PENSION RIGHTS CENTER

1140 19TH STREET, NW SUITE 602 WASHINGTON, DC 20036-6608
TEL: 202-296-3776 FAX: 202-833-2472
E-MAIL: PNSNRIGHTS@AOL.COM

STATEMENT OF NORMAN P. STEIN
PENSION RIGHTS CENTER
ON
"Challenges Facing Pension Plan Funding"
BEFORE THE
COMMITTEE ON WAYS AND MEANS
U.S. HOURSE OF REPRESENTATIVES
APRIL 30, 2003

Mr. Chairman, Mr. Rangel, and Members of the Committee, I am Norman Stein, a professor at the University of Alabama School of Law, where I am privileged to hold the Douglas Arant Professorship and to direct the law school's pension counseling program, which has helped many hundreds of individuals with their pension problems.

It is also my privilege to appear here today on behalf of the Pension Rights Center, the nation's only consumer organization dedicated solely to protecting and promoting the pension rights of workers, retirees and their families. Over the past 25 years, the Pension Rights Center has taken the lead in targeting inequities in the nation's retirement programs, and proposing realistic solutions. Working with a bipartisan coalition of retiree, labor, and women's groups, the Center has helped secure the enactment of five federal laws that are providing much-needed benefits to millions of retirees, widows, and divorced spouses. The Center has also worked with, and on behalf of, thousands of workers and retirees from companies around the country to stop cutbacks in, and to recover, pension and retiree health benefits.

The issues you are to discuss today, pension funding and particularly the continued appropriateness of the 30-year treasury rate for various statutory purposes appear to many as hyper technical matters, primarily of interest to actuaries and accountants and academics. The Committee's decision to hold a hearing on this issue alone, however, underscores the critical relationship between such seemingly technical issues, on the one hand, and the retirement security of millions of American workers, on the other. As you have heard from representatives of the business community, these technical issues also bear heavily on the financial health of many industries and individual companies.

My testimony today will focus separately on two issues: the proper discount rate for determining plan liabilities for certain statutory funding and PBGC purposes; and the commutation of annuity benefits into lump sum benefit amounts. In my comments, I will allude to some other funding issues, but will concentrate on alternatives to the 30-year

treasury rates for these two purposes. I would also be happy to take questions on other defined benefit funding issues.

Plan Funding. The business community and labor organizations have argued that the use of 30-year treasury rates currently overstates pension liabilities, artificially causing some plans to appear underfunded and to satisfy unnecessarily high minimum funding obligations. The nation's major actuarial organization concur with this assessment, although cautions that the low discount rates generated under current law confer greater benefit security on participants and enhance the financial stability of the Pension Guaranty Corporation.

Benefit security is a key concern for participants in defined benefit plans. Adequate funding levels are a necessary bulwark against unfunded plan terminations and sharp reductions in the benefits and benefit rights of participants in defined benefit plans. In the last ten years, plan underfunding has cost pilots and steelworkers, among others, thousands of dollars of critical pension dollars. In addition, a well-funded pension plan is in a much better position to enhance benefits and provide COLAs for retirees. The 30-year treasury rate provides a conservative benchmark for plan funding purposes and at least some actuaries have privately suggested to us that the current 30-year treasury rate does not greatly overstate pension liabilities, at least for purposes of determining whether a plan is underfunded for certain purposes.

We are, however, sympathetic to the arguments of the business community that the 30-year treasury rate is somewhat too high for valuing liabilities in most plans. In determining a replacement rate, however, we urge that this Congress proceed conservatively, less we find as the baby boomers begin retiring in substantial numbers a decade from now, that the private pension system is asset-short because of decisions about funding standards made precipitously ten years earlier.

The business community has advocated a replacement rate equal to as muchas 105% of a composite high-quality, long-term corporate bond rate. This rate, however, is no more appropriate for measuring pension liabilities than the 30-year treasury rate; if the latter possibly overstates liabilities in a manner detrimental to plan sponsor flexibility, the former will understate liabilities and may result in an era of plans unable to satisfy benefit commitments.

We do not come here with a recommendation for a replacement rate, but believe that an index that more closely tracks annuity purchase rates should be the committee's target. The corporate bond rate misses this target.

Determining Lump Sum Values. The 30-year treasury rate is also used for determining lump sum values for annuity benefits in defined benefit plans that provide for a lump sum distribution option. Two related arguments are made here: first, that the lump sum values are higher than the annuity values and thus bleed the plan of resources; and second, that the higher lump sum values encourage participants to take annuities, which subjects them to challenging money management problems in retirement.

The Pension Rights Center has never been an advocate of plans offering lump sum options, but once plans do offer such options, employees often rely on the availability of lump sums. Moreover, plans are permitted to cash out, on a mandatory basis, participants whose annuity benefits have a present value of $5,000 or less.

It does not logically follow that the same rate that is used for certain plan funding purposes should also be used to value lump sums. Participants cannot be expected to achieve the same rates of return that are reflected in annuity purchase rates or a composite bond rate. This is especially true for employees who receive small lump sum values in mandatory cashout situations. Moreover, reduction of lump sum values in this situation will make it less likely that a former employee will rollover their lump sum into an individual retirement account and thus preserve the benefits for retirement.

We are also skeptical that the 30-year treasury rate is the primary reason employees who have a choice of benefit form elect to take lump sums. In general, they take because they do not wish to leave a former employer in control of their retirement wealth. If Congress wishes to discourage the practice of lump sums, there are far more effective means of doing so then altering the interest rate used to value them. This is akin to trying to melt a glacier with a bic lighter.

Thus, in general, we would favor a much more conservative interest rate for valuation of lump sums than for plan funding and other statutory purposes, and especially so with respect to employees who are mandatorily cashed out by a plan.

We are also concerned that any change in the interest rates used to determine lump sum values not effect the benefit expectations of current participants. At a minimum, any change should apply only to benefit accruals occurring after a change in the section 417(e) interest rates. In addition, there should be a grandfathering provision for those within five years of retirement.

Thank you. I would be happy to take any questions.