Testimony of James A. Klein
President
American Benefits Council

before a hearing of the
Subcommittee on Health, Employment, Labor, and Pensions
Committee on Labor and Workforce
United States House of Representatives

on
Retirement Security:
Challenges Confronting Pension Plan Sponsors, Workers, and Retirees

June 14, 2011

Introduction.

Chairman Roe, Ranking Member Andrews, and Members of the Subcommittee, I am grateful for the opportunity to appear before you on this critically important topic. My name is James Klein and I am President of the American Benefits Council. 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.

My testimony today will cover three areas. First, I will briefly contextualize the critical role employers play in ensuring a secure retirement for American workers. Second, I will identify regulatory developments that threaten to undermine that role, potentially prompting some employers to discontinue or scale back their existing retirement plans, while chilling other employers from adopting new retirement plans. Finally, I will discuss the importance of maintaining the established tax incentives both for employers to promote workplace plans and for employees to contribute to them.

(1) The voluntary system for workplace savings plans.

I believe it would be useful to set the stage by briefly reviewing the scope of our voluntary system for workplace savings plans. According to the Bureau of Labor Statistics, just over half of all workers in the private sector participated in an employer-sponsored retirement plan of some kind in 2007. In particular, only one in five private-sector workers participated in a traditional pension (*i.e.*, a defined benefit plan), while about two in five participated in 401(k) and other defined contribution plans. Meanwhile, upwards of two in five private-sector workers had no opportunity whatsoever to participate in a retirement savings plan at work.

There are many recognized advantages of "qualified" plans offered at the workplace. Employers bring unique advantages to bear for employees when it comes to retirement savings and income: noncontributory plans that benefit employees who cannot afford to contribute; matching contribution arrangements that create enormous incentives to save; educational services underscoring the importance of savings; bargaining and purchasing power; economies of scale; fiduciary decision-making and oversight; and access to beneficial products and services. Employers are also in a strong position to know the retirement needs of their employee populations and can tailor retirement programs to these needs.

In short, employers play an important role in promoting a secure retirement for America's workforce. But given the voluntary nature of employer plans, policymakers must seek to support employers in facilitating and, where feasible, financing retirement income for employees. In particular, policymakers should recognize that providing retirement benefits is not the core business mission of employers. In today's globally competitive marketplace, employers are increasingly sensitive to the costs, risks, and potential liabilities of all their activities. Government policies that raise the costs, risks, and potential liabilities associated with retirement plan sponsorship jeopardize the employer commitment to providing retirement benefits. This danger is present for employers of all sizes. But given the importance of expanding workplace retirement plan coverage for individuals who lack it, policymakers should be particularly sensitive to the effect of such increased costs, risks, and potential liabilities on small employers and on their willingness to initiate employer-sponsored retirement plans for their workers.

(2) Regulatory complexity and burdens.

This brings me to my second point: 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 plan sponsors' and participants' interests. 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.

To achieve these objectives, regulatory activity must be well-coordinated across all agencies of jurisdiction to avoid conflicting or inconsistent guidance and enforcement. President Obama acknowledged the critical importance of this principle and of avoiding such regulatory conflicts in his January 18, 2011, executive order on Improving Regulation and Regulatory Review. Yet current examples of inconsistent guidance abound, particularly between the Department of Labor's current proposed regulations redefining the term fiduciary, and various regulations proposed by the Commodity Futures Trading Commission and the Securities and Exchange Commission under the Dodd-Frank Wall Street Reform and Consumer Protection Act. 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. The critical need for coordination with the CFTC is discussed further below

Moreover, compliance burdens on employer plan sponsors can be unreasonably magnified by requiring employers to comply first with statutory provisions and subsequently with regulations that articulate an interpretation of the statute that differs substantially from a good faith reading. The hybrid plan provisions of the Pension Protection Act of 2006 (PPA) are one example of this burdensome phenomenon. For example, the Pension Protection Act of 2006 prohibited cash balance plans and other hybrid plans from crediting interest at an above market rate. Treasury has issued proposed regulations that are clearly inconsistent with the statute and that expressly prohibit the use of thousands of interest crediting rates available in the market. Accordingly, these proposed regulations would force countless substantial plan modifications, as well as causing a very substantial portion of the cash balance plans in the country to reduce benefits.

This is but one example of a regulatory interpretation that was issued many years subsequent to the effective date of the statutory provision and bears limited resemblance to the plain meaning of the statute. As a result, plan sponsors face costly and unexpected compliance changes, some of which require substantial plan redesigns. Regulations should be crafted with an eye to effecting legislative intent while limiting and mitigating the unintended consequences for plan administration and plan benefits.

I would like now to turn to some specific developments that evidence this trend toward increased regulation, uncoordinated regulations, and undue burdens on employers who are trying to do the right thing for their workers by providing retirement plans.

(a) Definition of the term "fiduciary."

In October, the Department of Labor proposed regulations on the definition of the term "fiduciary" under the Employee Retirement Income Security Act (ERISA). The proposed regulations would set aside the rule that has defined the term for 35 years. We understand the Department's desire to update and improve the definition, and we agree that the employer 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. But the proposed regulations create too broad a definition of fiduciary. We are very concerned that an overly broad definition would actually have a very adverse effect on retirement savings by inhibiting investment education and guidance for plans and participants, raising costs, and shrinking the pool of service providers willing to provide such investment education and guidance.

