), many plans contain provisions requiring that the benefit payable in an optional form be at least actuarially equivalent to the accrued benefit payable at normal retirement. Section 1.411(a)(13)–1(b)(3) of the proposed regulations removes this "annuity whipsaw", but without § 411(d)(6) relief, these plans are unable to take advantage of it.

ASPPA COPA recommends that § 411(d)(6) relief be provided for plan amendments that change the amount payable under an optional form of payment from the actuarial equivalent of the projected annuity payable at normal retirement date to the actuarial equivalent of the current hypothetical account balance.

II. **Reasonable assumptions.** In the proposed regulations, § 1.411(a)(13)–1(b)(3) frequently uses the expression "reasonable assumptions." However, this expression is not defined. Given the broad range of plan designs and employee groups, it is difficult to contemplate a regulation adequately defining this term. For the benefit of plan sponsors, particularly small plan sponsors, it would be extremely helpful to have certain assumptions identified as "deemed reasonable".

ASPPA COPA recommends that certain assumptions should be deemed reasonable, but the term should not be defined. For example, interest rates that satisfy the definition of market-rate of return should be deemed reasonable interest rates. Additionally, ASPPA COPA recommends that the § 417(e) mortality, and no preretirement mortality, be deemed reasonable mortality.

III. **Decreases in benefits.** Section 411(a)(9) provides that the normal retirement benefit cannot be less than the early retirement benefit. Section 411(b)(1)(G) provides that a participant's benefit may not be decreased on account of increasing age or service. In a hybrid plan that provides market rate interest credits, it is easy to construct examples where the participant's monthly annuity benefit payable at age 63 is greater than the monthly annuity benefit payable at normal retirement age. Practitioners are confused about how to apply these rules and plan sponsors and participants would be best served by having clear guidance.

ASPPA COPA recommends that final regulations clarify:

- That decreases in benefits due to interest crediting rates decreasing or being negative are not a decrease in benefit due to increasing age or service.
- That decreases in benefits due to variable assumptions (such as § 417(e) assumptions) used to convert lump sum balances to annuities changing as described in the plan are not a decrease in benefit due to increasing age or service.
- That for purposes of § 411(a)(9) an early retirement benefit is any immediate annuity payable prior to normal retirement age whether or not a plan labels it an early retirement benefit. Guidance should explain when early retirement benefits need to be determined (for example, annually based on plan or birth date, at the end of each interest crediting period, etc.).
- How lump sums should be calculated in the case of an account-based plan where due to decreases in the hypothetical account balance the early retirement benefit exceeds the otherwise calculated normal retirement benefit. Should the plan

pay the account balance or as described in proposed regulation § 1.411(a)(13)–1(b)(4)(ii) the sum of the account balance and the § 417(e) lump sum based upon the difference in the early retirement benefit and the otherwise calculated normal retirement benefit?

IV. **"Set and forget" conversion rule.** The alternative method for establishing an opening account balance in the proposed regulation requires ongoing testing and adjustments that are not workable administratively.

ASPPA COPA recommends that the Service reconsider this alternative. As suggested in our original comments submitted March 27, 2008, final regulations should allow plans without early retirement subsidies that establish opening hypothetical account balances no less than the single sum value of the accrued benefit using § 417(e) mortality and interest to avoid future comparisons. This methodology would generally be cost effective for the small employer-sponsored plans with little or no possibility of discrimination in favor of HCEs.

V. **Noncompliant interest crediting rates.** Section 411(b)(5)(B)(i) and (ii) state that an applicable defined benefit plan "shall be treated as failing" to comply with the requirements of § 411 (b)(1)(H) unless the market rate of return and preservation of capital requirements are met. The fact that these are requirements, not safe harbors, is not clearly stated in the proposed regulations, however, and the lack of a clear statement has led to some confusion.

ASPPA COPA recommends that final regulations make it clear that interest credits that do not conform with the market rate of return or the preservation of capital rules under § 411(b)(5)(B)(i) may not use the general testing rule for age discrimination in § 411(b)(l)(H) to show compliance with § 411.

VI. **Lookback period.** Some plans have been drafted to base interest credits applied to hypothetical accounts using a lookback month during the current plan year while others have been drafted to use a rate determinable at the beginning of the plan year based on a lookback month during the prior plan year. For example, the 2010 interest credit under some plans is based on the November 2010 30-year rate while others define the rate for 2010 using the November 2009 rate. Both options apparently were acceptable under Notice 96–8.

Under § 1.411(b)(5)–1(d)(1)(iv)(B) a plan would seem to be limited to using an interest crediting rate based on one of the lookback months from the prior year: ". . . a plan that is using one of the interest crediting rates described in paragraph (d)(3) or (d)(4) of this section can determine interest credits for a stability period based on the interest crediting rate for a specified lookback month with respect to that stability period. For purposes of the preceding sentence, the stability period and lookback month must satisfy the rules for selecting the stability period and lookback month under § 1.417(e)–1(d)(4), although the interest crediting rate can be any one of the rates in paragraph (d)(3) or (d)(4) of this section and the stability period and lookback month need not be the same as those used under the plan for purposes of section 417(e)(3)."

We believe it should not be an imperative that the interest crediting rate under a cash balance rate be tightly tied to the period for which a credit is provided. It is necessary that the rate be definitely determinable and that the rate not be in excess of a market rate of return. But the use of a rate tied to the beginning of the period is no more "accurate" than a rate tied to the end of the period.

ASPPA COPA recommends that the final rule be clarified to accommodate both choices as long as the plan document describes the interest rate credit in a definitely determinable manner.

VII. **Crediting interest on distributions during the year.** Final regulation § 1.411(b)(5)–1(d)(1)(iv)(C) provides that "Interest credits under a plan must be provided on an annual or more frequent periodic basis and interest credit must be credited as of the end of the period." Proposed regulation § 1.411(b)(5)–1(d)(1)(iv)(D) provides that "A plan is not treated as failing to meet the requirements of this paragraph (d) merely because the plan does not provide for interest credits on amounts distributed prior to the end of the interest crediting period." The proposed regulation does not provide guidance that would be helpful for those plan sponsors who choose to credit interest on balances paid before the end of the period.

ASPPA COPA recommends that the final regulations clarify that it is permissible to prorate interest credit for the year of the participant's distribution for situations where payment is made prior to the next interest crediting date. Guidance should provide that if the actual crediting rate is not known, the rate used to project the hypothetical account balance to normal retirement age, a lesser rate, or a fixed rate could be used for this purpose. Guidance should also make it clear that the date through which interest is credited can be a date as of which the distribution is intended to be paid, and need not be the date the distribution actually is paid from the trust.

VIII. **Use of an index.** The proposed regulations do not endorse the use of an interest crediting rate that is based on an index, and generally requires that a Registered Investment Company (RIC) would have to be used for equity-based options. The apparent explanation for this requirement is that the use of the index itself will provide a return greater than a market rate of return because it does not reflect the underlying expenses inherent in actually investing funds. Also, a RIC that is based on an index will not exactly replicate the results of the index because when the makeup of an index changes, there is a lag before the RIC can adjust its holdings to match the index. The Service notes that a RIC can cease to exist or change its investment strategy and has asked for comments on how additional guidance should deal with these possibilities.

We agree that changes in RICs used as the basis to determine interest crediting rates can be problematic because the RIC may cease to exist or may be modified over time. We believe that this is much less likely to be a concern with broadly used indexes. To adjust for the concern that the index itself does not reflect a true market rate of return because of transaction costs and timing differences, a set reduction could be required. To reflect the reduced cost of investing in an index fund as contrasted with managed funds, the adjustment should be relatively small.

ASPPA COPA recommends that final guidance allow for the use of an interest crediting rate based on a widely acknowledged index. If indeed there is concern that such a rate would be greater than a market rate of return, final guidance could require a reduction in the rate by a minimum number of basis points (e.g., 20 bp).

IX. **Required changes in RICs.** The Service has asked for comments on how § 411(d)(6) would apply if a selected RIC ceases to exist or if the RIC substantially changes its investment strategy.

When an interest crediting rate is based on a RIC, or several RICs, the plan sponsor and plan participants anticipate that each RIC will continue to be in existence and that the investment strategy in existence as of the date the RIC was selected will continue. However, this is not always the case and the discontinuance of a RIC or a change in the investment strategy of the RIC will upset those expectations. Under these circumstances the plan sponsor should be allowed to replace such RIC with another RIC that provides the same (or similar) investment strategy and underlying expenses as the original RIC. Such a change should not be viewed as an amendment to the plan that is subject to anti-cutback requirements. If the RIC no longer exists, the actual investment income is zero. If there is a change in investment strategy, the replacement RIC that brings the choice back to the originally selected strategy has the effect of protecting the original expectations. Neither circumstance represents a settlor-type decision to change the underlying promise of the benefit defined by the plan—which would be the type of change the anti-cutback rule addresses. Plan document language could specify the conditions under which the substitution would be made so as to restrict the plan sponsor's discretion about the time of the change or the selection of the new RIC.

ASPPA COPA recommends that plan sponsors should be allowed to replace an existing RIC with a similar RIC without considering the change to an amendment that is subject to § 411(d)(6) restrictions. Final regulations could specify the type of documentation needed to implement the change in the RIC, suggest plan language that would be suitable to avoid employer discretion about the substitution, and provide guidance on what constitutes a similar RIC.

X. **Actual investment return and accrued benefits.** Assuming the diversification requirements are satisfied, the proposed regulations allow a plan to provide an interest crediting rate based on the actual rate of return on the aggregate assets of the plan. Fiduciaries need to be assured that a change in investment policy, or individual investments being selected, would not constitute a violation of anti-cutback rules under § 411(d)(6) or an impermissible forfeiture under § 411(a).

ASPPA COPA recommends that the final rule should clarify that a plan using actual investment results for the interest crediting rate is not constrained by anti-cutback or impermissible forfeiture rules, with respect to accrued, normal, or early retirement benefits, stemming from changes in investment decisions made by the plan fiduciary.

XI. **Annuity conversion rates for terminated plans.** Proposed regulation § 1.411(b)(5)–1(e)(2)(i)(B) provides guidance regarding the interest rate and mortality table used to calculate any benefit under the plan payable in the form of an annuity commencing *at or after normal retirement age*. Guidance is not provided on the conversion rates at earlier ages. Guidance is also not provided on how the 5-year average is to be determined if the plan is terminated mid-year.

ASPPA COPA recommends that the final regulations clarify that the annuity conversion rates required by this section also apply prior to normal retirement date. Guidance should also be provided on acceptable methods for determining the 5-year

average interest credit for mid-year terminations such as dropping the rate applicable to the year of termination or annualizing the rate for the short period up to the plan termination date.

XII. **Anti-cutback relief.** In the final regulations, § 1.411(b)(5)–1(e)(3)(ii) provides prospective § 411(d)(6) protection for plans with an interest crediting rate that exceeds a market rate of return to modify the rate to the extent necessary to satisfy the market rate of return rules. However, plan administrators need additional relief and guidance for several situations such as the following:

• In an effort to comply with the Pension Protection Act (PPA), a plan administrator whose plan document specified an interest crediting rate in excess of a market rate of return operationally applied a lower interest crediting rate than specified in the plan document. The lower interest crediting rate was chosen by the plan administrator to be consistent with the plan administrator's interpretation of the requirements of PPA. Plan participants were provided an ERISA § 204(h) notice that explained the change in the interest crediting rate. A retroactive plan amendment is needed to conform the document to operations as contemplated by § 1107 of PPA.

• A plan document has an interest crediting rate in excess of market rate of return and plan operations reflected the documented rate. The final regulations provide that § 411(d)(6) relief is available allowing the plan sponsor to prospectively change the interest crediting rate, but additional guidance is needed to address whether the interest crediting rate can be amended retroactively with § 411(d)(6) protection to conform to the final regulations.

• A plan is using an interest crediting rate that satisfies the requirements of § 1.411(b)(5)–1(d)(3) or §1.411(b)(5)–1(d)(4). However, the plan's method of applying this rule is not consistent with the requirements of § 1.411(b)(5)–1(d)(1)(iv)(B) which are effective for plan years after 2010. For example, instead of using a look-back month, the plan chooses the rate based upon the rate in effect on a single day.

ASPPA COPA recommends that § 1.411(b)(5)–1(e)(3) be amended to:

• Provide that a plan may be amended to conform its operational interest crediting rate for the first plan year beginning after the passage of PPA through the last day of the plan year ending after the final regulations are issued without a requirement to also provide the rate stated in the plan document, if greater, if the following conditions are met:

- The plan operationally used the interest crediting rate.
- The plan had a good faith belief that the plan as written did not conform to the requirements of PPA.
- The plan had a good faith belief that the lower interest crediting rate satisfied the statutory requirements of the PPA.

• Provide guidance on retroactive amendments to interest crediting rates to conform to the requirements of PPA.

• Provide § 411(d)(6) relief for plans with an acceptable interest crediting rate under § 1.411(b)(5)–1(d)(3) or § 1.411(b)(5)–1(d)(4) to amend the method of applying their interest credit rate to conform with § 1.411(b)(5)–1(d)(1)(iv)(B). In amending to conform with § 1.411(b)(5)–1(d)(1)(iv)(B) plan sponsors should be able to choose any acceptable options under § 417(e) for look back month, averaging, and stability period without regard to their current methodology and should be permitted to modify those methods without a requirement to provide the greater of two rates for the period prior to actual amendment of the plan.

XIII. **Floor offset arrangements.** Floor offset arrangements are specifically permitted in assessing age discrimination under § 411(b)(5)(C) to the extent otherwise permitted under § 401(a). Existing guidance on floor offset arrangements (principally Rev. Rul. 76–259) explains how an offset arrangement would apply where traditional plan benefits are offset by benefits provided from a true defined contribution account. Example 3 in the new final hybrid regulation at § 1.411(a)(13)–1 illustrates the 3-year vesting rule in a situation where a traditional plan benefit is offset by the cash balance account in a separate plan, thus confirming that floor-offset arrangements can be constructed with defined benefit as well as defined contribution offsets.

Guidance is needed on how the accrual rules are applied to the plans where a cash balance account is used in a floor offset arrangement. As in the case of a defined contribution offset, the net benefit from the richer plan should not be required to independently show that it satisfies an accrual rule. As in the case of a defined contribution offset, the floor offset should be limited to the amount provided from the vested portion of the hypothetical account.

Guidance is also needed for floor offset arrangements that consist of a cash balance plan offset by allocations under a defined contribution plan. Arguably, rules for such plans are already in place in Rev. Rul. 76–259. However, some interpret

current requirements to permit a plan design that offsets allocations against cash balance credits on an annual basis. We have concerns about the impact of such a design on the accrual rule that must be satisfied by the cash balance plan.

ASPPA COPA recommends that final regulations clarify that floor offset arrangements comprised of two defined benefit plans are tested under the accrual rules in aggregate and that the offset is limited to the vested portion of the offset benefit. This treatment would be comparable to the rule for defined contribution plans in Rev. Rul. 76–259.

In addition, ASPPA COPA recommends that regulations clarify that cash balance principal credits cannot be offset by defined contributions on an annual basis.

XIV. **Testing methodology with variable rates.** The cash balance safe harbor testing method in § 1.401(a)(4)–8(c)(3)(v)(B) provides that, if a cash balance plan uses a variable interest crediting rate, the rate specified in the plan that is used to project the account balance must be either the interest crediting rate for the current period, or an average of the rate for one or more prior periods not to exceed 5 years. Based on this regulation, which has not been updated for PPA, practitioners believe it is reasonable to use a rate that meets this safe harbor to project benefits for purposes of § 401(a)(4), § 401(a)(26), § 411, § 415 and § 416. Although the use of current, or recent, investment results to predict future returns has been the safe harbor, it does not reflect the fact that long-term returns are unlikely to be the same as recent returns—especially in times of irrational exuberance or bear markets. (In fact, the preamble to the proposed regulations notes that a 5-year average of equity rates is not a good predictor of future equity rates of return. Presumably a current year rate would also not be predictive.) The proposed regulations acknowledge the difficulty inherent in projecting negative returns for purposes of § 411, and permit an assumption of zero return when return is negative. The proposed regulation does not extend this approach to other code sections.

Placing a cap and floor on interest crediting rates used for projection would result in more realistic projections of hypothetical account balances than the current methodology based on a current rate or recent average. A concern about permitting a floor in excess of zero is that existing hypothetical balances may reflect unusually high returns, a negative return may just be part of returns reverting to the long term norm, and using a minimum crediting rate when returns are negative will overstate projected balances. However, if there were also a cap on the crediting rate, the cap would have prevented the (probably more significant) overstatement of likely projected balances that resulted from projecting the prior hypothetical account at an irrationally high long term rate.

ASPPA COPA recommends that final regulations provide guidance on the application of nondiscrimination, coverage, participation, accrual and maximum benefit rules when a plan uses a variable interest crediting rate. Specifically guidance should:

- Permit cash balance plans to project hypothetical balances for testing purposes, including § 401(a)(4), § 401(a)(26), § 411, and § 415, using the crediting rate for the most recent period or an average of prior periods, subject to minimum and maximum interest crediting rates. The floor could be, for example, the average rate of return on 1-year Treasury constant maturities and the cap the average of the S&P 500 over a 40-year period (a typical working lifetime).
- Provide safe harbor principle credit amounts that will be deemed to satisfy the meaningful benefit requirement of § 401(a)(26). Because determination of an appropriate credit should consider the methodology adopted for projecting benefits, ASPPA COPA requests that there be an opportunity to comment further on this issue when further guidance is provided on applying variable interest crediting rates for testing purposes.
- Clarify that the present value of accrued benefits for purposes of determining top heavy status is the hypothetical account balance as of the determination date.

XV. **Participant choice.** The preamble to the proposed regulations asks for comments on whether or not a statutory hybrid plan should be allowed to offer participants a menu of hypothetical investment options, including a life-cycle investment option under which participants are automatically moved into a less aggressive investment mix as they near retirement. ASPPA COPA has serious concerns about permitting participant choice of interest crediting rates. The defined benefit system has historically offered participants and spouses additional protections over the defined contribution system. However, the introduction of an alternative to 401(k) plans that provides a defined contribution allocation rather than elective deferral (pay credit), minimum guarantee, and automatic, though waivable, qualified joint and survivor benefits may be an option that many plan sponsors and plan participants value. If participant choice is offered in the defined benefit system, the addi-

tional protections need to be preserved, and a number of other issues will need to be addressed to assure these plans are workable administratively and not fraught with hidden liabilities for employers and fiduciaries.

A. **Choice of benefit structures.** The choice of interest crediting rates in a cash balance plan represents a participant being offered a choice between two different benefit structures. If participants are offered a menu of potential interest crediting rates, participants need to be provided with adequate information about how their choices will impact their potential monthly annuity benefit including how their choices will impact the assumptions used to convert their account balance to an annuity.

If participant choice of interest crediting rates is permitted, ***ASPPA COPA recommends*** that participants and their spouses should be provided information about the impact of their choices on their monthly annuity in advance of participants making interest credit choices.

B. **Disclosure.** Participant accounts in defined contribution plans either have the protection of the prudent expert rule or are subject to the rules of ERISA § 404(c). Thus, unless the participants are given the disclosures and information required under ERISA § 404(c) (and other protections, including the right to change investment elections at least quarterly), the trustees remain responsible for the investment performance of the participants' accounts. Similar protections for participants would not exist in a participant-directed cash balance plan under current law. PPA's addition of the preservation of capital rule for cash balance plans does not adequately make up for the loss of protection.

Thus, while the selection of an investment menu offered to participants is clearly a fiduciary duty in a defined contribution plan, in a defined benefit plan it would be settlor function; simply a plan design choice. Absent requirements in the regulations to provide basic disclosure about the hypothetical investment menu and other ERISA § 404(c)-type protections, the defined benefit plan that is supposed to provide greater security to the participant would have none of the protections extended to participants in the (supposedly less secure) defined contribution plans.

If participant choice of interest crediting rates is permitted, ***ASPPA COPA recommends*** that disclosure requirements similar to those for ERISA § 404(c) be required of cash balance plans offering choice. However, unlike ERISA § 404(c), cash balance plans should not be required to permit election changes more frequently than annually. Also, a cash balance plan should be able to limit options to a range of life-cycle funds, or funds representing conservative and moderate investment mixes so as to limit volatility for individual participants.

