ASPPA
WORKING FOR AMERICA'S RETIREMENT

Testimony for Cash Balance Hearing

Cash Balance Plan Regulations Will Promote New Defined Benefit Plans

Thank you, representatives from Treasury, IRS, DOL and EEOC, for this opportunity to testify on this important subject. My name is Brian Graff and I am the Executive Director of the American Society of Pension Actuaries. ASPPA is an organization of over 5,000 retirement plan professionals who assist small to mid-sized companies nationwide in establishing and maintaining retirement plans covering millions of American workers. All of ASPPA's members are united by a common dedication to a strong private retirement plan system.

I would also like to speak today on behalf of a group of Americans who are not represented at this hearing. These are the approximately 80 million working Americans who are not covered by a defined benefit plan. This represents 75 percent of our private workforce not covered by a plan that provides guaranteed benefits. The lack of defined benefit plan coverage is even more acute among small business workers. Less than 2 percent of the 40 million workers who are employed at firms with less than 100 employees are covered by a defined benefit plan.

These Americans will not have had their benefits affected by one of the "conversions" that will be discussed by many commentators at this hearing since they never had any defined benefits to begin with. They work at companies that you have never heard of, companies that do not have commercials on TV, but companies that will lead our economic recovery. Don't the workers at these companies deserve a chance at a secure retirement?

Some of these workers, if they are fortunate enough, at least have been covered by a defined contribution plan like a 401(k) plan. However, have you looked at your 401(k) statement recently? The front cover of this month's Money Magazine is entitled "Should you dump your 401(k)?" Workers throughout the country have been joking that their 401(k) plan should be called a 201(k) plan. But it is not funny if you are about to retire. The S&P 500 has dropped 16 percent over the last three years. According to a recent study by the Employee Benefit Research Institute, a three-year bear market immediately prior to retirement can significantly reduce income replacement rates generated by 401(k) accounts.

Right now, this is a very real issue for millions of American workers relying solely on defined contribution vehicles for retirement savings who have been forced to either delay retirement or seriously reevaluate their retirement standard of living expectations. The effect is more than just not being able to buy that dream retirement home. It can be the difference between being able to afford adequate long-term care or needed, but expensive, prescription drugs. These unfortunate consequences would have been greatly diminished if these Americans had been covered by a defined benefit plan providing guaranteed retirement benefits, not subject to the whims of investment markets.

Defined benefit pension plans provide a guaranteed monthly retirement benefit for employees. This annuity benefit continues for the life of the worker and cannot be exhausted. 401(k) plan benefits are not guaranteed. Ultimately, the level of benefits from a 401(k) plan and the length of time they continue to be paid is unknown to the retiree. Without increased defined benefit plan coverage, as Americans live longer than ever before, there is a greater risk that many Americans will outlive their retirement savings.

Ironically, according to a recent survey published in Plan Sponsor magazine, interest in defined benefit plan coverage among employees has increased by 20 percent as employees find it difficult to manage their 401(k) plan accounts. However, small and mid-sized businesses are no longer interested in traditional defined benefit plans because of their inherent funding uncertainties and because employees simply do not understand them. Cash balance plans can provide employers with more predictable funding requirements and, because of their "account-based" nature, they are often more appreciated by employees.

Remember, I am talking about employees currently without a defined benefit plan. Faced with consistent 401(k) plan account losses, a cash balance plan funded with employer contributions and with a guaranteed rate of return looks pretty good right now. Any worker covered only by a 401(k) plan would welcome the prospect of coverage under a cash balance plan funded by the employer and providing certainty respecting investments. In fact, putting aside any issues of "conversions," no rational or cogent policy argument could possibly be made that workers without any preexisting defined benefit plan are also better off without a cash balance plan.

For better or worse, the last and best hope for promoting new defined benefit plan coverage is cash balance or similar hybrid plans. The good news is that there are thousands of businesses throughout the country who, in light of current developments in the stock market, might be interested in adopting a defined benefit plan like a cash balance plan for their workers. Such plans could potentially cover millions of American workers. However, there are a number of significant legal uncertainties associated with cash balance plans because of the way benefits are accrued and distributed as compared to traditional defined benefit pension plans. Although these issues are technical in nature, they are critical to the legal operation of the plan.

The proposed regulations, in part, address these legal issues. Future guidance is expected to address the so-called "whipsaw" problem. Small and mid-sized companies are willing to guarantee market rates of return for employees, but in return they would like certainty as to the amount of benefits they are actually providing, not some mysterious benefit that is calculated using a wholly unrelated interest-rate benchmark that no longer has any economic substance. It is imperative that future guidance on cash balance plans not ignore this issue.

Unlike their larger firm counterparts, small and mid-sized businesses cannot afford high-priced lawyers to provide legal opinions allowing them to sort through the various unanswered questions. Until all of the important legal uncertainties surrounding cash balance plans are resolved in a clear and unambiguous way, small and mid-sized companies will refrain from offering these valuable defined benefits to employees.

Unfortunately, a number of witnesses at today's and tomorrow's hearing will be calling for the complete withdrawal of these proposed regulations despite their clear application to cash balance plans not created as a result of a conversion. Such suggestions are entirely irresponsible. It would seem that such part-time pension pundits simply do not care about the 80 million working Americans without any defined benefit plan, but would rather exploit a political issue that would ultimately be to the detriment of these workers. Such a result would be or extremely unfortunate retirement policy, and ASPPA implores both Treasury and IRS to ignore such pleas. As you listen to the testimony today and tomorrow, please do not forget about these uncovered workers.

ASPPA appreciates the efforts of the staff at all of the participating agencies in this project. Given all of the competing interests striking the appropriate balance is not an easy task and the proposed regulations represent an important first step toward finding the right balance. We commend you for your efforts and urge you to stay the course.

Any legislative or regulatory policy must keep in mind the vital role defined benefit plans play in providing working Americans with a more secure retirement. ASPPA strongly believes that the intent and spirit of the proposed regulations is wholly consistent with this critical objective. Account-based defined benefit plans, like cash balance plans, constitute vital and powerful tools for building a stronger and more effective private retirement system. When these regulations are completely finalized, it will most certainly lead to a significant number of new plans, particularly among small and mid-sized employers, providing defined benefits to employees who have never before had such benefits. We encourage you to finalize the regulations swiftly so that millions of working Americans at small and mid-sized companies nationwide have the opportunity to achieve a secure retirement future.

Thank you.