C. **Moral hazard.** With participant directed cash balance plans there are additional moral hazards for trustees and plan sponsors. The duty of a defined benefit plan trustee to invest so as to manage volatility would seem to be at odds with the ability of participants to elect an aggressive interest crediting option. If participants make aggressive elections, either assets would have to be invested aggressively, leading to volatile returns, or the plan sponsor could expect additional volatility in contributions. It can be argued that it is always prudent to invest the assets in a defined benefit plan in such a way that the assets exactly track the increases and decreases in plan liabilities. This would effectively lead to permitting defined benefit plan assets to be invested to track participant elections (thus shifting all investment risks from the plan sponsor to the plan participant), but without a structure similar to ERISA 404(c) to protect the electing participants and the fiduciaries. In the alternative, if the plan's investments are invested according to a traditional defined benefit investment strategy which does not correlate to participants' aggressive elections, there is a possibility that a well-funded plan could become underfunded very quickly in a period when aggressive investments perform well. This could lead to additional exposure for the PBGC and put participants at risk for shortfalls in anticipated benefits.

Because the interest crediting rate is part of the accrued benefit, and all related future interest credits are accrued at the time a participant accrues a pay credit, some would argue that a change in the crediting rate would appropriately be treated as a plan amendment for § 411(d)(6) purposes. A similar result arises from the notion that participants in a qualified retirement plan are not permitted to waive all or any part of their accrued benefit. An election of a different interest crediting rate would effectively be a waiver of any part of the benefit that would have been payable had the change not been made. In either view, the effect would be that the benefit resulting from the changed participant choice cannot be less than would have been provided applying the previously chosen interest crediting rate. If plans had to operate under this paradigm, participants would be encouraged to select one rate and subsequently change to another rate with different characteristics to achieve the greater of the two results. This moral hazard could be limited by placing

restrictions on the ability to change investments. However, limiting the ability to change when an initial election is no longer (or never was) appropriate would eliminate a right available under a self-directed defined contribution plan (with quarterly or more frequent changes permitted), placing participants in a defined benefit plan at a relative disadvantage.

If participant choice of interest crediting rates is permitted, ***ASPPA COPA recommends*** that:

• Plans permitting participant choice be required to provide the 3 percent aggregate minimum allowed for equity based interest credit rates for all hypothetical accounts under the plan.

• A change of election relating to an existing hypothetical account not be treated as a plan amendment or impermissible waiver of accrued benefit under § 411.

While PPA set capital preservation as the appropriate minimum in cash balance plans, if participant choice of interest crediting rates is permitted, a higher minimum is necessary to combine protection of accrued benefits with workable rules and to mitigate moral hazard. Since plan sponsors are not required to employ the prudent expert rule in determining the proper menu of funds for participant direction in cash balance plans, this minimum will also help to insure that sponsors choose funds of appropriate quality and risk characteristics. This combination of a higher cumulative minimum and § 411 relief would provide participants with greater protection than a defined contribution plan, while permitting flexibility in cash balance plan design.

D. **Other guidance required.** If choice of investment crediting rates is permitted, guidance would need to address the following concerns:

• § *401(a)(4).* Current regulations would already require that interest crediting rate options be available on a nondiscriminatory basis. Guidance should provide that changes in elections can only be prospective, and § 401(a)(4) testing is based on the interest crediting rate in effect on the testing date.

• § *401(a)(26).* Guidance should provide that benefit projections are based on the interest crediting rate in effect on the determination date.

• § *411(a).* Guidance should provide that no forfeiture occurs as a result of a change in an interest crediting rate election.

• § 411(b). As with other plan amendments, the application of the accrual rules would be based on the prospective interest crediting rate.

• § 411(b)(5). The § 411(b)(5) safe harbor regulations would have to be modified to provide that the similarly situated test is applied assuming a history of identical elections of investment choice for older and younger workers.

• *Alternative option.* Assuming the 3 percent cumulative minimum is required, and choices are available on a nondiscriminatory basis, plans should be permitted to use the cumulative 3 percent account to apply the general nondiscrimination test of § 401(a)(4), and to demonstrate compliance with § 401(a)(26) and § 411.

If the interest crediting rate in effect on the current testing date is a variable rate, the recommendations on testing methodology with variable rates in section IX above, including any averaging of returns for prior periods, would be applied based on the interest crediting rate in effect on that date.

XVI. **Ministerial Issues.**

A. Given that governmental plans are not subject to § 411, references to the special PPA delayed effective date rule should not be included in final § 411 regulatory effective date descriptions.

B. Regulation § 1.411(b)(5)–1(d)(5)(ii) relating to the use of the actual rate of return on plan assets should be added to the list of sections in Prop. § 1.411(b)(5)–1(f)(2)(i)(B) (dealing with the 2012 effective date).

These comments were prepared by a task force of ASPPA's Defined Benefit Subcommittee of the Government Affairs Committee and the ASPPA College of Pension Actuaries. The task force was chaired by Kevin Donovan, MSPA, and the comments were primarily authored by Marjorie Martin, MSPA, Judy Miller, MSPA, Mark Dunbar, MSPA, Karen Smith, MSPA and Thomas Finnegan, MSPA. Please contact us if you have any comments or questions on the matters discussed above.

Thank you for your consideration of these comments.

Sincerely,

Brian H. Graff, Esq., APM, Executive Director/CEO; Craig P. Hoffman, Esq., APM, General Counsel/Director of Regulatory Affairs; Ilene Ferenczy, Esq., APM, Co-chair, Government Affairs Committee; Karen Smith, MSPA, Co-chair, Defined Benefit Subcommittee; Judy A. Miller, MSPA, Chief of Actuarial Issues; Mark Dunbar, MSPA, Co-chair, Government Affairs Committee; James Paul, Esq., APM, Co-chair, Government Affairs Committee.

PREPARED STATEMENT OF THE U.S. CHAMBER OF COMMERCE

The U.S. Chamber of Commerce would like to thank Chairman Harkin, Ranking Member Enzi, and members of the committee for the opportunity to provide a statement for the record of the hearing entitled "The Power of Pensions: Building a Strong Middle Class and Strong Economy" which was held on July 12, 2011.

Even with the many challenges facing plan sponsors, the voluntary employer-provided retirement system has been overwhelmingly successful in providing retirement income. Private employers spent over $200 billion on retirement income benefits in 2008 and paid out over $449 billion in retirement benefits. According to the Bureau of Labor Statistics, in March 2009, 67 percent of all private sector workers had access to a retirement plan at work, and 51 percent participated. For full time workers, the numbers are 76 percent and 61 percent, respectively.

The Chamber and its membership promote all parts of the employer-provided retirement plan system. While we agree that efforts should be made to encourage the defined benefit plan system, we believe that it is equally important to recognize the success of the defined contribution system and to continue to encourage employers to participate and expand that system as well. In our statement, we highlight the successes of the defined contribution system and also point out challenges in the defined benefit system that have led to the declining numbers of defined benefit plans.

THE SUCCESS OF THE DEFINED CONTRIBUTION PLAN SYSTEM

While there has been a shift away from defined benefit plans, the number of defined contribution plans has increased exponentially. Since 1975, the number of defined contribution plans has almost quadrupled from 207,748 to 658,805 in 2007.[1] In 1992–93, 32 percent of workers in private industry participated in a defined benefit plan, while 35 percent participated in a defined contribution plan.[2] According to the 2008 National Compensation Survey, the participation for private industry workers in defined benefit plans has decreased to 21 percent, while participation in defined contribution plans has increased to 56 percent.[3]

In addition, the amount of assets held in these plans has significantly increased. The total assets of all employer-sponsored retirement plans, IRAs, and annuities equaled $17.5 trillion at year-end 2010. The largest components of retirement assets were IRAs and employer-sponsored defined contribution plans, holding $4.7 trillion and $4.5 trillion, respectively, at year-end 2010. Comparably, private-sector defined benefit pension funds held $2.2 trillion at year-end 2010.[4] Consequently, the investment capital from defined contribution plan savings has a significant impact on our economy.

Although there has been critique of the adequacy of account balances in defined contribution plans, we believe that this criticism paints an unfair picture. Since personal account plans did not become popular until the 1980s, there has not yet been a generation that has relied completely upon personal account plans for retirement. Moreover, studies show that account balances tend to be higher the longer 401(k) plan participants had been working for their current employers and the older the participants. Workers in their sixties with at least 30 years of tenure at their current employers had an average 401(k) account balance of $198,993.[5]

Through the passage of the Pension Protection Act of 2006, Congress encouraged even greater participation in defined contribution plans by implementing automatic enrollment and automatic escalation rules. EBRI has stated that automatic enrollment can nearly double participation in some defined contribution plans.[6] Moreover, a study by Vanguard found that automatic enrollment appears to raise plan participation rates most dramatically among certain demographic groups, particularly young and low-income workers, for whom plan participation rates are traditionally very low. For example, employees earning less than $30,000 and hired under auto-

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[1] Private Pension Plan Bulletin Historical Tables: U.S. Department of Labor, Employee Benefits Security Administration, June 2010, *http://www.dol.gov/ebsa/pdf/1975-2007historicaltables.pdf* (accessed August 11, 2010).

[2] Beckman, Allan. "Access, Participation, and Take-up Rates in Defined Contribution Retirement Plans Among Workers in Private Industry, 2006". Bureau of Labor Statistics. December 27, 2006. *http://www.bls.gov/opub/cwc/cm20061213ar01p1.htm* (accessed August 11, 2010).

[3] "Percent of Workers in Private Industry With Access to Retirement and Health Care Benefits by Selected Characteristics: 2008", Bureau of Labor Statistics, *http://www.census.gov/compendia/statab/2010/tables/10s0639.pdf* (Accessed August 11, 2010).

[4] 2011 Investment Company Fact Book: *A Review of Trends and Activity in the Investment Company Industry*, pp. 100–102. *WWW.ICIFACTBOOK.ORG*.

[5] 2011 Investment Company Fact Book: *A Review of Trends and Activity in the Investment Company Industry*, *WWW.ICIFACTBOOK.ORG*, p. 108.

[6] [EBRI CITE].

matic enrollment have a participation rate of 77 percent versus a participation rate of 25 percent for employees at the same income level hired under voluntary enrollment. Similarly, 81 percent of employees younger than 25 are plan participants under automatic enrollment, versus 30 percent under voluntary enrollment.[7] Consequently, automatic enrollment has been most successful with the groups that are most at risk for not being adequately prepared for retirement.

CHALLENGES FACING THE DEFINED BENEFIT SYSTEM

The number of defined benefit plans has been declining.[8] This decline is due to the number of challenges facing plan sponsors—of which the greatest are the need for predictability of the rules and flexibility to adapt to changing situations. Since 2002, Congress has passed five laws that address defined benefit funding.[9] For over a decade, the legality of hybrid plans was unresolved and those plan sponsors were unable to get determination letters.[10] In the recent financial crisis, plan sponsors faced unexpected financial burdens due to inflexible funding rules. All of these scenarios have had a negative impact on the employer-provided retirement system. Therefore, we urge Congress to keep in mind the need for predictability and flexibility to ensure that employers can continue to maintain plans that contribute to their workers' retirement security.

Funding Issues

The current economic environment has created challenges for employers that want to maintain retirement plans. In addition to complying with the normal set of rules and regulations, plan sponsors must make tough decisions about their retirement plans and other competing needs. Therefore, the more certainty that plan sponsors have about the rules, the better they will be able to make these important decisions.

On August 17, 2006, the Pension Protection Act of 2006 ("PPA") was signed into law. The act fundamentally changed the funding rules for defined benefit plans. A major impetus behind the PPA was to increase the funding level of pension plans. Consequently, most plan sponsors entered 2008 fully ready to comply with the new funding rules. The severe market downturn at the end of 2008 drastically changed the situation.[11] Because of the accelerated funding scenarios spelled out in the PPA, and notwithstanding the efforts of Congress to provide some temporary funding re-

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[7] [VANGUARD CITE].

[8] In 2007, 54 of the 100 largest employers offered a traditional pension plan to new workers, down from 58 in 2006, according to Watson Wyatt Worldwide. That 7 percent decline compares with a 14 percent drop as recently as 2005. Levitz, Jennifer. "When 401 (k) Investing Goes Bad". *The Wall Street Journal Online* 4 Aug. 2008. *http://online.wsj.com/article/SB121744530152197819.html* (accessed August 21, 2009) Also see Private Pension Plan Bulletin Historical Tables: U.S. Department of Labor, Employee Benefits Security Administration, June 2010, *http://www.dol.gov/ebsa/pdf/1975-2007historicaltables.pdf* (accessed August 11, 2010).

[9] Job Creation and Worker Assistance Act of 2002 (P.L. 107–147 increasing the range of permissible interest rates for determining pension liabilities, lump sum distributions, and PBGC premiums for under-funded pension plans to 120 percent of the current 30-year Treasury bond interest rate; Pension Funding Equity Act of 2004 replacing the interest rate assumption for 2 years; Pension Protection Act of 2006 fundamentally changing the funding rules for both single-employer and multiemployer defined benefit plans; The Worker, Retiree, and Employer Recovery Act of 2008 ("WRERA") providing limited funding relief; The Preservation of Access to Care for Medicare Beneficiaries and Pension Relief Act of 2010, providing defined benefit plan funding relief for both single-employer and multiemployer plans.

[10] In 1999, the Service's Director of Employee Plans issued a Field Directive that effectively halted the determination letter applications of hybrid plans from being processed. In 2002, the Treasury Department, with input from the Equal Employment Opportunity Commission and the Department of Labor, issued proposed regulations addressing the issue of age discrimination in hybrid plans but withdrew the proposed regulations in 2004 in order to clear a path for Congress to act. The uncertainty surrounding hybrid plans has been even more considerable in the litigation arena with contradictory decisions among various circuit courts.

[11] At the beginning of 2008, the average funded level of plans was 100 percent. Data from a study published by the Center for Retirement Research at Boston College indicates the following as of October 9, 2008:

- In the 12-month period ending October 9, 2008, equities held by private defined benefit plans lost almost a trillion dollars ($.9 trillion).
- For funding purposes, the aggregate funded status of defined benefit plans unpredictably fell from 100 percent at the end of 2007 to 75 percent at the end of 2008. (See footnote 5 of the study).
- Aggregate contributions that employers will be required to make to such plans for 2009 could almost triple, from just over $50 billion to almost $150 billion.

lief, many plan sponsors were faced with the reality of having to contribute two and three times the amount of the expected contribution.

A matter of recent concern is the consideration of increases to PBGC premiums. Increasing PBGC premiums without the opportunity for discussion of details, careful consideration of the potential impact, or buy-in from all interested parties would present another challenge to the private sector defined benefit pension system.

Raising the PBGC premiums, without making contextual reforms to the agency or the defined benefit system, amounts to a tax on employers that have voluntarily decided to maintain defined benefit plans. An increase in PBGC premiums, when added to the multi-billion dollar impact of accelerated funding enacted in 2006 could divert critical resources from additional business investment and subsequent job creation.

Regulatory Issues

In general, greater regulation often leads to greater administrative complexities and burdens. Such regulatory burdens can often discourage plan sponsors from establishing and maintaining retirement plans. The following are just a few examples of where the regulatory burden is overwhelming, particularly with respect to defined contribution plans.

Notice and Disclosure: Plan sponsors are faced with two increasingly conflicting goals—providing information required under ERISA and providing clear and streamlined information. In addition to required notices, plan sponsors want to provide information that is pertinent to the individual plan and provides greater transparency. However, this is difficult with the amount of required disclosures that currently exist. Although there is a reason, even a good reason, for every notice or disclosure requirement, excessive notice requirements are counterproductive in that they overwhelm participants with information, which many of them ignore because they find it difficult to distinguish the routine, e.g., summary annual reports, from the important. Excessive notice requirements also drive up plan administrative costs without providing any material benefit. It is critical that Congress coordinate with the agencies and the plan sponsor community to determine the best way to streamline the notice and disclosure requirements.

PBGC Rule on Cessation of Operations: In August 2010, the PBGC published a proposed rule under ERISA section 4062(e) which provides for reporting the liabilities for certain substantial cessations of operations from employers that maintain single employer plans. If an employer ceases operations at a facility in any location that causes job losses affecting more than 20 percent of participants in the employer's qualified retirement plan, the PBGC can require an employer to put a certain amount in escrow or secure a bond to ensure against financial failure of the plan. These amounts can be quite substantial.

We believe that the PBGC proposed rule goes beyond the intent of the statute and would create greater financial instability for plan sponsors. Furthermore, we are concerned that the proposed rules do not take into account the entirety of all circumstances but, rather, focus on particular incidents in isolation. As such, the proposed rule would have the effect of creating greater financial instability for plan sponsors.

The PBGC recently announced that it is reconsidering the proposed rule. However, we continue to hear from members that the proposed rule continues to be enforced. This type of uncertainty is an unnecessary burden on plan sponsors and discourages continued participation in the defined benefit plan system.

Alternative Premium Funding Target Election: The PBGC's regulations allow a plan to calculate its variable-rate premium (VRP) for plan years beginning after 2007, using a method that is simpler and less burdensome than the "standard" method currently prescribed by statute. Use of this alternative premium funding target (APFT) was particularly advantageous in 2009 because related pension funding relief provided by the Internal Revenue Service served for many plans to eliminate or significantly reduce VRP liability under the APFT method. However, in both 2008 and 2009 PBGC determined that hundreds of plan administrators failed to correctly and timely elect the APFT in their comprehensive premium filing to the PBGC, with the failures due primarily to clerical errors in filling out the form or administrative delays in meeting the deadline. In June 2010, the PBGC responded to the concerns of plan sponsors by issuing Technical Update 10–2 which provides relief to certain plan sponsors who incorrectly filed. We appreciate the PBGC's attention to this matter and its flexibility in responding to this situation. However, we are concerned that the relief provided does not capture all clerical errors or administrative errors that may have occurred and, therefore, some plan sponsors remain unfairly subject to what are substantial and entirely inappropriate penalties. As such, we believe that the rules established under the current regulation and the

Technical Update should be considered a safe harbor. The regulation should be revised to state that if the safe harbor is not met, the PBGC will still allow use of the APFT if the filer can demonstrate, through appropriate documentation to the satisfaction of the PBGC, that a decision to use the APFT had been made on or before the VRP filing deadline. Proof of such a decision could be established, for example, by correspondence between the filer and the plan's enrolled actuary making it clear that, on or before the VRP filing deadline, the filer had opted for the APFT. It is important that this regulatory change be made on a retroactive basis, so as to provide needed relief to filers for all post-PPA plan years.

Cash Balance Plan Regulations: On October 18, 2010, the Internal Revenue Service issued long-awaited regulations affecting cash balance benefit plans under the Pension Protection Act of 2006. In addition to the delay in receiving this regulatory guidance, plan sponsors were disappointed that the regulations deviated from clear congressional intent. The Chamber is engaged in on-going conversations with the Treasury Department and is asking Treasury and the IRS to set forth a clear and rational approach to PPA compliance for Pension Equity Plans. Moreover, because of the complexity of hybrid plans and their regulation, we are requesting additional guidance to ensure that plan sponsors have sufficient clarity and flexibility to adopt and maintain hybrid pension plans with legal certainty.

Top-Heavy Rules: The top-heavy rules under ERISA are an example of extremely complex and burdensome regulations that do not offer a corresponding benefit. We recommend that this statute be eliminated altogether.

ACCOUNTING ISSUES

In 2006, the Financial Accounting Standards Board ("FASB") undertook a project to reconsider the method by which pensions and other benefits are reported in financial statements. They completed Phase I of the project but left Phase II, which would have removed smoothing periods from the measure of liabilities, until a later date. After significant negative feedback from the plan sponsor community, FASB indefinitely postponed the implementation of Phase II.

In 2010, FASB issued two proposals concerning accounting requirements for businesses that participate in multiemployer plans. Each proposal would have required the participating employer to include estimated withdrawal liabilities on their statement regardless of the likelihood of withdrawal. As you are aware, the information included on financial statements is used to determine the credit-worthiness of a company. Therefore, disclosing an estimated withdrawal liability could be misleading and negatively impact an employer's ability to get appropriate financing either from banks or bonding agencies. In addition, even if an individual employer is not directly impacted, that employer may be indirectly impacted if other employers who participate in the plan suffer financial trouble due to the disclosure of this information. FASB recently revised this proposal at the urging of the business community.

The threat of accounting changes from FASB is a constant worry of plan sponsors. These changes can have significant ramifications for their businesses—impacting credit determinations and loan agreements—without having any impact on the actual funding of the plans. This persistent threat discourages participation in the employer-provided retirement system.

CONCLUSION

The best way to encourage plan sponsors to maintain retirement plans is to create a predictable and flexible benefit system. Moreover, we believe that all types of benefit plans should be equally encouraged, as there is not one type of plan that is suitable for every employer. We look forward to working with this committee and Congress to enact legislation that will encourage further participation in all parts of the employer provided retirement system.

Thank you for your consideration of this statement.

Insider | July 2011

TOWERS WATSON

Prevalence of Retirement Plan Types in the *Fortune* 100 in 2011

Account-Based Benefit Plans Dominate

By Brendan McFarland

Towers Watson has been tracking retirement plans offered to newly hired salaried employees of *Fortune* 100 companies for many years. In 2011, the number of these large companies offering new salaried employees only a defined contribution (DC) plan, such as a 401(k) plan, grew significantly. Today, less than a third of these companies offer any defined benefit (DB) pension to newly hired salaried employees, and only 13 sponsor a traditional DB plan open to newly hired workers.

Large employers have been rethinking their retirement offerings for some time now. Over the last 10 years, many of them have shifted from traditional DB plans to DC and account-based DB plans. Several factors have driven the shift, including a desire to reduce overall retirement costs (perhaps due to higher compensation and benefit costs elsewhere, especially health care), greater mobility in the workforce, the popularity of account-based designs with employees, government and accounting regulations, market trends and board pressures, and a belief that such a shift reduces financial risk.

The shift to DC plans as the primary retirement vehicle transfers the responsibility and risk for capital accumulation for retirement from employers to employees, who are left to manage their own contribution levels, withdrawals (and loans), investments and retirement distributions. For the employer, the move creates other risks, such as that counter-cyclical workforce trends will necessitate increased severance pay, raise benefit costs and result in less mobility within an organization.

History of *Fortune* 100 plan sponsorship

Since 1998, there has been a steady — yet dramatic — overall shift in retirement offerings to newly hired employees. At the end of 1998, 90 of the *Fortune* 100 companies offered some sort of DB benefit, either a traditional or hybrid (account-based, usually cash balance) plan. Today, only 30 companies offer DB plans to their new hires (see *Figure 1*).

Consequently, offering DC plans as the sole retirement plan became increasingly common over this period, jumping from only 10 *Fortune* 100 companies at year-end 1998 to 70 companies in this year's *Fortune* 100.

The decline of traditional DB plans is striking. A traditional DB plan provides a defined benefit amount at retirement, usually in the form of an annuity, based on a formula that normally relates to pay and years of service. The value of benefit accruals is typically back-loaded, meaning benefit values increase faster as participants near retirement. As such, traditional DB plans are better suited to long-tenured employees than to those with shorter tenures. After all, one reason for establishing these plans was to encourage valuable workers to stay with the employer (another was to enable employees to retire with sufficient income to maintain a reasonable standard of living in retirement). Over time, however, employers have changed their focus from providing retirement income to workers who stay until retirement to providing a more uniform level of retirement-directed capital accumulation for all employees. So, many companies have instead opted for more portable, account-based retirement programs such as hybrid DB and DC plans.

"In 1985, 89 *Fortune* 100 companies offered a traditional DB plan to their newly hired workers. Today, only 13 offer traditional DB plans."

Figure 1. *Fortune* 100 retirement plan prevalence for new hires (1985–2011)

	1985	1998	2002	2004	2005	2006	2007	2008	2009	2010	Today
Total DB pension plans	90	90	83	73	62	57	53	47	43	37	30
Traditional DB plan	89	67	48	38	32	28	27	23	19	17	13
Hybrid pension plan	1	23	35	35	30	29	26	24	24	20	17
DC plan only	10	10	17	27	38	43	47	53	57	63	70

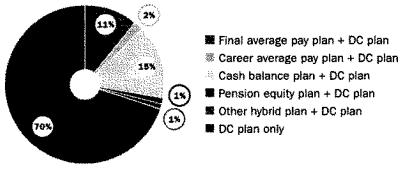
Note: Sponsorship is shown as type of plan offered to salaried new hires at the end of the year and is based on the following year's *Fortune* 100 list.
For example, the 2010 data are based on the 2011 list and include plans offered at year-end 2010. The "Today" column reflects changes implemented between January 1, 2011, and May 31, 2011.
Source: Towers Watson.

Figure 2. Retirement prevalence trend for new hires for 2011 *Fortune* 100 companies (1998–2011)

	1998	1999	2000	2001	2002	2003	2004	2005	2006	2007	2008	2009	2010	Today
Total DB pension plans	72	72	72	71	70	69	66	64	57	50	45	40	37	30
Traditional DB plan	64	59	58	53	47	40	37	36	33	29	22	20	17	13
Hybrid pension plan	8	13	14	18	23	29	29	28	24	21	23	20	20	17
DC plan only	28	28	28	29	30	31	34	36	43	50	55	60	63	70

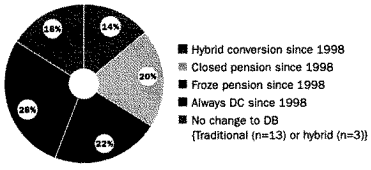
Note: Sponsorship is shown as type of plan offered to salaried new hires at the end of the year. The "Today" column reflects data through May 31, 2011. Trend data are shown for the 2011 *Fortune* 100 companies and capture changes to retirement plans for these companies since 1998.
Source: Towers Watson.

Figure 3. Plan types offered today by *Fortune* 100 companies (for newly hired employees)



N=100
Source: Towers Watson.

Figure 4. Most recent change in newly hired employee retirement program since 1998



N=100
Source: Towers Watson.

In hybrid plans, the employer defines, that is, specifies, the retirement benefit — similar to a traditional DB plan — but the final benefit is defined as a lump-sum account balance rather than as an annuity. The benefit value of hybrid plans typically accrues more evenly over a worker's career (though designs can vary benefit accrual by age, service or a combination of the two). If hybrid plan participants leave their employer, they usually can take their lump-sum account balance with them, transferring it to an individual retirement account, much like DC plan participants, or they can convert the account balance into an annuity. (Note that many traditional DB plans also now provide for lump-sum distributions at retirement.)

"Forty-two of the 70 companies that currently offer only a DC plan to new hires froze or closed their traditional pension plan after 1998."

In 1985, 89 *Fortune* 100 companies offered a traditional DB plan to their newly hired workers, while 11 offered only an account-based plan. Over the past 25 years, the pattern has flipped almost completely. Today, 87 of today's *Fortune* 100 companies offer only account-based retirement plans to newly hired workers, while 13 offer traditional DB plans.

A historical look at the retirement plans of today's *Fortune* 100

Some of the changes in the reported retirement offerings arise from annual turnover in the *Fortune* 100 list, reflecting mergers, spin-offs, new or rapidly growing businesses, and bankruptcies. Historically, seven to eight companies drop off the list in any given year. Six companies are new to the 2011 list, and, over time, we have found that new list members are less likely to have ever offered a DB plan. For example, at year-end 1998, 28 companies in today's *Fortune* 100 provided only a DC plan to new hires (see *Figure 2*), while 10 companies in the 1999 *Fortune* 100 sponsored only a DC plan (Figure 1).

Nevertheless, while list turnover has had some effect on the trend, there is no escaping the conclusion that companies have moved away from traditional DB plans. Indeed, to control for annual turnover in the *Fortune* 100, we analyzed the evolution of retirement offerings from this year's *Fortune* 100 list of companies since 1998 (Figure 2).

The movement away from traditional plans to account-balanced retirement plans and its timing is still apparent. Today, 70 of the 2011 *Fortune* 100 offer only a DC plan to new hires, compared with 28 of those same companies back in year-end 1998. Between year-end 2010 and May 2011, seven more companies stopped offering DB plans to new hires and adopted a DC-only retirement benefit approach. Of the 30 companies currently offering a DB plan to new hires, half sponsor cash balance plans (as shown in *Figure 3*). Traditional final-average-pay plans make up the second-largest DB offering, with career-average-pay plans and other hybrid plan types making up the remainder.

Forty-two of the 70 companies that currently offer only a DC plan to new hires froze or closed their traditional pension plan after 1998 (see *Figure 4*).

When a sponsor freezes a DB plan, benefits tied to service, those tied to pay or all benefits stop accruing for some (based on age, years of service or both) or all plan participants. When a sponsor closes a pension plan, benefits for current participants typically continue to accrue, but the plan does not admit employees hired after a certain date. Twenty-two companies in this year's *Fortune* 100 list have frozen a pension plan since 1998, while 20 have closed plans to newly hired employees.

Fourteen sponsors took a different route, converting their traditional DB plans to hybrid plans. *Figure 5* depicts the timing of these hybrid conversions since 1998.

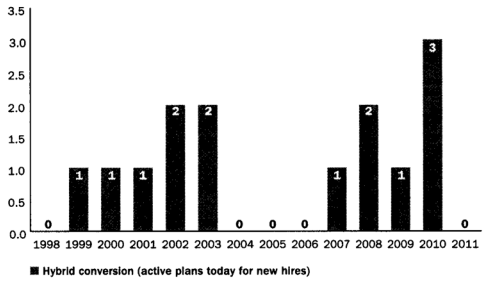
Over the last several months, none of the *Fortune* 100 companies transitioned from a traditional DB to a hybrid plan. Before 2004, hybrid conversions were occurring at a steady pace. Between 2004 and 2006, there were no conversions, most likely due to legal and regulatory uncertainty created by the 2003 *Cooper v. IBM* ruling, which found that cash balance plans were inherently age discriminatory. But later rulings and the Pension Protection Act of 2006 (PPA) cleared away some of the legal fog that had surrounded these plans and appeared to trigger new conversions. Of *Fortune* 100 companies that converted to hybrid plans (that are still active for new hires today), half the conversions took place before the PPA was signed into law and half after.

Transitioning workers from a DB plan to a DC plan: Grandfathering, partial grandfathering and no grandfathering

There are various approaches for managing the transition of pension-eligible employees to a DC-plan-only environment, and most companies take one of three broad approaches. The first is full grandfathering, where all those participating in the DB plan as of a certain date continue accruing benefits, either at the same or a reduced level. The second approach is partial grandfathering, in which only participants who meet certain age and/or service requirements continue accruing benefits in the DB plan. All other participants are switched over to whatever retirement plan is offered to new hires. The third approach is not to grandfather anyone — all current participants stop accruing benefits and are enrolled in the DC plan offered to new hires.

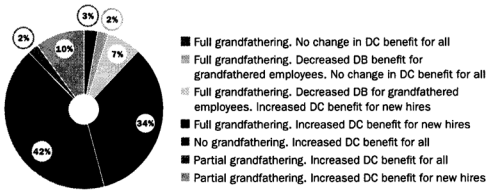
Of the 41 companies we analyzed, 46% implemented full grandfathering, 12% opted for partial grandfathering,[1] and the remaining 42% did not grandfather anyone.[2]

Figure 5. Hybrid conversions for active plans for newly hired employees (1998–2011)



N=14
Source: Towers Watson.

Figure 6. Transition approaches of *Fortune* 100 sponsors moving from DB to DC



N=41
Source: Towers Watson.

As shown in *Figure 6*, within the three broad transition approaches, employers varied the details. The most frequent approach (42%) was not grandfathering anyone and increasing benefits in the DC plan for all workers. The next most common tack (34%) was offering full grandfathering with unreduced benefits for current participants and increasing DC benefits for newly hired workers relative to what their pension-eligible counterparts received. Nine percent of companies fully grandfathered their workers but reduced future DB accruals (2% used full grandfathering, decreased the DB plan benefit and did not change the DC benefit for anyone, and 7% used full grandfathering, decreased the DB plan benefit and increased DC benefits for new hires).

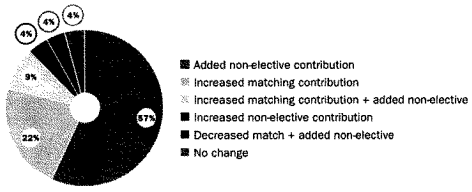
"Over the last several months, none of the *Fortune* 100 companies transitioned from a traditional DB to a hybrid plan."

[1] Of the five companies that used partial grandfathering, four based eligibility on points (combination of age and service). The thresholds varied from 45 points (two companies) to 62 points (one company) to 65 points (one company). The fifth company that implemented partial grandfathering based its criteria on age only (40 years old).

[2] If a company implemented one grandfathering approach and later changed it, these results capture its latest approach. For the 17 companies that offered no grandfathering, four previously offered full grandfathering and closed their plan to new hires. These companies later froze their plan and subsequently offered no grandfathering.

"The dominant approach among these grandfathering companies was to add a non-elective contribution to the DC plan."

Figure 7. Actions taken for new-hire DC plan in companies that fully or partially grandfathered pension-eligible workers



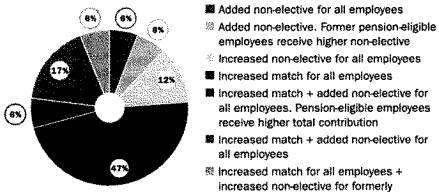
Note: Results are shown where transition data were available for 23 of the 24 companies that fully or partially grandfathered their workers.
N=23
Source: Towers Watson.

Figure 8. DC employer contributions from companies that fully or partially grandfathered pension-eligible workers (new hires versus grandfathered employees)

	Total matching contribution	Total non-elective contribution	Total DC contribution
Grandfathered employees	**3.90%**	**1.18 %**	**5.09%**
New hires	**4.25%**	**3.55%**	**7.80%**

Note: Results are shown where full contribution data were available for 22 of the 24 companies that fully or partially grandfathered their workers. If discretionary contributions were shown in ranges, the maximum value was used. The data assume employees make the contributions necessary to receive the maximum matching contribution.
N=22
Source: Towers Watson.

Figure 9. Actions taken in DC plan by non-grandfathering companies



N=17
Source: Towers Watson.

Changes made by *Fortune* 100 companies to DC plans after eliminating the DB formula

Almost all companies that offered some level of grandfathering (58%) increased DC benefits for new employees to mitigate the loss of the pension benefit. As shown in *Figure 7*, the dominant approach (57%) among these grandfathering companies was to add a non-elective contribution to the DC plan — meaning the employer contributes whether or not the employee does (similar to cash balance plan pay credits). All the changes depicted in *Figure 7* are for newly hired workers or existing workers who did not meet age and service requirements for grandfathering.

The second most popular approach (22%) was increasing the matching contribution for workers who were no longer pension-eligible.

Because non-pension-eligible workers receive higher DC benefits than their grandfathered counterparts, we next quantify DC contributions as a percentage of pay for these two groups among the grandfathering companies. *Figure 8* shows total DC employer contributions for a newly hired 35-year-old employee earning $50,000/year versus a grandfathered 35-year-old employee earning $50,000/year with five years of service.

Total employer contributions to DC plans for new hires, on average, are roughly 2.7% of compensation higher than contributions for their pension-eligible counterparts. Most of this increase reflects a higher non-elective contribution for new hires. The higher DC benefit for new hires, however, typically does not fully mitigate the pension loss.[3]

We next analyze what happened to DC plans when the sponsor did not grandfather any DB plan participants and moved everyone to a DC-only program. As shown in *Figure 9*, 76% of companies that did not grandfather any plan participants increased their matching contribution to the DC plan, and 53% added or increased a non-elective contribution. It is interesting to observe that, in 18% of non-grandfathering companies,[4] workers whose DB pensions were frozen received bigger DC contributions than those who had never had a pension.

Transitioning workers from a traditional DB plan to a hybrid plan

Some companies chose to convert their traditional DB plan to a hybrid plan. Of the 14 companies that converted to hybrid plans since 1998, five kept existing workers in the traditional plan and enrolled newly hired employees in the hybrid plan,[5] and four allowed employees to choose between the traditional

pension and the hybrid plan. The remaining five froze the current traditional plan benefit and moved all workers over to the hybrid plan.[6]

Annual allocations for account-based retirement plans

Eighty-seven percent of *Fortune* 100 companies now offer their newly hired employees only account-based plans. We next analyze the percentage of pay employers allocate to these accounts annually. *Figure 10* shows the total retirement (DB plus DC) allocation from *Fortune* 100 sponsors of account-based plans to 35-year-old newly hired employees earning $50,000/year.

On average, sponsors of hybrid pension plans provide 9.04% of pay to their newly hired employees' retirement accounts. Newly hired employees with only a DC plan receive 6.46% of pay — roughly 2.5% of pay less than at companies that also sponsor hybrid pensions. The higher allocations from hybrid plan sponsors are not surprising. These companies chose to switch from a traditional plan to a hybrid plan rather than move to a DC-only approach, arguably demonstrating a stronger commitment to providing retirement benefits to their employees.

Among companies providing only a DC plan to new hires, employer contributions vary significantly, depending on whether the company once sponsored a pension (7.67%) or was always a DC-plan-only employer (4.77%).

The difference in allocation amounts (shown in *Figure 11*) between employers that always had a DC plan and those that once had a pension is attributed to companies' eliminating their DB benefits and then boosting the match, adding a non-elective contribution or both, as discussed earlier in this analysis.

Conclusion

The established trend away from traditional DB pension plans continues as more companies adopt DC-only or account-based DB approaches going forward. Today, 70 *Fortune* 100 companies provide DC-only retirement benefits to new hires, a significant increase since the late 1990s.

Companies use various approaches in transitioning from a DB to a DC-only environment. Some grandfather existing workers, while others stop DB accruals for everyone. While the loss of future pension accruals is substantial, most companies provide additional DC contributions, at least partially replacing the value of the lost DB accruals.

So far in 2011, there have been more retirement changes than usual — seven companies have given up their DB plans in favor of an all-DC retirement environment for new hires. There were no conversions to hybrid plans during this period.

These recent changes — and more almost certainly on the horizon — signal a large-scale redistribution of corporate resources for retirement. Employers are spreading their retirement dollars more evenly across the workforce, rather than concentrating benefits on older workers. Traditional DB plans offered employers greater control over workforce retirement patterns. Account-based plans generally place more responsibilities on employees and are less directed toward traditional retirement patterns.

Figure 10. Total annual allocations for account-based retirement plans for new hires

	n	Total retirement contribution	Total hybrid contribution	Total DC contribution
Hybrid pension plans (DB+DC)	17	9.04%	4.56%	4. 47%
DC only	67	6.46%	n/a	6.46%
DC — once DB	39	7.67%	n/a	7.67%
Always DC-only	28	4.77%	n/a	4.77%

Note: Results are shown where full contribution data were available. If discretionary contributions were indicated in ranges, the maximum value was used. Matching and non-elective contributions are included. The data assume employees make the contributions necessary to receive the maximum matching contribution.
N=84
Source: Towers Watson.

Figure 11. Retirement contributions from companies providing only a DC plan to new hires

	n	Total matching contribution	Total non-elective contribution	Total DC contribution
DC — once DB	39	4.57%	3.10 %+	7.67%
Always DC	28	3.63%	1.14%*	4.77%

Note: Employer contributions are shown for a newly hired employee at age 35 earning $50,000/year. Results are shown where full contribution data were available. If discretionary contributions were indicated in ranges, the maximum value was used. The data assume employees make the contributions necessary to receive the maximum matching contribution.
+ Twenty-eight of 39 companies provide a non-elective contribution to their DC plan. The vast majority of these companies began the non-elective contribution after eliminating the pension plan for new hires. For companies that once offered a pension but now provide this additional contribution, the average non-elective contribution for a 35-year-old new hire earning $50,000/year is 4.32% (median is 3%).
* Of the 28 companies that have not provided a DB plan since 1998, only six make non-elective contributions. The average contribution for these companies is 5.33% (median is 4%).
N=67
Source: Towers Watson.

[5] See Towers Watson's "Employer Commitment to Retirement Plans in the United States," December 2009, found at www.towerswatson.com.

[6] Six percent added non-elective contributions and gave formerly pension-eligible employees higher non-elective contributions. Six percent increased the match and added non-elective contributions, with pension-eligible employees receiving higher DC contributions. Six percent increased the match for all employees and increased non-elective contributions for formerly pension-eligible employees.

[7] All five of these were implemented after the PPA was passed.

[8] One company previously allowed choice but later moved all grandfathered workers into the hybrid plan.

Response to Questions of Senator Enzi by Diane Oakley

Question 1. We all agree that well-run defined benefit plans offer very good benefits for employees and are an attractive retention tool for employers. However, many businesses may struggle with the burdensome regulations or convoluted laws associated with setting up and maintaining a defined benefit plan. In your opinion, which is easier for large companies to set up a defined contribution or a defined benefit plan? Does a defined contribution plan offer more of a "turn-key" operation for many businesses? What about for small- and medium-sized business to set up? Why is this?

Answer 1. DB pension plans offer employers a cost-efficient, useful workforce management tool for employee recruitment and retention. In today's economy, most companies do not start out as large firms, rather over time they grow in size from

start-up organizations or they become larger in size as a result of a merger. Also, private-sector industry shifts have occurred as the number of domestic manufacturing jobs with long-tenured employees has declined, while there has been a growth in information technology companies that typically have employees with shorter average tenures. As a result fewer companies offer new employees pensions today than even just 10 years ago.

Among the Fortune 1000 companies, we have seen an upward trend in the number of corporations covering employees under defined contribution (DC) plans rather than defined benefit (DB) plans due in large part to the growing level of regulations that you refer to in the next questions. This has occurred in spite of the reality that DB plans due to their embedded economic efficiencies can provide the same level of retirement income for nearly half the amount that an individual would need to accumulate in a 401(k) account. DB plans require employers to continue to fund the promised benefits and that commitment means that in tough economic patches employers do not have the flexibility that we saw many larger employers with 401(k) plans exercise when they suspended employer matching contributions in 2009 and 2010 and which they are now starting to resume.

While it might be easier to set up a DC plan because the financial services industry has developed the capacity to deliver turn-key programs, the ongoing operating cost of a DB plan once established for larger employers is more cost effective. DC plans have higher administrative costs of maintaining individual accounts and annual testing, although with bundled service approaches the cost is often borne by employees through the fees charged to their accounts.

DB plans are often tailored to the companies' human resource needs, and while DB plans may require additional actuarial work we have seen very efficient models develop in the public sector under which state-wide municipal retirement plans can scale up services and deliver cost-effective DB plans to public employees in small local communities.

When the DB(k) plan was created as part of the Pension Protection Act of 2006 (PPA), I believe that there was some of that intent but the delay in issuing regulations on such plans has stalled possible implementations of DB(k) plans. NIRS has offered several policy options that could help employers consider covering workers under DB plans which include changing the law to make plan funding less volatile, allowing employees to contribute to DB plans on a pre-tax basis and creating a way that third parties could sponsor a pension plan.

Question 2. When ERISA was first enacted in 1974, our retirement system was a lot simpler and 401(k) plans didn't really take off until much later. In today's environment, does it make sense to have three regulatory entities overseeing the retirement benefit system? In this case, we have the Department of Labor's Employee Benefit Security Administration, the Pension Benefit Guaranty Corporation and the Internal Revenue Service.

Answer 2. See response to question 3.

Question 3. At the hearing, I introduced into the record a six page list of required employee disclosures pursuant to Federal retirement and health laws. In addition, those laws and regulations require many additional filings and reports to regulators. Recently, the President issued Executive Order 13563 requiring agencies to look at the regulatory burden and to come up with plans to reduce redundant, overlapping or burdensome regulations. Should the Administration place special attention on reducing regulatory burdens in the retirement area? What suggestions would you have for DOL in implementing e-disclosure policies?

Answer 2 and 3. Let me combine my response to these two questions. I agree that the operations of pension plans have become more complex since ERISA was enacted. I started working with pension plans just as ERISA passed and it was thought to be a complex law even in its original form and it has changed significantly over time.

Of course, in 1974 the change in the law that enabled the creation of 401(k) plan was still to come. I believe that the history of 401(k) plans illustrate how the unintended consequence of a small change in the pension and tax law can lead to major policy shifts, in that 401(k) plans, which were created as supplements to what was then the mainstay of retirement—defined benefit plans, have become the only retirement savings plan offered to the majority of workers covered by employer-sponsored plans.

The first area for the Administration to look at in reducing regulatory burden is regulations being interpreted by the IRS and other agencies in ways that do not reflect the intent of Congress.

Let me illustrate this with another unintended consequence example that is coming out of the rulemaking process with regard to established practices on normal retirement age, especially for public pensions. In language designed to allow for phased retirement, Pension Protection Act of 2006 (PPA) set forth a definition of "normal retirement age." At the time, there was no discussion of normal retirement age practices in the public sector nor was there any intent to broadly change State pension laws at the time. Still, the IRS chose to use a PPA provision dealing with in-service distributions under phased retirement as the basis for questioning whether or not a retirement age that is conditioned (directly or indirectly) on the completion of a stated number of years of service is permissible in public sector plans.

Under the IRS regulations—scheduled to apply to public sector pension plans beginning in 2013—all governmental pension plans would be required to specifically define a normal retirement age as an actual age. However, many governmental plans define normal retirement age or normal retirement date as the time or times when participants qualify for unreduced retirement benefits under the plan, which is set forth in State and/or local statutes and may not state a specific age.

Furthermore, under many governmental pension plans, a participant can reach normal retirement age by satisfying one of several age and service combinations. Sponsors of such plans would find it very difficult to select a single age to be the plan's normal retirement age. Selecting an age that is higher than the lowest age would likely impair the constitutionally protected rights of the participants to any benefit conditioned on normal retirement. Selecting an age that is lower than the highest age could impact the actuarial cost of the plan. While meetings have occurred between governmental plan representatives and the Treasury Department, the issue remains unresolved.

Question 4. Studies show that many new employees like having a defined contribution plan because they can see their money grow from year to year. Also, many new employees do not envision that they will be with the same company for 30 years. Should Congress expand the opportunities under the defined contribution system to adjust to this new workforce philosophy?

Answer 4. For many years while 401(k) plans were gaining popularity, employees were able to look at their quarterly statements and see the money in their DC plan account grow. The last decade has been an eye-opener for many families about the investment risk in 401(k) plans.

During the last decade's first recession, many participants tried not to look at the shrinking 401(k) account balances when their quarterly statement arrived and many had recovered from investment losses just as the great recession hit in 2008. Over recent years they have seen account balances fall significantly once again and equity investments have continued to swing down and up.

The economic shocks we have lived through since the start of this century have shown workers how risky our new retirement system can be. In a recent NIRS Opinion Survey, we asked if it was easier to prepare for retirement today than it was in comparison to earlier generations. Nearly 6 out of 10 women and nearly half of the men told us that it was **much harder**. Also, more than 8 out of 10 women told us that the average worker cannot save enough on their own to guarantee a secure retirement and 3 out of 4 men felt the same way.

Most working Americans have seen their earnings slip in real terms over these years and few cannot afford to make added retirement contributions to make up the losses. I indicated in an earlier response that employers have a difficult time dealing with volatility but they have more wherewithal than most employees do to rebound from the beating their accounts took in the recent financial storms. This has created a growing appreciation for traditional defined benefit plans.

In the public sector where a number of States allow new employees to choose between participating in a DB or DC plans, the large majority speak with their money and choose the traditional DB plan. Congress has helped retirement savings plans take advantage of defaults to encourage participation in retirement plans, so you have seen the power that a default can have. In the State of Washington where employees have a choice between a traditional DB plan and hybrid arrangement that includes a DC plan and the default is to the hybrid arrangement. This provides an interesting example, 6 out of 10 employees actively choose the traditional DB plan over the default option with its DC plan. NIRS will be releasing a report on the choice selections between DB and DC plans in the coming weeks and we would be happy to share all of the details with you.

Over the last several decade Congress has done a lot of heavy lifting to make pension plans more portable by expanding rollover flexibility among plans. This has been extremely helpful to workers when they change jobs. Of course, the other side of portability is that lump sum distributions often lead to leakage when employees

leave one job for another and fail to make a roll over. Even modest lump sums, especially from employment early in a career would compound significantly with interest and improve long-term retirement security for many Americans if we could discourage early withdrawals.

Last, Boston College did a "chicken or the egg" type of analysis of job changing and the decline of pensions. In 2006, they found evidence that the move from DB plans into DC plans beginning in the 1990s caused employees to turn over at higher rates—as opposed to the other way around, as is sometimes assumed. They further found that DB pension coverage increases tenure with an employer by 4 years, as compared to having no retirement system in place. DB coverage increases tenure with an employer by 1.3 years as compared with DC coverage. Having a DB and DC plan showed the greatest retention effects, as the two plans together increase tenure by a full 3.1 years, as compared with a DC-only plan.

Question 5. At the hearing, we heard that one of the big issues for companies in sponsoring defined benefits is the change in accounting standards and rules requiring fair market value of pension liabilities which are reported on companies' balance sheets. Many companies believe that this has led to increased volatility for companies' balance sheets. Even if we revise the pension funding rules pursuant to ERISA for counter-cyclical events, would the current accounting rules still be an issue?

Answer 5. I agreed with the witness who spoke to the accounting change that the change in the accounting standards requiring fair market value of pension liabilities has led to increased volatility on corporate balance sheets. NIRS has found that it also contributed to the trend toward freezing DB plans in the private sector. As Congress considered the PPA, many private plan sponsors suggested that the funding rules that moved in a similar direction would force sponsors to consider freezing pensions and that appears to be the case. In the wake of the financial crisis, Congress provided modest pension funding relief for private pension plans and a further consideration of restoring greater time horizons to the funding requirements, which would have an important bottom line effect in generating cash flow, could help companies have the resources to hire new employees.

The FASB accounting rules would still pose challenges in private sector and similar concerns now face public employers, with the release of the recent exposure draft on pension accounting by GASB. The balance sheet numbers will impact stock prices and credit ratings but the pension funding rules go straight to the cash flow bottom line today even though the pension plan liabilities are far in the distant future.

Question 6. In your research, you found that defined benefit plans get "more bang for the buck" than defined contribution plans, however, your research comes from public pension plans. What about the volatility and accounting issues associated with private sector defined benefit plans? Do the longer period for amortization and "smoothing" allowed by public pension plans create stability for public pension plans or do they create more funding problems for State and local governments' pension obligations?

Answer 6. NIRS "Better Bang for the Buck" compares the cost of providing a certain level of lifetime income under both a DC plan and a DB plan. It finds that the DB plan generally provides a 46 percent cost advantage to provide the same benefit. The analysis looks at a generic DB plan that would occur in either the private or public sectors. The analysis did not look at funding volatility in and of itself.

The paper calculates how much money would be needed in a DC plan to provide a certain level of income in retirement to last for almost all of a person's life. It then compares that amount with the amount of money that would need to be accumulated in a DB plan with the same benefit level. The pooling of longevity risk, maintaining portfolio diversity and higher investment returns from DB plans due to professional asset management add up to a 46 percent cost advantage. Investment risk occurs in DB and DC plans but it generally resides with employers in DB plans and with employees in DC plans.

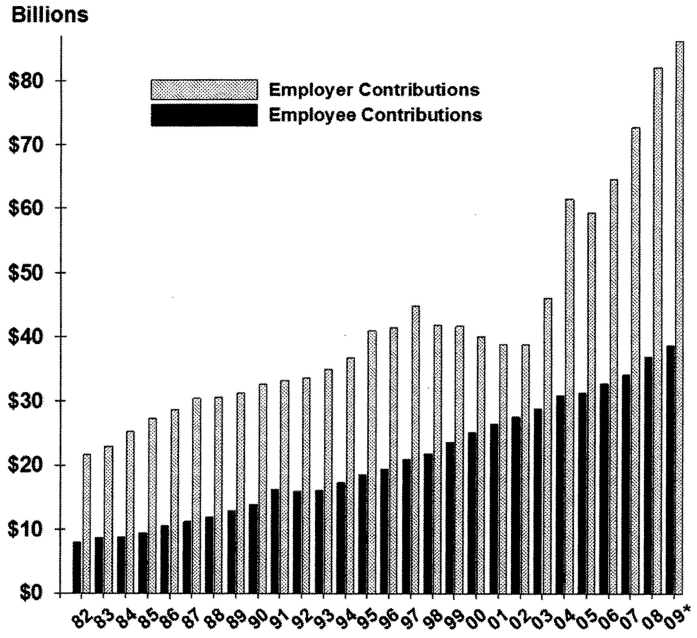
Because the States that sponsor the large public pensions, which cover 85 percent of the public workforce, are sovereign governments there is no Federal agency insuring the benefits promised to public employees.

Without Federal restrictions on the actuarial tools (smoothing and amortization) that plan sponsors can use to create a more stable and predictable flow of dollars into pension plans, public pension trusts gradually reached aggregate funding levels in excess of 100 percent by 2000. The vast majority of individual public pensions attained funding levels that GOA has cited as appropriate for public pensions by that same time, but some plans fell short when it came to prefunding their liabilities for various reasons, including budgetary pressures.

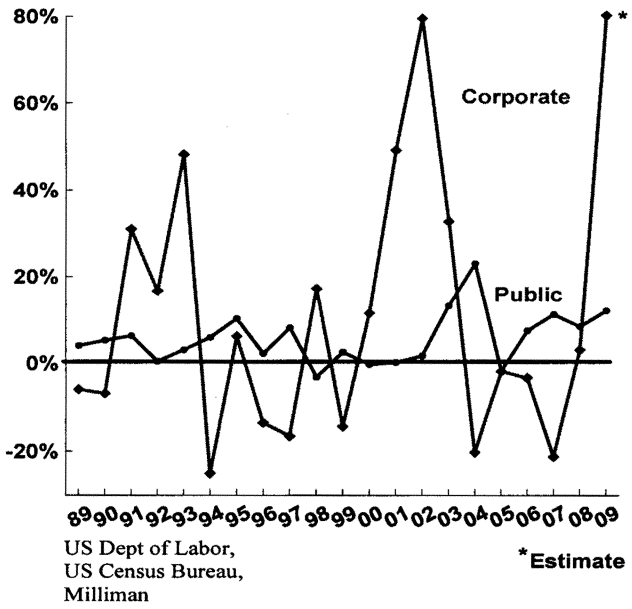
The predictable cost of providing a DB plan in the public sector as well as the contributions made to DB plans by public employees have allowed these plans to continue to provide retirement security to millions of American workers. The first chart shows the historical employer and employee contributions made into public pensions from 1982 through 2009. The shared forced saving of public employees has been a steady component of public pension funding while employer contributions were adjusted back when plans in many States reach full funding levels. The second chart compares the percentage increase in plan contributions for both public and private employers and illustrates how the longer period for amortization and "smoothing" offer sponsors of public pensions a more predictable cost for their pensions which enabled most plans to reach adequate funding levels over time without creating extreme burdens on taxpayers in any 1 year. Over the last several years nearly all States have adjusted their pension plans in various ways to put them on a path back on a sounder financial basis over time.

PUBLIC PENSIONS TYPICALLY ARE SHARED FUNDING RESPONSIBILITY

EMPLOYEE AND EMPLOYER PENSION CONTRIBUTIONS, 1982 TO 2009



CHANGE FROM PRIOR YEAR IN CORPORATE AND PUBLIC PENSION CONTRIBUTIONS, 1989–2009



RESPONSE TO QUESTIONS OF SENATOR ENZI BY CHRISTOPHER T. STEPHEN, ESQ.

Question 1. We all agree that well-run defined benefit plans offer very good benefits for employees and are an attractive retention tool for employers. However, many businesses may struggle with the burdensome regulations or convoluted laws associated with setting up and maintaining a defined benefit plan. In your opinion, which is easier for large companies to set up a defined contribution or a defined benefit plan? Does a defined contribution plan offer more of a "turn-key" operation for many businesses? What about for small- and medium-sized business to set up? Why is this?

Answer 1. DC plans were originally created to be supplemental retirement income to traditional DB Plans and Social Security benefits. We all know that over the last 25 years, DC plans have largely become the primary retirement savings vehicle for workers, as many companies have reduced, frozen or terminated their DB plans. As I testified during the hearing, there are many reasons for this transition, but the "tipping point" was when Congress (1) amended the Full Funding Limit rules (effective in 1988), and (2) introduced pro-cyclical funding requirements that dramatically increased funding obligations during difficult economic times. Up until that time, the tax code allowed employers to contribute more to their retirement plans in good times, and less in bad times, recognizing the need for more capital in bad times.

Policies that increased volatility in contribution rates and required more funding by companies during down financial markets has created a trend over the last two decades for employers to freeze or completely eliminate DB plans. The current funding rules are pro-cyclical, making operation and maintenance of a DB a one-way-wrench that requires substantial increases in funding when companies are least able to afford it. We cannot have a vibrant defined-benefit system as long as the funding rules require exorbitant contributions at exactly the wrong time.

No business of any size—whether it is a small electric co-op in Iowa or Wyoming or J.P. Morgan which Forbes cites as the largest company in the world—can survive or thrive if it does not have predictable, manageable, and budgetable costs on an annual basis, let alone a 5- to 10-year horizon. That is exactly what has become of the DB system—substantially increased volatility and unpredictability in the fund-

ing rules has made sponsoring a DB plan an unpredictable, unmanageable, and unbudgetable cost that companies will be liable for over decades.

Companies need certainty. In late September 2011, *The New York Times* and *The Wall Street Journal* both reported that health-insurance premiums paid by employers rose by 9 percent in 2011, with the average annual cost of family coverage topping $15,000 according to a study from Kaiser Family Foundation, and that unemployment insurance premiums are rising for employers as States struggle to repay $38 billion in Federal loans for unemployment benefits. And, at the same time, the Administration continues to pursue its goal to increase PBGC premiums by $16—$17 billion on the very companies struggling to keep their DB Plan in place. This unfair tax increase on DB plan sponsors is just another example of government injecting unpredictability and pro-cyclical, anti-growth policies into a system it allegedly wants to preserve and enhance. In that context, it is wrong for the government to even consider taxing plan sponsors.

Question 2. When ERISA was first enacted in 1974, our retirement system was a lot simpler and 401(k)s didn't really take off until much later. In today's environment, does it make sense to have three regulatory entities overseeing the retirement benefit system? In this case, we have the Department of Labor's Employee Benefit Security Administration, the Pension Benefit Guaranty Corporation and the Internal Revenue Service.

Answer 2. If the three agencies are going to continue to oversee the retirement benefit system, much better coordination is needed among them. For example, each agency discusses the need to slow the decline of the DB Plan system, but there is no concerted effort to do so. Instead, the PBGC spearheads an extremely counterproductive proposal to impose a large tax only on defined benefit plan sponsors. In our public policy discussions with the Hill and the Administration, Treasury and Labor are not involved, leaving us more convinced than ever of the need for more coordination among the agencies. That coordination could potentially head off misguided proposals like the PBGC's.

Question 3. At the hearing, I introduced into the record a 6-page list of required employee disclosures pursuant to Federal retirement and health laws. In addition, those laws and regulations require many additional filings and reports to regulators. Recently,the President issued Executive Order 13563 requiring agencies to look at the regulatory burden and to come up with plans to reduce redundant, overlapping or burdensome regulations. Should the Administration place special attention on reducing regulatory burdens in the retirement area? What suggestions would you have for DOL in implementing e-disclosure policies?

Answer 3. The retirement plan system is slowly being overrun by overlapping, unnecessary, and burdensome requirements. First, the volume and complexity of employee communications have reached such an extreme point that many employees simply do not read anything anymore, yet longer and more complicated disclosures are constantly being added. Second, the cost of preparing, printing, and mailing these notices is growing. Despite the fact that the world, including much of the Federal Government, is moving toward electronic communication, DOL is moving toward *more* paper, *more* cost, and *less* effective communication. Finally, all the new rules are spawning a wave of baseless litigation as class actions in search of a settlement have hit the retirement plan system. These issues must be addressed if we are to have a vibrant, growing private retirement system.

Question 4. Studies show that many new employees like having a defined contribution plan because they can see their money grow from year to year. Also, many new employees do not envision that they will be with the same company for 30 years. Should Congress expand the opportunities under the defined contribution system to adjust to this new workforce philosophy?

Answer 4. Congress should expand opportunities throughout the retirement security arena, to enable workers to save more for a secure retirement, and, encourage employers to invest more in their greatest asset—employees. That is, Congress should not pick "winners and losers" in the retirement savings arena. Rather, it should enact policies that encourage employers to provide and contribute to plans, and that incentivize employees to save for their own retirement.

As I said in my testimony, NRECA is proud that the vast majority of its members offer comprehensive retirement benefits to their committed employees through a traditional DB plan (the NRECA Retirement Security Plan) and a DC Plan (the NRECA 401(k) Plan). These "multiple-employer" retirement benefit plans (under § 413(c) of the Internal Revenue Code) are operated to maximize retirement savings for employees, retirees and their families and provide each co-op employee the financial means to enjoy a comfortable and secure retirement.

The strongest recruitment and retention tool for electric cooperatives continues to be their employee-benefits program—particularly their DB Plans. As a consumer-owned business, each electric cooperative is focused on serving its community through its workforce. While many publicly traded, international companies see 20 to 30 percent or more annual employee turnover, electric cooperatives see less than a 5 percent annual employee turnover, with more than ⅔ of cooperative employees spending their entire working careers within the cooperative family. Our members understand the very real recruiting, training, and development costs for new hires are 1.0 to 2.0 times annual pay. As such, our DB Plan rewards long service employees, and allows our members to invest in these key employees without having to face these substantial replacement costs. This "works" for our businesses.

For other business and industries, however, a traditional DB Plan may not "work" for its employees or business model. For employers, DC Plans have predictable, manageable, and budgetable costs, which make them an important part of total compensation. Also, as your question states, many employees have transitioned away from career employment at one company. At the same time, while the DC Plan system has achieved many successes, with approximately 670,000 private-sector DC Plans covering 67 million Americans, it still presents challenges to provide the necessary level of retirement benefits to many Americans.

Eliminating or diminishing the current tax treatment of employer-sponsored retirement plans like the NRECA Retirement Security Plan or 401(k) Plan will jeopardize the retirement security of tens of millions of American workers, impact the role of retirement assets in the capital markets, and create challenges in maintaining the quality of life for future generations of retirees. While we work to enhance the current retirement system and reduce the deficit, policymakers must not eliminate one of the central foundations—the tax treatment of retirement savings—upon which today's successful system is built. As Congress and the Administration consider comprehensive tax reform and deficit reduction, we urge you to preserve these provisions that both encourage employers to offer and workers to contribute to retirement plans.

Question 5. At the hearing, we heard that one of the big issues for companies in sponsoring defined benefits is the change in accounting standards and rules requiring fair market value of pension liabilities which are reported on companies' balance sheets. Many companies believe that this has led to increased volatility for companies' balance sheets. Even if we revise the pension funding rules pursuant to ERISA for counter-cyclical events, would the current accounting rules still be an issue?

Answer 5. Not available.

Question 6. Your cooperative members operate a "multiple employer" defined benefit plan that allows multiple defined benefits plans to be rolled into a larger plan. Multiple employer plans seem to allow small businesses some of the benefits large companies have with their big participant pools. What can be done to allow other entities to have access to the multiple employer structure? Are there major regulatory burdens or roadblocks to implementing and running a successful multiple employer plan?

Answer 6. Our "multiple-employer" DB Plan provides cooperatives with a convenient and affordable mechanism to pool resources, maximize group purchasing power and leverage economies of scale that would otherwise be unavailable to small businesses like cooperatives. In fact, that is why NRECA created the Plan in 1948—our members could not afford all of the administrative expenses to set up and operate a plan on their own, and financial institutions were not interested in employers of our size.

There are, however, several statutory and regulatory burdens and roadblocks hindering the formation of association-based multiple-employer plans (MEPs) like ours, that are dedicated to doing the right thing for their members and their employees.

• **If Congress pursues a policy to expand MEPs, Federal laws and regulations should recognize the difference between bona fide "employer association-based MEPs," and "open MEPs" for fiduciary responsibility and liability purposes.** For true bona fide association-based multiple employer plans (like NRECA), participating employers share a relationship and common business goal unrelated to employee benefits and typically have voting authority with respect to the association. Employer-association MEPs assume enormous liabilities *for other employers* when sponsoring the MEP; in exchange for assuming the risk, complexity and cost, the central MEP sponsor must have control over policies, provider selection, plan management, and investments. If, for example, 1,000 participating employers in an employer-association-based MEP were obligated to assume responsibility for management and monitoring of the MEP, the advantages of the MEP de-

sign (centralization of cost and complexity), would be eviscerated, leading to increased costs and confusion. In that model, individual employers would need to hire sub-administrators to provide monitoring administration services, defeating the purpose of the MEP. To the extent Congress looks to expand opportunities for companies to join and/or establish MEPs, Congress should recognize bona fide association-sponsored MEPs' centralized responsibility and accountability and eliminate burdens at the participating employer level. **Further, Congress should be very leery of opportunistic for-profit companies who seek to establish "open MEPs," where employers share no "common-bond" relationship or voting authority with respect to the sponsoring entity, so there is no separate entity to assume those obligations**. With an open MEP, since there is no bona fide employer association sponsor, it makes sense to require participating employers to maintain these obligations. If any clarifications are made to current law on MEP structure or fiduciary responsibility and liability, Congress should carefully assess the structure, operation, oversight and participant protections in "open MEPs."

• **Expand eligibility to participate in employer association-based MEPs.** Under ERISA § 3(5), an employer includes an association of employers. Under various DOL advisory opinions specific to health and welfare plans, the DOL advised that employers who lack certain characteristics, such as the requisite degree of control, may not be eligible to participate in an employer association-sponsored plan. These opinions were primarily issued to address entities attempting to circumvent State health insurance requirements. Recent comments by the DOL suggested that the interpretation of 3(5) would be the same as to retirement plans. This interpretation generally does not impact existing association-sponsored MEPs or employers already participating in them, particularly "closed" association-sponsored MEPs like NRECAs. However, a narrow interpretation of the definition of employer would discourage the expansion of association-sponsored MEPs, or the formation of "open MEPs." Obviously, concerns about eligibility would further diminish the likelihood that an employer would establish or participate in a DB MEP. ***Congress could facilitate "open MEPs" or the expansion of existing association-sponsored MEPs, with appropriate safeguards.***

• **Congress should change rules that disqualify and penalize an entire MEP for the compliance failure of one participating employer.** Code section 413(c) and in particular Treas. Reg. § 1.413–2(a)(4) provides in essence that to the extent a single participating employer fails to comply with tax qualification requirements, all participating employers in the MEP and the MEP itself will be disqualified. Further, under revenue procedures, if a single participating employer fails to comply, the tax penalty is based not on the assets attributable to that employer, but on the assets of the *entire plan*. This rule is impractical and counter to a policy that encourages MEPs. ***Instead, Congress should implement a reasonable rule that imposes obligations only on the party that fails to comply.*** For example, the employer responsible for the breach could be (a) compelled to take corrective measures pursuant to IRS correction programs; and, (b) statutorily required to fund the liabilities affiliated with its own failure.

• **Enhance DB Plan Portability.** One primary advantage of an MEP like NRECA's is portability. In a true association-sponsored MEP like ours, employees of one co-op may transfer to another participating co-op without losing eligibility, service, or vesting credit. ***This portability should be preserved for existing MEPs and possibly made more widely available.***

• **Reporting and disclosure requirements for DB MEP Administration must be streamlined and simplified.** One of the most challenging aspects of MEP administration involves the reporting and disclosure requirements of Title I, Part I of ERISA. Unlike a single employer plan where the employer knows the employment status, address, compensation, marital and disability status of employees, in the MEP design, the participating employer, not the MEP administrator, has the data related to employee status. Similarly, unlike a union-based multi-employer plan where the benefit design is often the same or similar for collectively bargained employees, or a single employer plan where the plan design is largely the same for all employees, in the MEP design, each participating employer's benefit design is often different, including eligibility, benefit accrual, normal retirement date, vesting, etc. This creates necessary flexibility for employers operating in different markets with different compensation rates and is one of the most attractive features of an MEP for employers. However, it is also one of the most expensive and challenging to administer. For example, MEP administrators (like NRECA) may have thousands of different Summary Plan Descriptions (SPDs) and correspondingly complex disclosure requirements. Managing these difficulties requires extensive resources and increased expenses. ***Congress should examine ways to make electronic compliance as feasible as possible and provide flexible deadlines that recognize the***

difficulties of data collection and disclosure obstacles applicable to many different employers with unique benefit designs.

RESPONSE TO QUESTIONS OF SENATOR HAGAN BY DIANE OAKLEY

Question 1. Ms. Oakley, in your work at the National Institute on Retirement Security, have you seen a need for financial literacy programs not just in young people, but also in adults who are making important decisions about their retirement?

Answer 1. Senator Hagan, a wide body of research indicates that indeed, there is a need for increased financial literacy for Americans in all areas of personal finance.

According to Council for Economic Education (CEE), your State, North Carolina, is a leader on financial literacy for young people having already put in place standards for economic and personal finance education and requiring school districts to implement those standards and offer classes. Thanks to CEE and other programs like JumpStart we are reaching children and helping them understand about money, the economy and the importance of savings.

Financial Literacy for adults is also critical, especially today, as financial matters have become more complex and more of the risks for reaching important lifetime goals, like a secure retirement, are falling squarely on the shoulders of working Americans. We have often heard that adults take more time to plan a 2-week vacation than they take to plan their retirement. Research also tells us that Americans with a higher level of financial literacy are in a better position to manage their income during their working and retirement years. Economist Annamaria Lusardi found that retirement planning is a powerful predictor of wealth accumulation; those who plan have more than double the wealth of those who have done no retirement planning.

However, financial literacy can only do so much when it comes to helping Americans achieve retirement security. Even if an individual understands how to save for retirement, the bigger challenge is to convert that knowledge into action. Retirement plans that make it easy for Americans to save are far more valuable than financial literacy programs. For example, providing employees with access to a traditional pension eases the burden on Americans. The plan does the work—collecting regular savings, investing with professional asset management, and paying a stable monthly income in retirement that lasts until death. With a pension, the average employee does NOT have to be a financial planner, an investment advisor and an actuary in addition to their regular day job. This is particularly important as millions of Americans near retirement are struggling with how to contend with the ongoing volatility of the financial markets.

Ultimately, financial literacy is important, but not a silver bullet for what ails the Nation's retirement crisis. Twenty-five years ago more than 80 percent of large and mid-sized firms offered workers a defined benefit plan 25 years ago, but today less than a third do and that share continues to decline. If we have any hope of putting America back on track to reach the "retirement security" component of the American Dream, we need to restore the board pooling of "retirement risks" that is at the foundation of traditional pensions.

RESPONSE TO QUESTIONS OF SENATOR ENZI AND SENATOR HAGAN BY DAVID MARCHICK

SENATOR ENZI

Question 1. In your research, you found that defined benefit plans get "more bang for the buck" than defined contribution plans, however, your research comes from public pension plans. What about the volatility and accounting issues associated with private sector defined benefit plans? Do the longer period for amortization and "smoothing" allowed by public pension plans create stability for public pension plans or do they create more funding problems for State and local governments' pension obligations?

Answer 1. Unavailable.

SENATOR HAGAN

Question 1. Mr. Marchick, in your testimony you highlighted the liquidity that pension funds provide to U.S. financial markets. I agree that this is an important function, but it would seem to me that retirement assets, broadly speaking, provide that function. Regardless of whether assets reside in defined benefit or defined contribution plans, they are typically longer-term and more patient capital.

Can you help me understand the liquidity impact that we would see if pension assets were held elsewhere, for example in defined contribution plans? Would this pension fund liquidity disappear?

I also noted that in your testimony you cited return differentials between pension funds and other retirement assets. It is my understanding that pension funds are typically permitted to engage in certain activities not permitted by most defined contribution plans, such as investing in private equity funds or hedge funds.

What impact does the broader investment mandate enjoyed by some pension funds have on the return differentials you see between defined benefit and defined contribution plans?

Answer 1. Unavailable.

AMERICAN BENEFITS COUNCIL,
WASHINGTON, DC 20005,
February 3, 2011.

OFFICE OF REGULATIONS AND INTERPRETATIONS,
Employee Benefits Security Administration,
Attn: Definition of Fiduciary Proposed Rule,
Room N–5655,
U.S. Department of Labor,
200 Constitution Avenue, NW,
Washington, DC 20210.

Re: RIN 1210–AB32, Definition of Fiduciary Proposed Rule

DEAR SIR OR MADAM: On behalf of the American Benefits Council (the "Council"), I am writing today with respect to the proposed regulations addressing the definition of a fiduciary.

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

The Council has requested to testify at the hearing scheduled for March 1, 2011 and, if necessary, March 2, 2011. We thank the Department of Labor (the "Department") for scheduling the hearing and for extending the comment period. We believe that those were important steps in ensuring a full public policy dialogue with respect to this critical proposed regulation.

We understand the desire of the Department to update and improve the regulatory definition of a fiduciary. We agree that the retirement community would benefit from rules that establish clear lines between fiduciary advice, on the one hand, and non-fiduciary education, marketing, and selling on the other hand. However, we believe that the proposed regulations create too broad a definition of fiduciary. As discussed in more detail below, we are very concerned that an overly broad definition would actually have a very adverse effect on retirement savings by raising costs, inhibiting investment education and guidance for plans and participants, and significantly shrinking the pool of service providers willing to provide such investment education and guidance.

We know that the Department does not have any intent to create an overly broad definition that would adversely affect retirement savings or trigger burdensome and unnecessary costs that will be borne in whole or in part by participants. Accordingly, we look forward to a very constructive dialogue on the critical issues raised by the proposed regulations.

Defined contribution plan participants and individual retirement account or annuity ("IRA") owners have generally been given the opportunity and responsibility to make their own investment decisions and to design their own path toward retirement security. This is an enormous challenge for individuals who are not investment professionals and may not be familiar with the investment markets. The public policy challenge is how to facilitate participant education and engagement with respect to effective investment strategies, while at the same time protecting participants from misleading self-interested advice. Finding a balance between these two goals should, in our view, be the core objective of the new definition of a fiduciary.

Moreover, as discussed further below, it is essential that the Department's proposed regulations be coordinated with guidance issued by the Securities and Exchange Commission ("SEC") and the Financial Industry Regulatory Authority regarding the standard of conduct applicable to brokers and dealers. Without coordination, brokers and dealers would be subject to different and conflicting standards

with respect to the same advice, reducing their ability to provide clear sound advice to participants.

The proposed regulations would also pose great challenges for defined benefit plan sponsors seeking investment information and valuation services. In particular, it is critical that the proposed regulations be coordinated with specificity with the Commodity Futures Trading Commission's "business conduct" regulations regarding swaps; without clear coordination, the Department's regulations could render swaps unavailable to plans, with devastating results.

The importance of coordinating among Federal agencies has recently been strongly emphasized by the President in a January 18, 2011 Executive order:

> Some sectors and industries face a significant number of regulatory requirements, some of which may be redundant, inconsistent or, overlapping. Greater coordination across agencies could reduce these requirements, thus reducing costs and simplifying and harmonizing rules. In developing regulatory actions and identifying appropriate approaches, each agency shall attempt to promote such coordination, simplification, and harmonization.

Finally, as discussed below, we strongly urge the Department to provide broad transition relief to avoid significant disruption of the retirement plan world.

ENSURING THE CONTINUED AVAILABILITY OF INVESTMENT EDUCATION AND GUIDANCE AND SERVICES TO RETIREMENT PLANS

The Department's regulations could have very significant effects on the provision of services to plan sponsors, and on the provision of investment education and guidance to plans, plan participants, and IRA owners. In this regard, the regulations could cause certain established means of providing such services, education, and guidance to cease, which could leave plans and participants with less access to investment education and guidance. That is clearly undesirable.

We have the following recommendations with respect to avoiding this result:

- *Substantive modifications.* There are certain modifications to the proposed regulations that would be consistent with the Department's objectives but would not unnecessarily disrupt established and successful means of providing investment education and guidance. The remainder of this letter addresses those issues.
- *Effective date.* The regulations are proposed to be effective within 180 days of finalization. That is not enough time. These regulations could cause portions of the investment advice industry to be restructured or eliminated. For example, in some cases, advisors may need to alter the type of education and guidance they provide or possibly eliminate certain services in order to avoid fiduciary status. These advisors will need significant training. In other cases, advisors will become fiduciaries, and this may require restructuring their compensation packages, as well as the fee structures of their employer. Even if existing agreements are grandfathered (as discussed below), new agreements regarding investment services will need to be developed. And potentially far more entities and persons will need to be insured as fiduciaries. All of this requires a substantial amount of time, especially at a time when administrative frameworks and systems are being strained by adjustments to broad new disclosure regimes. A transition period of at least 12 months following finalization of the regulations (and implementation of any necessary prohibited transaction exemptions) is critical to avoid periods when investment information is materially less available for plans and IRAs.

  In addition, we urge the Department not to disrupt existing agreements. For example, a plan sponsor may have an existing agreement with a consultant to provide non-fiduciary investment information regarding the plan's investment options as well as other investment options that could be offered to plan participants. It would be very disruptive to cause that agreement to be terminated prior to its expiration by reason of the fact that the new rules would transform the arrangement into a fiduciary relationship. It may not be possible to renegotiate a different agreement under the new rules with the same service provider; it may even be the case that for a period of time, no service provider is prepared to provide services under the new rules. In this context, the forced termination of existing arrangements would certainly not be appropriate.

  Other existing arrangements may raise even more difficult problems. For example, swap agreements set out long-term financial and contractual obligations that cannot be modified without extensive and expensive renegotiations. The proposed regulations have great potential to force such renegotiations by, for example, treating certain valuations under typical agreements as fiduciary advice,

which would, in turn, trigger prohibited transaction issues and termination provisions in swap agreements.

We are still gathering information on the extent of the adverse effects on existing arrangements, but what we have uncovered to date convinces us that there is a great need not to disrupt existing arrangements that may be very difficult to modify or replace, especially in the short term.

• *Coordination with other guidance.* If certain established means of providing investment information cease to be workable, members of the retirement plan community will be looking for alternative means of providing such information. In this regard, it is critical that all available tools be ready and available when investment information delivery systems are being redesigned. This means that the finalization of the proposed regulations should be coordinated with other rulemaking that could affect investment information delivery systems. For example, the proposed regulations implementing the prohibited transaction exemptions under the Pension Protection Act of 2006 (the "PPA") should be finalized at least 12 months before the effective date of the fiduciary definition regulations, so that during the 12-month period, the plan community can explore whether use of the exemptions can provide a workable way to provide investment information.

It is important that the Department clarify that all currently applicable prohibited transaction exemptions would remain in effect. In that regard, if the Department is planning, in light of the regulation, to revisit any exemptions affecting the investment advice area, it is critical that this be coordinated with the finalization of the fiduciary definition regulations, so that all available means of providing investment information can be evaluated prior to the effective date of the new rules.

Coordination with the SEC is very important, as discussed further below. If the Department's regulations are finalized and effective at a time when broker/dealers' obligations under the securities laws are not settled, this will result in broker/dealers being unable to redesign their investment information delivery systems due to ongoing uncertainty. This could have a devastating effect on the availability of investment information from broker/dealers, which traditionally have been a very important source of such information, especially for small businesses and IRA owners.

Coordination with the CFTC and the SEC regarding swaps is also critical. If the Department's proposed regulations and the CFTC's proposed business standards were finalized in their current state, plans would effectively be forced to cease using swaps, with devastating results, as discussed further below.

CLARIFICATION OF THE BASIC DEFINITION OF "FIDUCIARY"

Individualized Specific Advice Should be Required in All Cases

In general. We are very concerned that the furnishing of investment recommendations may, under the proposed regulations, be treated as a fiduciary act even if the recommendations are not specific or individualized. For example, assume that an investment adviser (within the meaning of section 202(a)(11) of Investment Advisers Act of 1940) ("Investment Adviser") provides a firm newsletter to an IRA owner customer. The firm newsletter provides a discussion of the general market outlook, including a discussion of which industry sectors may be gaining or losing strength in the near future.

Arguably, the newsletter is providing recommendations regarding the "advisability of investing in, purchasing, holding, or selling securities." If so, the newsletter would appear to be fiduciary advice under the proposed regulation since (1) the newsletter is provided to an IRA owner, (2) the newsletter is provided by an Investment Adviser, (3) the newsletter does not appear to be covered by any of the "limitations" in § 2510.3–21(c)(2), and (4) compensation, such as brokerage commissions, would be earned in connection with purchases or sales of securities. Furthermore, under the proposed regulations, affiliates of the Investment Adviser' employer would also appear to be fiduciaries with respect to the matters addressed in the newsletter.

Clearly, the newsletter should not be treated as fiduciary advice. The newsletter is simply an effort to educate and engage individuals with respect to market trends. Such education should not be inhibited and we do not believe that the Department intended this result. (Of course, if a newsletter were sold that provides specific investment advice on particular investments that participants should buy or sell within a specific plan, the newsletter should be treated as fiduciary advice.)

The proposed regulations should be clarified so that in order to constitute fiduciary advice, recommendations must in all cases (1) be individualized to the needs

of the plan, plan fiduciary, or participant or beneficiary, and (2) address the purchase, sale, or holding of specific securities, rather than market trends or asset allocations. This should apply in the case of subclauses (A), (B), and (C) of § 2510.3–21(c)(1)(ii), in addition to applying for purposes of subclause (D).

Interaction with Interpretive Bulletin 96–1. Without the clarification described above, the meaning of Interpretive Bulletin 96–1 ("IB 96–1") would be cast into doubt. It is true that the proposed regulations specifically provide that the provision of investment education and materials within the meaning of IB 96–1 does not give rise to fiduciary status. But IB 96–1 has generally been read to permit education about investments that does not involve individualized advice regarding specific securities. The proposed regulations would call that interpretation into question by clearly implying that at least some non-individualized non-specific market guidance can constitute fiduciary advice.

If finalized in their current form, the proposed regulations would thus put a significant chill on investment education. Any non-individualized investment education that is not precisely addressed in IB 96–1 would be called into question and thus may cease to be provided. This would have a very adverse effect on critical educational tools currently in effect, leaving participants with far less information, especially low- and middle-income participants who may not be able to afford to acquire investment assistance elsewhere. In addition, this structure will clearly stifle any future innovation with respect to investment education, such as the application of IB 96–1 to plans (in addition to plan participants) as discussed below. We do not believe that the Department intended these results, which can be avoided by clarifying the regulations in the manner recommended above.

Fiduciary Relationship: "*May Be Considered*" *is Too Low a Threshold to Trigger Fiduciary Duties and Liabilities*

As discussed above, recommendations should be fiduciary advice only if individualized and specific. However, that alone is not enough. For example, assume that a plan participant has done extensive research and consulted with an advisor, and has decided tentatively to invest in a group of mutual funds available under the plan. As a last-minute check, the individual asks a friend in the employer's human resources department if the participant's fund selections make sense for an individual in his situation. The human resources employee says she is not an expert but the choices make sense to her and are consistent with what many others are doing. Under the regulation, that reaction may be investment advice if the human resources employee is compensated in part for dealing with plan-related questions.

Alternatively, instead of calling the human resources employee, the employee calls a friend who is an Investment Adviser of an affiliate of the financial institution offering some of the funds under the plan. The Investment Adviser has nothing to do with the plan and his affiliate operates completely independently of the institution offering some of the plan's funds. The Independent Adviser says that he cannot give the participant investment advice, but the choices seem generally appropriate for someone in the participant's position. That reaction is clearly investment advice under the proposed regulations (and would thus be a prohibited transaction).

These examples are not real investment advice. These are situations where individuals receive very incidental comfort regarding decisions made independently by them. Yet the proposed regulations would turn this into investment advice that triggers personal liability and, in the case of the Investment Adviser, a prohibited transaction. This is not the right result.

A fiduciary relationship should not be treated as existing unless:

> There is a mutual understanding that the recommendations or advice being provided in connection with a plan or IRA:
>
> (1) will play a significant role in the recipient's decisionmaking, and
> (2) will reflect the considered judgment of the adviser.

The "may be considered" standard is such a low threshold that almost any casual discussion of investments will satisfy it. An ERISA fiduciary relationship is a very serious relationship with the highest fiduciary standard under the law, including (1) application of the prudent expert standard, (2) a duty to act solely in the interest of the participants and beneficiaries, and (3) very significant potential liability. In that context, fiduciary status should not be triggered by casual discussions but only by serious communications that reflect a mutual understanding that an adviser/advisee relationship exists.

Thus, we urge the Department to replace the "may be considered" standard with the standard described above. Moreover, no recommendations should be treated as giving rise to fiduciary status unless such recommendations meet this standard.

Thus, this standard should be a part of subclauses (A), (B), and (C) of § 2510.3–21(c)(1)(ii), in addition to being part of subclause (D).

Requiring Individualized Specific Advice and Raising the "May Be Considered" Threshold Would Address Other Concerns

A number of concerns have been identified regarding the proposed regulations' "status" rules under which an adviser may, for example, become a fiduciary by reason of being a fiduciary for another purpose, an Investment Adviser, or in some cases an affiliate of an entity that meets one of these "status" requirements. (If the Investment Adviser "status" rule is retained, it should be clarified that the exclusions under section 202(a)(11) of the Investment Advisers Act of 1940 apply in determining who is an Investment Adviser for purposes of the regulation.) For example, if a financial institution serves as a directed trustee, any discussion of the market by an affiliate of the financial institution, however benign the discussion, could arguably be treated as fiduciary advice under the proposed regulations solely by reason of the conceptually irrelevant point that the affiliated financial institution serves as a directed trustee. This inappropriate result is avoided if the proposed regulations are modified, in accordance with the suggestions set forth above, to provide that advice is treated as giving rise to fiduciary status if and only if:

(1) There is a mutual understanding that the recommendations or advice being provided in connection with a plan or IRA:

(a) will play a significant role in the recipient's decisionmaking, and
(b) will reflect the considered judgment of the adviser, and

(2) The recommendations or advice is individualized to the needs of the plan, plan fiduciary, or participant or beneficiary.

Thus, proposed regulation § 2510.3–21(c)(1)(ii) should be revised so that a person cannot be a fiduciary by reason of providing investment advice unless the person's recommendations or advice satisfies the above requirements.

"*Management of Securities or Other Property*": *the Proposed Regulations Would Transform Contract Reviews and Other Non-Investment Advice Into Investment Advice*

The proposed regulations would include within the definition of "investment advice" the following: "advice . . . or recommendations as to the management of securities or other property." The preamble states that:

> This would include, for instance, advice and recommendations as to the exercise of rights appurtenant to shares of stock (e.g., voting proxies), and as to selection of persons to manage plan investments.

The broad language of the proposed regulations raises many questions:

• A plan decides to change trustees, chooses a new trustee, and begins negotiating a trust agreement with the new trustee. The plan asks for advice with respect to the terms of the trust agreement from the plan sponsor's internal and external ERISA and contract attorneys, as well as the plan sponsor's compliance personnel, human resources department, and tax department. The trustee is involved in the "management" of plan assets, and the terms of the trust agreement affect that management. Does that mean that all of the above personnel advising the plan with respect to the trust agreement are fiduciaries? If it does, the cost of trust agreements and many other routine plan actions will increase exponentially with the imposition of new duties and large potential liabilities. Also, many of the above persons may refuse to work on the project without a full indemnification from the plan sponsor. We do not believe that this type of cost increase and disruption was intended.

What about the persons working on the agreement for the new trustee? If such persons make any "recommendations" to the plan in the course of negotiations, they would become fiduciaries because the seller exemption, on its face, only appears to apply to sales of property and not services. Any such recommendations would thus trigger fiduciary status and corresponding prohibited transactions. Theoretically, this could chill all meaningful give-and-take during the negotiations, and many institutions may be unwilling to act as trustee. Again, we do not think that this was intended.

• A plan has decided to enter into a swap and must execute a swap agreement. The terms of the swap agreement will have a significant effect on the plan's rights with respect to the swap. The plan asks its internal and outside securities counsel to work on the swap agreement, and to consult with the plan's internal and outside ERISA counsel. The plan also asks its investment manager for input on the types of provisions that are important for plans to include (or exclude) in swap agreements. The plan accountant is also asked to review the agreement. Finally, the com-

pany's own compliance personnel, contract experts, and finance department also review the agreement.

The terms of the swap agreement affect the "management" of the swap. So do all of the above personnel become fiduciaries under the proposed regulations? If the answer is yes, plans' cost of investments will skyrocket, as an enormous new set of individuals and companies that have little material role in plan investments become fiduciaries, with far greater potential liability and a higher standard to meet. In addition, as noted above, many persons would likely refuse to review the agreement absent a full indemnification by the plan sponsor.

- A plan negotiates a loan agreement in connection with an ESOP. Is everyone who works on the loan agreement a fiduciary? Could individuals working on the loan agreement for the lender become fiduciaries if they make any "recommendations" during negotiations?
- Are Board recommendations regarding proxy voting on employer securities a fiduciary act? They could be under the proposed regulations.

To avoid the inappropriate results described above and many other similar results, we strongly urge you to provide a precise and appropriately narrow definition of "management" in the regulations. Under the definition, "management" would include:

- The selection of persons to manage investments;
- *Individualized* advice as to the exercise of rights appurtenant to shares of stock; and
- Any exercise of discretion to alter the terms of a plan investment in a way that affects the rights of the plan, unless such exercise of discretion has been specifically reviewed and agreed to by a plan fiduciary. In the swap context, for example, swap terms can be modified without plan review and consent by, for example, swap data repositories. If any such changes are made, anyone making those changes is acting for the plan and should be treated as a fiduciary. Moreover, such treatment is necessary in order to prevent harm to the plan.

This would target the actions identified by the Department in the preamble and would give the Department the flexibility to identify additional forms of "management". But it would not have the inappropriately broad consequences illustrated above.

Even Without the Management Issue, the Proposed Regulations Would Transform Legal Advice and Other Non-Investment Advice Into Investment Advice

Assume that the definition of "management" is revised in accordance with our suggestion. Let us go back to the swap example set forth above.

- Assume that ERISA counsel advises the plan that entering into a swap with the particular dealer would raise prohibited transaction issues and counsels the plan not to enter into the swap for that reason. Under the proposed regulations, that would clearly constitute investment advice, making the ERISA attorney a fiduciary.
- Assume that the plan sponsor's contract experts determine that, separate from any investment issue, the swap agreement gives the dealer too much discretion in interpreting critical terms and advises the plan not to enter into the swap. That internal contract expert would be rendering investment advice under the proposed regulations and thus would also clearly be a fiduciary.
- Assume that the plan sponsor's compliance personnel are concerned about whether the swap, as structured by the dealer, would comply with the law and advise the plan not to enter into the swap for that reason. Again these internal compliance personnel would be rendering investment advice under the proposed regulations and thus would be fiduciaries.

These inappropriate results can be avoided by adding an additional exception to the regulations. Under this exception, advice would not be treated as investment advice if it relates to the compliance of the investment with applicable law or relates to risks separate from the advisability of the underlying investment.

Clarity: *Permitting the Parties' Agreement to Clarify Fiduciary Status*

Both plan sponsors and service providers have emphasized to the Council the importance of clarity with respect to who is and who is not a fiduciary. We know that similarly this is an important issue for the Department. In this regard, we remain concerned that, even with our suggested changes, it would be difficult in many circumstances to determine whether a fiduciary relationship exists.

Accordingly, we recommend that the regulations provide that a service provider, adviser, or appraiser is not a fiduciary if the parties agree in writing to that effect. (This rule would apply separately from, and in addition to, the seller exemption.)

We also propose the following safeguards be adopted as part of the rule we are suggesting:

• The agreement would have to describe the type of advice that the parties agree is not fiduciary advice. For example, assume that a plan uses a particular investment manager ("Manager A") for Pacific Rim investments. The agreement could provide that any advice not related to Pacific Rim investments is not fiduciary advice.

• The agreement would also have to describe how the decisions on which the nonfiduciary advice may be given would be made. Under the agreement between Manager A and the plan, for example, Manager A agrees to be available to discuss investment opportunities outside the Pacific Rim, but the agreement specifies that the plan relies on different investment managers with respect to such other investments. The plan wants Manager A to be available as a sounding board and as a source of questions for the other investment managers, but the plan does not make such other investment decisions based on Manager A's advice. In these circumstances, Manager A would not be a fiduciary with respect to the advice it renders regarding such other investments.

• Similarly, if a swap counterparty provides information to a pension plan as required by the terms of a financial instrument or if requested by a fiduciary to a pension plan prior to entering into a financial instrument, the fiduciary to a pension plan and the counterparty should be able to agree that the plan is relying on other advisors and that counterparty is not a fiduciary to the pension plan.

On a separate but related point, we urge the Department to clarify that an advisor is not treated as having acknowledged fiduciary status under Proposed Regulations § 2510.3–21(c)(1)(ii)(A) unless such acknowledgement is made in writing. Clarity with respect to fiduciary status is critical, and the regulations should not make fiduciary status turn on oral, informal discussions.

Plan-Level Education: *Application of IB 96–1*

We believe that there is no legal or conceptual reason why the principles of IB 96–1 regarding investment education should not be extended to defined benefit and defined contribution plans. The provision of investment education to defined benefit and defined contribution plan fiduciaries should not give rise to fiduciary status.

Plan Sponsor and Advisor Employees: *Who Should Be a Fiduciary?*

By very significantly lowering the threshold for fiduciary status, the proposed regulations raise serious questions regarding which plan sponsor and advisor employees may be treated as fiduciaries. For example, it is, of course, common for a plan sponsor to form a committee of senior executives to oversee plan issues, including plan investment issues. It is certainly clear that such committee has fiduciary status. But plan sponsors have expressed concern about the status of other employees who perform the research and analysis necessary to present investment issues for the committee's review and resolution.

Such other employees may provide recommendations for the committee to consider. This is simply how companies work. Middle-level employees frame issues for senior employees to resolve; issues are best presented in the context of a recommendation based on the advantages and disadvantages of any decision, so that senior employees can quickly appreciate the relevant factors. Many employees may participate in the research and the preparation of the recommendations to the committee. If all of these employees were fiduciaries, the effects would be severely negative.

• The cost of fiduciary insurance would skyrocket, if such insurance would be available at all for such employees.

• It would certainly become more difficult to get employees to work on these projects in the face of potentially staggering liabilities and lawsuits.

• Creative work and recommendations would likely be stifled as middle-level employees propose conservative approaches with less downside (and correspondingly less upside).

The bottom line is that the employees preparing the reports for the plan committee are not the decisionmakers. They are the researchers who prepare recommendations based on objective criteria for the committee members to evaluate and resolve. And the proposed regulations could potentially sweep in a huge number of employees, since the middle-managers formulate their recommendations based on the work of employees who in turn work for them.

As noted, this issue applies to third-party advisors as well as to plan sponsors. Recommendations by advisors may be formulated by a team of employees employed by the advisor. It would not make sense to treat the entire team of individuals as fiduciaries.

Accordingly, we ask that you clarify the regulations to address the situation where a company or committee within a company serves as a fiduciary with respect to investment decisions or recommendations. In that case, the employees who help the company or committee make those decisions or recommendations should not be fiduciaries. Otherwise, we could have a real problem as potentially hundreds of employees without decisionmaking power become fiduciaries. This is not to suggest that employees of a fiduciary company cannot be a fiduciary. For example, an advisor company's employee may have the advisory relationship with a plan or participant and may become a fiduciary by reason of that relationship. Or an employee newsletter might be sold to the company employees making very specific recommendations regarding the investments available under the company's plan in which the employees should invest. But these cases are different. In these cases, employees involved are making direct investment recommendations that are not filtered through supervisors or entities that are fiduciaries.

SELLER/PURCHASER EXEMPTION

Scope of the Exemption

The deletion of the "regular basis" and "primary basis" requirements from the existing regulation puts enormous pressure on establishing a workable distinction between selling and advice. If a one-time recommendation can give rise to fiduciary status, it is essential to distinguish between fiduciary recommendations and the selling of investment products or services. In both cases, the participant or plan is provided with in-depth recommendations regarding investment decisions. But clearly in the case of selling, there is no fiduciary relationship nor would the commercial world be workable if such a fiduciary relationship were imposed.

Thus, we applaud the Department for including an exemption for persons acting as, or on behalf of, purchasers or sellers. However, it is critical that the scope of this exemption be clarified. Consider, for example, the following situations:

- A plan offers 40 mutual funds sponsored by fund families X, Y, and Z, as well as target date funds sponsored by fund families X and Y. A representative of X meets with a participant to promote her firm's target date funds. The representative makes all appropriate disclosures regarding her self-interest. The recommendations made by the representative seem clearly covered by the proposed seller exemption, as they should be.
- Same plan as above. A representative of Z meets with a participant and provides the participant with an illustrative portfolio consisting of Z funds. This representative also makes all the appropriate disclosures and recommends the illustrative portfolio as better than X and Y's target date funds. This recommendation should clearly be covered by the seller exemption. Otherwise, the law would be, without justification, favoring target date funds over a group of funds that can perform the same function.
- Same plan. An Investment Adviser with a commercial relationship with Y meets with a participant to promote Y's target date funds. The Investment Adviser states in writing that she receives compensation for selling Y's funds, and makes all other appropriate disclosures. Again, the proposed seller exemption should clearly cover this arrangement. The Investment Adviser discloses the compensation arrangement with Y and makes all other appropriate disclosures necessary to alert the participant to the Investment Adviser's self-interest. There is no reason for such an arrangement not to be covered by the seller exemption.
- Pursuant to an RFP, a plan interviews three investment consultants to review the plan's mutual fund offerings on an ongoing basis. As part of the interview process, the plan asks all three to come prepared with a review of the plan's current offerings, together with recommendations for any changes. This is a very common part of the RFP process and it should be clarified that responses to RFPs (and similar marketing initiatives) do not constitute fiduciary advice.
- IRA account. A representative of Z (a financial institution) meets with a client who indicates that he would like to roll over his section 401(k) account plan balance to an IRA. After discussing the client's goals and assets, the representative of Z recommends that the client open an IRA custodial account with specific investments. The representative not only recommends products manufactured by Z but also by firms Y, X and V with whom Z has selling agreements. The representative makes all appropriate disclosures regarding her self-interest. All of these recommendations should be covered by the proposed seller exemption. The fact that Z makes other firms' investments available (i.e., an "open architecture firm") versus solely its own manufactured products should not affect the analysis. Both open architecture firms and those that only sell their own proprietary products should be able to avail themselves of the seller's exemption with the appropriate disclosures.

• A pension plan fiduciary is contacted by an investment bank to discuss potential trades with the investment bank as a counterparty, the investment bank provides information in advance of the trade to the pension plan fiduciary. The parties agree in writing either at the establishment of the counterparty relationship, or in the terms of the trade, that the plan fiduciary (and not the investment bank) is the fiduciary to the pension plan with respect to any dealings with such investment bank and that any information provided by the investment bank is not provided on a "fiduciary" basis to the pension plan. The information provided to the plan fiduciary should not be viewed as a "recommendation" or "investment advice" even if specific to the pension plan. Instead, the parties should be able to rely on the investment expertise of the plan's investment manager, and not the investment bank counterparty which clearly has a conflict of interest. Otherwise, dealers will either refuse to deal with pension plans and plan fiduciaries or provide only "generic" information to potential pension plan counterparties which will put pension plan fiduciaries at an information disadvantage.
• A defined benefit plan asks an asset manager for information regarding liability-driven investing. The manager provides white papers it has drafted on the topic and shares some general approaches on how defined benefit plans can implement liability-driven investing. The manager offers its services to the plan fiduciaries, which could be in the form of managing a separate account to a liability benchmark and/or investing in a liability-driven fund offered by the asset manager. It is unclear whether the seller exemption would cover this selling of investment services, but it clearly should if the manager discloses its potential self-interest in the separate account and fund contexts.

We ask the Department to clarify the purchaser/seller exception in accordance with the above discussion. The seller exemption should apply in any case where the entity providing a recommendation has a self-interest in the decision to be made by the plan or participants, and that self-interest is clearly and effectively communicated. Conceptually, it does not make sense to distinguish among sellers of an investment product, providers of an investment-related service, and any other entities that have a financial interest in the decision made by the plan or participant. The fundamental principle is clear: any person with an interest in an investment decision to be made by a plan or participant should be entitled to promote products and services as long as such person makes his or her self-interest clear. Any other rule would effectively prohibit marketing, promotion, and selling, which is not ERISA's purpose.

See also the discussion of the seller exemption in the context of distribution advice below.

Disclosure

Under the proposed regulations, the seller/purchaser exception only applies if the recipient of the advice:

> knows or, under the circumstances, reasonably should know, that the person is providing the advice or making the recommendation in its capacity as a purchaser or seller of a security or other property . . . whose interests are *adverse* to the interests of the plan or its participants or beneficiaries, and that *the person is not undertaking to provide impartial investment advice*. **[emphasis added]**

We have several comments regarding this language. First, the reference to "adverse" interests should be deleted. The relationship between a seller of investment products and an investor is by no means "adverse". The seller's objective is to establish a long-term mutually beneficial relationship. If the investor is not happy with the product or the service or feels somehow misled or taken advantage of, that will result in a short-term relationship and unhelpful word-of-mouth for the seller. It is certainly true that sellers of investment products profit by selling, but that is true of all product and service providers, including doctors, lawyers, counselors, etc. In short, the term "adverse" is inaccurate and unduly negative, and it does not provide the recipient of the disclosure with any meaningful information.

Second, the reference to "not undertaking to provide impartial advice" is not necessarily correct. Sellers may in many circumstances be impartial because their objective is not short-term profits, but a long-term relationship.

In lieu of the "adverse" and "not . . . impartial advice" references, the proposed regulations should be modified to be more accurate and precise. Regulation § 2510.3–21(c)(2)(i) should be amended by deleting all the words starting with "whose interests are" replacing them with the following:

> who has a financial interest in the transaction to which the recommendation or other information provided relates.

This is an accurate portrayal of the relationship between a seller and investor, much more accurate than the description in the proposed regulations. It would be a disservice to both the seller and the investor to describe their relationship inaccurately.

Finally, we believe that the regulation should make clear that disclosures of the seller/purchaser's relationship to the investor, as described above, should satisfy the "knows or reasonably should know" standard. So if a seller/purchaser were to make the above disclosure in writing, and provide a general description of the financial interest, that should satisfy the seller/purchaser exception.

PLAN MENU OF INVESTMENT OPTIONS

The proposed regulations would confirm that the offering of a service provider menu of investment options does not constitute fiduciary advice. It should be clarified that this treatment does not turn on the service provider menu meeting any requirements regarding the number or nature of investment options. The critical issue, however, is: how does an employer select a plan menu of investment options from the broader service provider menu? In that regard, the proposed regulations clarify that "the provision of general financial information and data" to assist the employer in selecting a plan menu is not fiduciary advice.

Today, one of our greatest challenges in the retirement security area is broadening the retirement plan coverage among small businesses. It is critical that we step back and consider this proposed rule in that context. Small businesses will generally adopt a retirement plan only if the process is simple and inexpensive. If the process is burdensome, complicated, or costly, small businesses simply will not adopt retirement plans. In this context, imagine the hardware store owner who would like to adopt a plan for his 12 employees. Assume that the service provider presents its menu of 300 investment options, provides objective data regarding all 300, and tells the hardware store owner (1) to decide how many to offer and (2) to pick the right options for his employees, subject to fiduciary liability if he picks imprudently. Alternatively, the hardware store owner can find some independent consultants, interview them, choose one (subject to fiduciary liability), and pay that consultant a substantial amount of money to pick and monitor the plan menu.

Needless to say, if that is the message that the hardware store owner receives, he will not adopt a plan for his employees. So if the rule set forth in the proposed regulations is finalized without further clarification, we may well see a marked decline in retirement plan coverage.

Service providers need a way to provide employers with help in choosing the plan menu so that the process is simple and inexpensive. In this regard, we urge you to treat all of the following as not triggering fiduciary status:

- The service provider may provide the plan fiduciary with objective factors that others commonly use in selecting plan menus, such as fund ratings, past performance (measured against competitive funds), risk measurements, fees, and manager tenure.
- The service provider may screen funds based on objective criteria that are provided by the plan fiduciary or that are commonly used in the industry. For example, if the plan fiduciary establishes criteria based on fund ratings, past performance (measured against competitive funds), fees, risk, and manager tenure, the service provider may screen the available funds based on such criteria and provide the plan fiduciary with fund options that meet the plan fiduciary's criteria. Within each investment category, there would generally be multiple funds for the plan fiduciary to choose from, but in some circumstances, there could be a single fund.
- The service provider may present non-individualized model plan menus that other similar businesses have chosen or that reflect a conservative, moderate, or aggressive investment approach, with an explanation of objective differences between the menus.
- In the context of responding to an RFP, it is very common for service providers to provide a non-individualized model plan menu of investment options. This is necessary for pricing purposes and it is made very clear that the model menu is not being recommended. This should not give rise to fiduciary status.
- The service provider may provide objective reasons that a plan fiduciary might choose one fund over another or might choose one model portfolio over another.
- In some cases, a plan fiduciary may have decided to remove an investment option and may ask a service provider for a replacement fund that is, based on objective criteria, very similar to the fund being removed. Responding to this request with objectively similar funds—or a single fund if only one is objectively similar—should not give rise to fiduciary status.

• In some cases, the service provider encourages a plan to have at least one investment option in every specified asset class and to have a set of target date funds (or similar investments).
• A service provider might design its arrangements so that all "mapping" is done to the plan's QDIA.
• The service provider may also use the seller exemption. It makes little sense to prohibit a service provider from using the seller exemption in situations where the service provider is selling a particular plan menu.

Finally, the disclosures regarding "not undertaking to provide impartial investment advice" need to be modified to be accurate, as discussed above. The disclosure with respect to the service provider menu should provide as follows:

> The investment alternatives available were selected based on various criteria, including past performance, fees, quality of management, popularity, reputation, stability, financial relationships with the service provider, and/or compatibility with the service provider's administrative systems.

The disclosure with respect to assistance in selecting the plan menu should be modified as follows:

> The service provider may have a financial interest in the investment alternatives that are offered under the plan.

VALUATION

We have multiple concerns regarding the proposed position that, subject to a narrow exception, asset valuations are fiduciary acts.

Transaction-Based Distinction

We believe that it is critical that the regulations draw a distinction between two very different types of valuations. On the one hand, there are valuations that affect the amount of money that a plan pays or receives for the asset being valued. For example, if a plan is buying or selling real estate or closely held securities, a valuation may be relevant in determining how much a plan pays or receives. These valuations can materially affect the total amount of plan assets available to provide benefits to participants. This letter refers to such valuations as "Transaction-Based Valuations."

On the other hand, there are valuations that do not affect the total amount of plan assets available to pay benefits to participants. For example:

• A plan must value annuity contracts, separate accounts, GICs, and other assets without a readily ascertainable value in order to determine the required minimum distributions ("RMDs") that must be made under section 401(a)(9) of the Internal Revenue Code (the "Code").
• All defined benefit plan assets must be valued in order to determine the plan sponsor's funding obligations, as well as for purposes of applying the various benefit restrictions applicable under ERISA section 206(g) and Code section 430. These benefit restrictions include restrictions on a plan's ability to pay benefits in certain forms, such as lump sums.
• In many circumstances, a participant's defined contribution plan account may hold an interest in an asset such as a separate account, a GIC, an annuity contract, collective investment fund, or another asset without a readily ascertainable market value. In order to determine the amount payable to a terminating participant, it may be necessary to value such assets.

Though these valuations could affect the timing or form of distribution and/or the relative benefits paid to different participants, the valuations have no effect on the total assets available to pay benefits to participants. There is thus no risk that total plan assets may be inappropriately reduced by such valuations. On the contrary, these are everyday valuations that are necessary to the normal operation of a plan.

Moreover, if these valuations give rise to fiduciary status, holding these types of assets in plans will at the very least become much more expensive by reason of (1) the significant additional liability assumed by the person valuing the asset, and (2) the fact that many service providers will cease providing valuations due to the potential liability. In fact, it is very possible that the prohibited transaction rules would preclude many investment product providers from valuing their own products.

In addition, persons performing routine valuations would be forced to engage in new and difficult legal analyses. For example, in valuing assets for purposes of the RMD rules, what is a fiduciary's duty? To minimize the value to preserve as much as possible in the plan? To maximize the value to avoid possible plan disqualification and/or participant excise tax problems? In valuing assets for purposes of fund-

ing determinations, is there a duty to minimize the value to increase funding obligations? Or is there a duty to maximize the value to permit the continued availability of all forms of distributions? Or should the appraiser be concerned that lump sums could drain the plan of assets, so that the valuation should be minimized?

In addition to sharply increased costs, we envision this regulation creating extremely difficult new issues for which there are no answers, like the issues noted above. Thus, routine plan operations will be thrown into question, and many service providers may simply refuse to provide such routine valuations, leaving plan sponsors without a means to operate their plans. And what purpose would be served by the additional cost, legal uncertainty, and operational chaos? None that we can think of. No problem has been identified that would justify the enormous disruption triggered by imposing fiduciary status by reason of performing routine valuations that do not affect total plan assets.

Other "Non-Transaction-Based" Issues

We are very concerned that we have barely scratched the surface of all the issues that could arise if the proposed regulations' treatment of valuations were finalized. For example, even custodians that simply report valuations prepared by others could be swept into fiduciary status. Similarly, service providers that value managed or unitized investment options (such as a fund of funds) based on third-party values could be treated as fiduciaries. Clearly neither of these results would be appropriate.

But it may be particularly helpful to explore the "non-transaction-based" issues in the context of one example: investment in uncleared swaps. (Similar issues may exist with respect to cleared swaps.) In the case of uncleared swaps (which will still exist in large numbers after the Dodd-Frank Act), a swap has to be valued frequently—often daily—in order to adjust the collateral posted by one or the other parties to secure the obligation under the swap agreement. Generally, it is the "dealer" that performs the valuation, subject to review and possible contestation by the plan (or other end user). The valuation by the dealer may be a fiduciary act under the proposed regulations:

- The valuation is an appraisal of property;
- The valuation is provided to a plan or plan fiduciary;
- The valuation is performed pursuant to a written agreement that it may be considered in connection with making decisions regarding management of assets (i.e., the posting of collateral), and the valuation is individualized to the needs of the plan; and
- Neither the seller exemption nor the valuation technically exemption applies. (In our view, the seller exemption should clearly apply, as discussed above, but in its current form, the exemption may not apply since the valuation is not performed in the context of a sale.)

If the dealer's valuation is a fiduciary act, then the valuation is also a prohibited transaction that runs afoul of ERISA section 406(b), since the dealer's interest is adverse to the plan's. One might argue that the dealer should not perform the valuation due to its self-interest and that all valuations should be performed by independent third parties. But that would cause very significant disruption in the swaps market. Moreover, the plan reviews the dealer's valuation and has the right to challenge it, so the conflicted nature of the dealer's valuation is not of concern. But most importantly, the Dodd-Frank Act *requires* the dealer to make the valuation available to the plan. See section 731 of the Dodd-Frank, adding section 4s(h)(3)(B)(iii)(II) of the Commodity Exchange Act. So the option of solely using an independent third party to value the swap is simply unavailable.

Even if this problem could be solved, an additional problem exists. As noted above, the plan has the right to contest the dealer's valuation and rely instead on an independent party's valuation. This system would no longer be available under the proposed regulations. By reason of performing the valuation, the independent appraiser would become a fiduciary with an exclusive duty of loyalty to the plan. Accordingly, the appraiser would cease to be independent, leaving the dealer and the plan with no way to resolve their valuation dispute.

Thus, the proposed regulations would create unworkable conflicts in the law with respect to swaps. How many more conflicts or problems are lurking out there with respect to this valuation issue? We do not know, nor does anyone. And that is our point. This valuation issue needs far more study and work before it moves forward. This is clearly true with respect to Non-Transaction-Based Valuations, since no problems or issues have been identified that would justify the disruption and cost that would be triggered by finalization of the proposed regulations.

Transaction-Based Valuations

Transaction-Based Valuations, such as in the context of ESOPs, seem to have provided the impetus for including valuations in the proposed regulations as fiduciary acts. The preamble to the regulations specifically states that "a common problem identified in the Department's recent ESOP national enforcement project involves the incorrect valuation of employer securities."

We have two concerns with respect to Transaction-Based Valuations. First, as in the case of Non-Transaction-Based Valuations, we are very uncertain what the fiduciaries' duties would be. In the preamble, the Department states that it:

> would expect a fiduciary appraiser's determination of value to be unbiased, fair, and objective, and to be made in good faith and based on a prudent investigation under the prevailing circumstances then known to the appraiser.

If this is truly the standard, it needs to be reflected in the regulations, because that would not be how we read the law. A fiduciary is required by law to "discharge its duties with respect to a plan solely in the interest of the participants and beneficiaries." A fiduciary is required by law not to be unbiased and objective; on the contrary, a fiduciary is required to represent the participants. For example, in negotiating with a service provider over fees, a fiduciary is required to solely represent the plan's interests, not to be an unbiased and objective arbiter of what level of fees are "fair" for both parties.[1]

Without further regulatory clarification, an appraiser's duty would be to minimize a plan's purchase price and maximize a plan's sales price. That would mean that the opposing party would be required to hire a second appraiser, doubling the cost, and then there could well be a further negotiation based on the disparate valuations and, as in the case of swaps, possibly the need to hire an independent appraiser. Moreover, as discussed, by requiring that appraisers be plan fiduciaries, the proposed regulations would prohibit such "independent" party from being truly independent, leaving the plan without a mechanism to resolve the dispute. This could possibly also leave many ESOPs without a means to satisfy the "independent appraiser" requirement of Code section 401(a)(28)(C).

In short, applying a true fiduciary duty to an appraiser would be very disruptive, as well as unworkable, with respect to all Transaction-Based Valuations. Yet the preamble indicates that that is not what the Department intended. In fact, the result intended by the Department—a fair and objective valuation—may not be achievable through fiduciary status, which imposes wholly different obligations. Thus, we urge the Department to revisit this issue, so as to achieve the worthy objective described in the preamble.

Second, appraisals do not fall within the statutory definition of fiduciary advice. Appraisals are not "investment advice" under ERISA section 3(21)(A)(ii). As aptly discussed in Advisory Opinion 76–65, an appraiser is not rendering a view as the advisability of an investment decision; an appraiser is simply providing an opinion as the value of property.

In short, we urge the Department to pursue its worthy objectives with respect to the valuation of employer securities through a different approach that is workable and consistent with the statute.

COORDINATION WITH OTHER AGENCIES

As noted above, on January 18, 2011 the President issued an Executive order emphasizing the importance of agency coordination. This means far more than agencies letting each other know about regulatory projects being developed. In the President's words, coordination means "harmonizing rules" and avoiding "inconsistent" or "overlapping" rules. Such coordination among the Department, the SEC, and the CFTC is essential as described below.

Broker/Dealers: *Coordination Between the Department and the SEC*

Under the proposed regulations, a very large number of brokers and dealers will become fiduciaries, such as a broker or dealer who gives individualized advice to a customer regarding IRA investment. This could present a major problem in light of the broker/dealer's compensation structure. As a fiduciary, the broker/dealer's opportunity to receive commissions or other compensation in connection with the advice would in many cases, absent an applicable exemption, cause the broker/dealer to have committed a prohibited transaction solely by reason of the fact that the customers' trading practices could affect the broker/dealer's compensation. We recognize

[1] See generally *Bedrick By & Through Humrickhouse* v. *Travelers Ins. Co.*, 93 F.3d 149, 154 (4th Cir. 1996) ("[t]here is no balancing of interests; ERISA commands undivided loyalty to plan participants").

that the Department's regulations are only proposed, but in their current state, they would generally provide broker/dealers with a choice: restructure an entire industry's compensation arrangements or cease providing certain essential services to customers.[2] Thus, the Department's proposed regulations could have a very adverse effect on the provision of investment assistance to participants, which is exactly the opposite of what is needed.

The SEC's Study. The SEC's staff ("Staff") recently completed the study required by section 913 of the Dodd-Frank Act regarding the standards of care applicable to broker/dealers and investment advisers with respect to the provision of investment advice to retail customers (the "Study"). The Dodd-Frank Act specifically directs the SEC to study the effects of subjecting broker/dealers to the rules applicable to investment advisers. In addition, the SEC is authorized to issue regulations subjecting broker/dealers to such rules.

The Dodd-Frank Act is, however, clear that, unlike the Department's proposed regulations, any possible change in the standard of care applicable to broker/dealers is not intended to require "standard compensation" arrangements to be restructured: the "receipt of compensation based on commission or other standard compensation for the sale of securities shall not, in and of itself, be considered a violation of such standard applied to a broker or dealer." On the contrary, the Dodd-Frank Act clearly emphasizes addressing broker/dealers' compensation structures through disclosures of "material conflicts of interest."

In the Study, the Staff recommended:

> the consideration of rulemakings that would apply expressly and uniformly to both broker-dealers and investment advisers, when providing personalized investment advice about securities to retail customers, a fiduciary standard no less stringent than currently applied to investment advisers. . . .

Study at v-vi.

The Staff's reasoning for this conclusion included the following:

> a harmonization of regulation—where such harmonization adds meaningful investor protection—would offer several advantages, including that it would provide retail investors the same or substantially similar protections when obtaining the same or substantially similar services from investment advisers and broker-dealers. . . .
>
> [R]etail customers do not understand and are confused by the roles played by investment advisers and broker-dealers, and more importantly, the standards of care applicable to investment advisers and broker-dealers when providing personalized investment advice and recommendations about securities.

Study at viii, 101.

Coordination. The regulatory projects undertaken by the Department and the SEC have enormous overlap; i.e., they overlap with respect to all retail customers saving for retirement under arrangements subject to the Department's regulations. Yet neither the Study nor the Department's proposed regulations indicate that there will be any coordination with the other project. The Study states that "the requirements of ERISA are beyond the scope of the Study." Study at 87. The Department's proposed regulations do not mention the upcoming Study, despite the fact that it addresses the same issue.

This lack of coordination is of great concern for many reasons:

• *Executive Order.* This lack of coordination is directly contrary to the Executive order issued by the President on January 18, 2011, which requires coordination, not simply notifying other agencies of pending projects. The order is critical of regulatory requirements that are "inconsistent or overlapping" and requires agencies to attempt to promote "coordination, simplification, and harmonization."

• *Inconsistent with the Study.* The Study concludes that the existence of differing standards harms and confuses investors. Yet without coordination between the two agencies, we appear to be moving toward enshrining a system whereby broker/dealers providing advice to the same customer would be subject to two very different standards with respect to different parts of the customer's portfolio.

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[2] In fact, in order to avoid having to restructure its entire compensation structure, a broker/dealer that is not an investment adviser may in some cases have to refrain from providing individualized advice with respect to plans and IRAs. This would result in far less advice being available to investors, especially in the IRA context. In addition, other broker/dealers may decline to seek investment adviser status just so as to enable them to continue to provide *non*-individualized advice with respect to plans and IRAs. Again, this would not appear to be a favorable development from a public policy perspective. These approaches, however, may not be possible under the upcoming guidance from the SEC, as discussed below.

The Study also emphasizes "business model neutrality" by not prohibiting any business model and thus preserving "investor choice among . . . services and products and how to pay for these services and products (e.g., by preserving commission-based accounts, episodic advice, principal trading and the ability to offer only proprietary products to customers)." Study at 113. The Department's proposed regulations would directly conflict with the Study's business model neutrality.

The Executive order also stresses that, consistent with the law and regulatory objectives, it is important to "reduce burdens and maintain flexibility and freedom of choice for the public."

Significance of the Regulations. These two regulatory projects have great potential to modify the investment information available to millions of Americans and to have enormous effects on the financial industry. Projects of this magnitude deserve coordinated, careful consideration. In this regard, a Presidential memorandum issued concurrently with the Executive order states that, "[i]n the current economic environment, it is especially important for agencies to design regulations in a cost-effective manner consistent with the goals of promoting economic growth, innovation, competitiveness, and job creation." President Obama echoed this sentiment in the recent State of the Union address.

Small Businesses. Without coordination, there is a great risk that IRA owners and employees of small businesses in particular will be cut off from a main source of investment advice, since broker/dealers provide substantial assistance in these areas. This is not what anyone wants. The President has made clear that his objective is "to promote innovation"—not eliminate business opportunities. Moreover, the Presidential memorandum places emphasis on "ensuring that regulations are designed with careful consideration of their effects . . . on small businesses." The lack of coordination with respect to broker/dealers does not reflect consideration of small business interests.

Recommendation. The Department and the SEC should coordinate and articulate a single standard of conduct applicable to brokers and dealers in providing investment advice. That single standard should apply with respect to (1) the retirement savings of "retail customers" (as defined for purposes of the Dodd-Frank Act) and (2) any other advice related to retirement savings to which the SEC applies the retail customer standard. Having a single standard is critical because it would not serve investors well to have their advisors subject to inconsistent and overlapping rules.

In developing that single standard, the Department and the SEC will need to work within the statutory framework of the Dodd-Frank Act, which permits brokers and dealers to receive "standard compensation". Standard compensation should be interpreted to include, for example, commissions, sales incentives, and the benefits of principal trading. Under the Dodd-Frank Act, any issue related to such compensation is to be addressed through disclosure of "material conflicts of interests".

Interaction With the Business Conduct Standards Regarding Swaps Proposed by the CFTC

On December 22, 2010, the CFTC published proposed business conduct regulations regarding swaps. Those proposed regulations have very significant interactions with the Department's proposed regulations, rendering coordination acutely necessary. If both sets of regulations were finalized in their current state, swap dealers and major swap participants ("MSPs") that enter into swaps with plans would become plan fiduciaries solely by reason of complying with the business conduct regulations. This would create automatic prohibited transactions, so that the end result would be that retirement plans would cease to be able to use swaps, which would have a devastating effect on plans and on the swap market.

The solution is clear. In addition to the specific changes recommended below, the Department's regulations need to state that no action *required* by the CFTC's business conduct standards shall transform a plan's counterparty into a plan fiduciary. Otherwise, the two sets of regulations would be in irreconcilable conflict.

Defined benefit plans use swaps to hedge their asset and liability risks. Without swaps, plan assets and liabilities would be far more volatile, leading to greatly increased funding volatility. Increased funding volatility would, in turn, force plan sponsors to set aside much greater reserves to address possible future funding obligations. Those reserves would directly reduce money available to invest in jobs and in the economic recovery. In short, making swaps far less available would have far-reaching adverse effects throughout the economy. In addition, without swaps, the greatly increased volatility with respect to funding adequacy would undermine the security of participants' benefits.

Risk analysis. Under the CFTC's proposed regulations, if a plan enters into a swap with a swap dealer or MSP, the swap dealer or MSP must provide the plan with "material information concerning the swap in a manner reasonably designed to allow the [plan] to assess . . . [t]he material risks of the particular swap, . . . [t]he material characteristics of the particular swap, . . . and . . . [t]he material incentives and conflicts of interest that the swap dealer or [MSP] may have in connection with the particular swap." Moreover, in the case of a high-risk complex bilateral swap, the swap dealer or MSP must provide the plan with:

> a scenario analysis designed in consultation with the [plan] to allow the [plan] to assess its potential exposure in connection with the swap. The scenario analysis shall be done over a range of assumptions, including severe downturn stress scenarios that would result in significant loss.

Prop. Reg. § 23.431(a). The definition of a high-risk complex bilateral swap is not entirely clear, but it appears likely broad enough to sweep in many swaps commonly entered into by plans. Even if the swap is not a high-risk complex bilateral swap, but it is a bilateral swap that is not available for trading on a designated contract market or swap execution facility, the swap dealer or MSP must provide the plan with a scenario analysis upon request.

Unless the seller exemption applies, it is clear that a swap dealer or MSP that complies with the above would be a fiduciary under the Department's proposed regulations: (1) the swap dealer or MSP would be providing a plan with individualized investment advice regarding investment risks, (2) the advice "may be considered" by the plan, and (3) the swap dealer or MSP would receive compensation under the swap agreement. Some have taken the position that the swap dealer or MSP's advice is not really advice, but rather the provision of objective data and thus would not trigger fiduciary status under the proposed regulations. We question this position for two reasons. First, risk analyses are not rote exercises based on universally accepted facts; they can be highly subjective and will vary greatly, as demonstrated by the fact that the CFTC's regulations recognizes that the scenario analyses may be based on confidential proprietary information. Prop. Reg. § 23.431(a)(1)(iv). Second, the Department's proposed regulations do not contain any general exception for advice based on factual data. On the contrary, the existence of *very specific* exceptions for factual data provided with respect to plan menu issues and for IB 96–1 raises a strong inference that no such general exception applies.

We strongly believe that the right answer in this case is that the seller exemption should apply to the swap dealer or MSP in this case. The swap dealer or MSP is the opposing party, and the plan knows not to rely on anything provided by such an opposing party. It is critical, however, that the applicability of the seller exemption be clarified to apply to swap counterparties. Without this clarification, swap dealers or MSPs would be required to be fiduciaries and, as such, would be engaging in a prohibited transaction in the case of swaps with plans. Thus, all plan swaps would be required to cease.

Review of plan's representative. Under the CFTC's proposed regulations, if a swap dealer or MSP is simply entering into a swap with a plan, the swap dealer or MSP must engage in a swap-by-swap in-depth analysis of whether the plan's representative is qualified to function as an advisor to the plan. Prop. Reg. § 23.450. It is clear under the CFTC's regulations that the swap dealer may not simply accept representations to that effect, but rather must engage in its own scrutiny of any representations given.

Thus, there is a very strong argument that the swap dealer or MSP is effectively rendering advice to the plan regarding its choice of an advisor. As noted in the preamble to the Department's proposed regulations, advice to a plan regarding its choice of an investment advisor is a fiduciary act under the proposed regulations. Thus, the swap dealer or MSP may be treated as a fiduciary with respect to the plan under the proposed regulations, triggering a prohibited transaction in the case of swaps with plans. Unless the two sets of proposed regulations are modified, this analysis could result in a cessation of all plan swaps.

Recommending a swap. Under the CFTC's proposed regulations, if a swap dealer or MSP "recommends" a swap or trading strategy to a plan, the swap dealer or MSP has (1) a duty to act in the best interests of the plan, and (2) a duty to have a reasonable basis to believe that the swap is suitable for the plan.

So the question is: under what circumstances would a swap dealer or MSP be treated as "recommending" a swap or trading strategy. This is very unclear under the CFTC's proposed regulations. The preamble to the CFTC's proposed regulations states that a:

> recommendation would include any communication by which a swap dealer or major swap participant provides information to a counterparty about a par-

ticular swap or trading strategy that is tailored to the needs or characteristics of the counterparty, but would not include information that is general transaction, financial, or market information, swap terms in response to a competitive bid request from the counterparty.

In our view, if the swap dealer or MSP clearly informs the plan in writing that the swap dealer or MSP is functioning as a counterparty and not as an advisor, everything communicated to the plan by the swap dealer or MSP should be treated as "selling" not recommendations. But the CFTC's proposed regulations contain no such seller exemption. On the contrary, under the CFTC's proposed regulations, it is very possible that the CFTC's proposed regulations could be interpreted differently to turn common-place selling—e.g., "this is appropriate for you because it addresses your need to hedge your interest rate risk"—-into a "recommendation", triggering a duty of the swap dealer or MSP to act in the best interests of the plan. If that is so, problems arise.

If a swap dealer or MSP must act in the best interests of the plan, that would seem to imply a duty to advise the plan regarding the swap. Unless the seller exemption applies, that would clearly make the swap dealer or MSP a fiduciary under the Department's proposed regulations, creating a prohibited transaction in the case of swaps with plans. Thus, again it is critical that the seller exemption be clarified to apply to the swap dealer or MSP.

DISTRIBUTION ADVICE

The preamble to the proposed regulations invites comments regarding "whether and to what extent the final regulations should define the provision of investment advice to encompass recommendations related to taking a plan distribution." This issue needs to be divided into two analytically separate parts: (1) advice regarding whether to take a distribution, and (2) advice regarding how to invest any distribution that may be made. As discussed below, from a statutory and conceptual perspective, these questions need to be addressed separately.

Distribution Advice is Not Fiduciary Advice Under the Statute

ERISA section 3(21)(A)(ii), on which the proposed regulations are based, specifically refers to "investment advice." A decision whether to invest in an S&P 500 index fund inside a plan or to take a distribution from the plan and invest in the same fund outside the plan is simply not an investment decision. Thus, advice regarding that decision is not investment advice under the statute, and the Department lacks the statutory authority to treat such advice as giving rise to fiduciary status.

Distribution Advice Cannot Be Fiduciary Advice Conceptually

The lack of a statutory basis to treat distribution advice as fiduciary advice makes conceptual sense. A fiduciary has a duty to the participants as *participants*. A distribution decision is a decision in which an individual must weigh his or her needs as a participant versus his or her needs as a non-participant. By definition, a fiduciary cannot help in that regard, since a fiduciary is required by law to act on behalf of a participant as a participant and not consider the participant's needs as a non-participant. So, advice regarding distributions is, by definition, made in a non-fiduciary capacity.

Advice Regarding Investment of Distributed Assets in an IRA or Another Plan Can Be Investment Advice, Subject to the Seller Exemption

We appreciate the Department's concern with respect to advice provided to participants regarding how to invest distributed assets in an IRA or another plan. Such advice could be investment advice with respect to the IRA or other plan. However, this issue is an excellent reminder of how critical the seller exemption is, and how important it is that the scope of that exemption be clarified in accordance with our recommendations so that entities are able to promote and sell investment products for IRAs, subject to the clear disclosures discussed above with respect to the seller exemption.

Coordinating With Other Guidance

If the Department decides to issue guidance that goes beyond the framework discussed above, it is critical that the Department do so in a coordinated manner. Issuance of any guidance treating distributions as fiduciary advice should be coordinated with expansion of IB 96–1 to apply to distributions so that the retirement plan community understands how to stop short of fiduciary advice but still provide valuable education. For example, guidance regarding the allocation between annuity distributions and non-annuity distributions should be treated as education to the ex-

tent that no specific options (such as a particular provider's annuity) are recommended. In addition, the investment advice area contains many prohibited transaction exemptions that permit advice to be given under appropriate circumstances not contemplated expressly by the statute. We would certainly need similar prohibited transaction exemptions to make the distribution area function appropriately if distribution recommendations become fiduciary advice. So any regulatory guidance treating distribution advice as fiduciary advice should be combined with appropriate prohibited transaction exemptions. Providing the regulatory guidance without prohibited transaction exemptions would almost certainly create the same type of havoc that withdrawing all investment advice prohibited transaction exemptions would create.

However, as noted above, we strongly believe that there is no statutory basis to treat distribution recommendations as fiduciary advice.

Advisory Opinion 2005–23A

Finally, we urge the Department to revisit Advisory Opinion 2005–23A. In the Advisory Opinion, recommendations regarding the investment of distributed assets made by *any* plan fiduciary are automatically fiduciary advice. This is inconsistent with the clear longstanding rule of law that an entity is only an ERISA fiduciary with respect to those functions for which it has fiduciary powers and duties. So, for example, if an affiliate of a directed trustee that has no responsibility regarding the investment of plan assets were to make recommendations regarding the investment of distributed assets, such affiliate is clearly not a plan fiduciary with respect to those recommendations and there is no reason to treat it as such. We urge the Department to revise Advisory Opinion 2005–23A accordingly.

Our position here is not inconsistent with *Varity Corporation* v. *Howe*, 516 U.S. 489(1996). In *Varity*, the plan administrator, acting as the plan administrator, provided misleading information regarding the plan. This case stands for the proposition that a fiduciary, when acting as a fiduciary, is subject to ERISA's fiduciary standards. It does not apply to a plan fiduciary who is acting as a wholly separate capacity, i.e., as a seller of services unrelated to its status as a plan fiduciary.

IRA AND NON-ERISA PLAN ISSUES: APPLICATION OF IB 96–1 AND THE INVESTMENT MENU EXCEPTIONS

The proposed regulations apply to IRAs. We are concerned that the regulations were developed in the plan context and do not reflect consideration of the many unique factors affecting IRAs. This letter does not address in a substantive way the issue of whether IEAs should be covered by these regulations. This is an issue that can be more directly addressed by other organizations, but we believe that the Department should consider separating the proposed regulations into two parts, one addressing plan issues and one addressing IRA issues.

At a minimum, however, we note that the proposed regulation can be read not to apply the IB 96–1 and investment menu exceptions to IRAs and non-ERISA plans subject to the Code. This should be corrected. IRA owners and non-ERISA plan participants need investment education, just as ERISA plan participants do, so there is no reason not to make the IB 96-1 exception applicable to IRAs and non-ERISA plans subject to the Code. In addition, IRA sponsors and non-ERISA plans subject to the Code can provide a menu of investment options and can provide objective assistance with respect to choosing among such options, just as service providers in the ERISA plan area would do. The investment menu exceptions should thus apply to IRAs and non-ERISA plans subject to the Code.

In short, we believe that the proposed regulations address a wide range of critical issues. An extended and robust public policy dialogue on all of these issues is needed to avoid (1) a material reduction in the services, investment education, and guidance available to plans, plan participants, IRA owners, and plan sponsors and (2) a substantial increase in costs.

We very much appreciate the opportunity to comment on these important proposed regulations.

Sincerely,

JAN JACOBSON,
Senior Counsel, Retirement Policy.

THE ERISA INDUSTRY COMMITTEE,
WASHINGTON, DC 20005,
November 12, 2010.

RIN 1212–AB20
LEGISLATIVE AND REGULATORY DEPARTMENT,
Pension Benefit Guaranty Corporation,
1200 K Street, NW,
Washington, DC 20005–4026.

Re: Comments on Proposed Rule Regarding Liability for Termination of Single-Employer Plans; Treatment of *Substantial Cessation or Operations* (RIN1212–AB20)

LADIES AND GENTLEMEN: The ERISA Industry Committee ("ERIC") is pleased to submit these comments on the proposed regulation under ERISA § 4062(e), regarding the consequences of a substantial cessation of operations at a facility in any location. The proposed regulation was published in the *Federal Register* on August 10, 2010.

ERIC is a nonprofit association committed to the advancement of the employee retirement benefit plans of America's largest employers. ERIC's members provide comprehensive retirement benefits to tens of millions of active and retired workers and their families. ERIC has a strong interest in proposals that would affect its members' ability to provide secure pension benefits in a cost-effective manner.

ERIC is deeply concerned that the proposed regulation is inconsistent with the text and purpose of § 4062(e). The proposed regulation would expand the application of § 4062(e) to routine events that are far less significant than "ceas[ing] operations at a facility in any location." For example, the proposed regulation would reach operational changes within an ongoing facility, and the relocation or sale of an ongoing operation.

Such an expansion would have the effect of overriding the reporting waivers for many events covered by § 4043. In addition, because the § 4062(e) liability is calculated using the PBGC's termination assumptions (rather than ERISA's funding assumptions), expanding the application of § 4062(e) would require many employers to make contributions far in excess of what ERISA generally requires; this undermines ERISA's detailed and highly reticulated funding rules.

The PBGC should withdraw the proposed regulation and issue a new proposed regulation that corrects the following deficiencies in the current proposal:

1. The proposed definitions of "operations," "facility," and "cessation" are inconsistent with the statute. They should be revised to follow the statutory mandate that § 4062(e) does not apply unless a facility closes.

2. By stating that the relocation or sale of an ongoing operation triggers the application of § 4062(e), the proposed regulation departs from 34 years of consistent administrative practice.

3. The proposed regulation fails to keep within reasonable bounds the circumstances in which an employee's separation from employment would be deemed to occur "as a result" of a cessation of operations at a facility. It allows all employee separations that can be connected by a virtually limitless daisy chain of events to be deemed to result from a cessation of operations at a facility at the beginning of the chain.

4. The proposed regulation fails to address the special but commonplace circumstances of frozen plans.

5. The proposed regulation fails to include a reasonable exemption for well-funded plans.

ERIC reserves the right to supplement these comments.

DISCUSSION

1. Definitions of "Operations," "Facility," and "Cessation"

Section 4062(e) was first introduced as a provision related to "termination of a substantial facility."[1] In the last 36 years, the language of § 4062(e) has not changed: § 4062(e) applies only if "an employer ceases operations at a facility in any

[1] *See* H.R. 2, 93d Cong. § 462(g) (as passed by the Senate, Mar. 4, 1974); Staff of S. Comm. on Labor and Public Welfare, 93d Cong., Summary of Differences Between the Senate Version and the House Version of H.R. 2 to Provide for Pension Reform 18 (Comm. Print 1974). Although the heading was changed from "Termination of Substantial Facility" to "Treatment of Substantial Cessation of Operations," the language of the provision has not changed since it was first introduced. Moreover, the heading still indicates that a cessation of operations at a facility refers to something "substantial."

location." This simple phrase has been understood to mean that § 4062(e) applies only if operations cease—*i.e.*, the facility is closed.

Rather than define the statute's phrase as a whole, the proposed regulation breaks it down into separate definitions of "operation," "facility," and "cessation." By doing so, the proposed regulation expands the application of § 4062(e) to routine events that do not rise to the level of a "cessation of operations at a facility in any location." ERIC has the following concerns with each proposed definition:

- "***Operation***." The statute does not authorize the proposal to replace the term "operations" with "an operation." This change could result in § 4062(e) being triggered by routine events that are anything but cessations of operations—*e.g.*, changing the way a space is used or outsourcing an operation within an ongoing facility.
- "***Facility.***" The term "facility" should be defined based on its location, rather than an operation. By stating that a single facility may be comprised of more than one building, without any geographic restrictions, the proposed regulation leaves open the possibility that a single facility can be spread across the country. This possibility ignores the statute's phrase "in any location."
- "***Cessation.***" A stoppage of operations should not constitute a cessation unless the facts and circumstances indicate that the stoppage is permanent. The proposed 1 week resumption rule (for a voluntary cessation) and 30-day discontinuance rule (for an involuntary cessation) are arbitrary and would sweep in common events that are not intended to be cessations. For example, a disaster like Hurricane Katrina would have been treated like a cessation of operations for many businesses in New Orleans that never intended to close and eventually resumed operations.

In accordance with the statute, "facility" should be defined by reference to its location: a "facility at any location" means a building (or buildings on a campus) at a particular location. "Operations" should be defined as the work performed at the facility; and a cessation of operations at the facility should not be deemed to occur unless all of the facility's operations have ceased—*i.e.*, the facility has closed. Any concern that an employer might try to avoid § 4062(e) liability by continuing only an operation related to basic maintenance of a building (as distinct from changing the operations performed at the facility) should be addressed through an anti-abuse rule.

In addition, stopping operations should not result in a "cessation" unless the facts and circumstances indicate that the stoppage is permanent. The determination of whether a stoppage is permanent should not be based on a fixed time period. If the PBGC nevertheless determines that a time period is necessary, (a) the time period should be no less than 90 days; (b) the time period should not apply in the case of a labor disruption; and (c) the standard should be rebuttable.

2. Relocation and Sale of Ongoing Operations

PBGC Opinion Letters from the last 34 years have consistently indicated that relocating or selling an ongoing business generally does not trigger a § 4062(e) inquiry. Absent a change to the statute, the new regulation should preserve this history. Accordingly:

- When ongoing operations are relocated, § 4062(e) should not apply if the operations are continued—regardless of how many employees make the move. *See*, *e.g.*, Op. Ltr. 77–134.
- When ongoing are sold (whether in an asset sale or a stock sale), § 4062(e) should not apply if the operations are continued. At the very least, § 4062(e) should not apply if (a) the facility's employee population does not shrink by more than 20 percent and (b) the buyer continues the plan or a similar plan without substantial changes. *See*, *e.g.*, Op. Ltrs. 86–13, 82–29, 78–29, 76–52.

The proposed regulation appropriately allows an employee's separation to be ignored if a replacement is hired before the cessation is complete. This rule should be expanded to apply when replacement employees are hired within a reasonable period after the cessation. For example, if ongoing operations are relocated from City A to City B and the employer intends to replace the employees who do not make the move, the employer should not be penalized merely because some positions are not filled for a reasonable period after the move. Also, replacement employees should be taken into account from their date of hire, without regard to whether they are eligible to participate in the plan.

ERIC appreciates that the PBGC may waive the § 4062(e) liability in appropriate circumstances. However, in order to ensure reasonably consistent results and to ease the burden on employers and the PBGC in cases involving insignificant events, the regulation should include safe harbor standards under which waiver or reduced liability is automatic. At a minimum, the regulation should provide for an automatic waiver of the § 4062(e) liability (including the reporting requirement) in the circumstances described above.

3. "As a Result"

The proposed rule that a separation from employment at one facility can be "as a result" of a cessation of operations at another facility is overly broad and vague. It allows all employee separations that can be connected by a virtually limitless daisy chain of events to be deemed to result from a cessation of operations at a facility at the beginning of the chain.

Although there might be cases where a cessation of operations at one facility affects employment at other facilities, linking causation across facilities should be the exception rather than the rule. The regulation should include a rebuttable presumption that separations at one facility do not result from a cessation of operations at another facility. In other words, the proposed standard for a plan administrator to decide whether a § 4062(e) event has occurred, when to file a notice of an event, and how many affected participants to report should end the inquiry unless there are unusual circumstances.

To the extent that linking causation across facilities is permitted, the regulation should limit the time period over which a chain reaction may occur to 30 days or less. No separation occurring after this period should be linked to a cessation of operations that occurred before the period started.

4. Plans Frozen to New Entrants

When a plan is frozen to new entrants, the percentage of active employees who participate in the Plan declines steadily over time—especially if the plan sponsor's business is successful. By ignoring this fact, the proposed regulation would sweep in many insignificant events.

For example, suppose a plan was frozen to new entrants in the 1990's. At the time of the freeze, the plan sponsor had 20,000 employees in the United States and all of them participated in the plan. Since the freeze, attrition has resulted in the number of active employees participating in the plan falling to 1,000, but the size of the business has remained steady or grown. Under the proposed regulation, a cessation that results in only 200 participating employees losing their jobs—1 percent or less of the total U.S.-based employee population—would be a § 4062(e) event.

As another example, suppose that when a plan was frozen, the employer had 5,000 employees and they all participated in the plan. Since that time, the employer's business has grown and it now employs 20,000 employees. Under the proposed regulation, a cessation that results in 1,000 participating employees losing their jobs—only 5 percent of the total employee population—would be a § 4062(e) event.

In order to avoid these absurd results, the regulation should include an exemption for frozen plans that meet minimum funding requirements. Alternatively, the regulation should allow the active participant base to include employees who would have been active participants if not for the freeze.

5. Exemption for Well-Funded Plans

ERIC appreciates that the PBGC intends to continue its practice of negotiating with affected employers in appropriate cases. However, in order to ensure reasonably consistent results and to alleviate the burden of a reporting requirement in cases where the risk to the PBGC is not significant, the regulation should specify criteria under which no action will be required.

Many plans that are not fully funded on a termination basis nevertheless do not pose a significant risk to the PBGC. For example, a plan with an Adjusted Funding Target Attainment Percentage ("AFTAP") of 90 percent or more does not pose a significant risk to the PBGC. The regulation should relieve the sponsors of plans in this category from worrying about § 4062(e).

Adding a reasonable exemption for plans that do not pose a significant risk to the PBGC would not only ease the burden on plan sponsors, allowing them to deliver benefits more efficiently: it would enable the PBGC to allocate its limited resources to the cases that warrant attention.

ERIC appreciates the opportunity to submit these comments. We look forward to working with you to create workable rules that enable the PBGC to protect itself against the cost of terminating underfunded plans without imposing unnecessary burdens on employers. If we can be of further assistance, please let us know.

Sincerely,

MARK J. UGORETZ,
President & CEO.

[Whereupon, at 4:03 p.m., the hearing was adjourned.]

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