There has been some perception that the concerns related to the proposed regulations only relate to service providers, and primarily involve IRAs. That is not the case. The proposed regulations raise very serious issues for plan sponsors.

"May be considered" standard. Under the proposed regulations, an individual can become a fiduciary solely by reason of providing casual investment information that "may be considered" by the recipient. Assume, for example, that a plan participant has consulted with an advisor and has decided tentatively to invest in a group of investment options available under the plan. As a last-minute check, the individual asks a colleague in the employer's human resources department if the participant's fund selections make sense for an individual in her situation. The human resources employee says he is not an expert but the choices make sense to him and are consistent with what many others are doing. Under the regulation, that casual reaction is fiduciary advice. Similarly, if the participant were to ask a call center operator the same question, any

answer would be investment advice. But neither interaction is really investment advice. An ERISA fiduciary relationship is a very serious relationship with the highest fiduciary standard under the law. 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.

If the proposed rule were finalized, plan sponsors may need to inform human resources departments and call centers never to discuss investments in any manner. This would hurt and frustrate participants, which is the last thing that plan sponsors want to do. Nor would that be a positive development from a policy perspective.

Plan sponsor employees. 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 under the proposed regulations, large numbers of middle-level employees who frame issues and make recommendations for senior employees to consider would also be fiduciaries. If all of these employees were fiduciaries, the effects would be severely negative. For example, the cost of fiduciary insurance would skyrocket, if such insurance would be available at all for such employees. These costs would ultimately be borne by participants in the form of higher costs and lower benefits.

Plan investment menus. Today, one of our greatest challenges in the retirement security area is broadening retirement plan coverage among small businesses. Small businesses will generally adopt a retirement plan only if the process is simple and inexpensive. 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 options 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. Yet under the proposed regulations, if the service provider did anything more to help the hardware store owner, the service provider would be deemed a fiduciary. So if the rule set forth in the proposed regulations is finalized in its current form, we are likely to 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. For example, 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.

Valuation. We believe that the proposed regulation's application of fiduciary status attributable to the provision of valuation services is overly broad and needs to be reconsidered. First, it would sweep in countless routine valuations, such as valuing annuity contracts for purposes of determining required minimum distributions. Second, even in the areas that are the object of the Department's express concerns – such as ESOP valuations – the nature of the fiduciary duty needs work. The Department wants to ensure an objective valuation. A fiduciary advocates for participants; a fiduciary is precluded by law from being objective.

Management of securities. Under the proposed regulations, advice regarding the management of securities constitutes investment advice. This raises serious issues for plan sponsors. For example, assume that a plan decides to change trustees and begins negotiating a trust agreement with the new trustee. The trustee is involved in the "management" of plan assets, and the terms of the trust agreement affect that management. Are all of the plan sponsor's legal and compliance personnel fiduciaries by reason of working on the trust agreement? Under the proposed regulations, the answer is yes. This will cause the cost of trust agreements and many other routine plan actions to increase exponentially with the imposition of new duties and large potential liabilities.

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.

There are many similar examples. To avoid such inappropriate results and enormous new costs and burdens on plan sponsors, the proposed regulations need significant modification.

Legal and other non-investment advice. Assume that ERISA counsel advises the plan that entering into a swap with a 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. Again, this is an unworkable result for plan sponsors who need to be advised on compliance issues.

In sum, the increased cost and confusion attributable to the proposed regulation is a source of significant concern for our plan sponsors. The Council and many other organizations representing employers have communicated these concerns to the Department of Labor. We appreciate the support we have received from many Members of Congress, and hope that on a bipartisan basis Members of Congress will continue to join us in warning the Department of the dangers inherent in an overly broad proposal that does not fully take account of ramifications that could raise costs or otherwise chill employers from offering plans in the first place.

(b) Electronic disclosure.

ERISA requires the extensive provision by plan sponsors of reports, statements, notices and other documents. Unfortunately, current regulations severely restrict the circumstances in which email and other paperless means of communication can be utilized. The regulations contemplate the use of electronic media only if a participant either (i) uses an electronic network (*e.g.,* a computer or a smart phone) as an integral part of his or her duties as an employee, or (ii) affirmatively consents to receiving documents electronically in a manner that demonstrates the ability to access electronic disclosures. This standard severely restricts the use of email as a means of communication for many categories of employees and former employees, even in circumstances where the employer has email addresses and routinely uses email or other electronic disclosure for other forms of communication. As a result, the multitude of notices and statements that plan administrators must provide to plan participants and beneficiaries are typically provided through labor intensive and costly paper media.

There are enormous potential cost savings that would benefit participants, beneficiaries, employers and the environment if the existing regulation were revised to more broadly accommodate electronic communication, including use of home computers and personal cell phones or internet connections. We appreciate that not every participant or beneficiary has access to a particular system, but believe that these participants can be accommodated through rules that allow participants to opt out of electronic delivery and request paper copies of the relevant materials.

DOL recently instituted a Request for Information Regarding Electronic Disclosure by Employee Benefit Plans. We appreciate DOL's initiation of this project, as we believe that appropriate electronic disclosure is a more user-friendly, efficient, and cost-effective means of providing necessary information to plan participants and beneficiaries and is a method that is more popular with participants and beneficiaries. Effective electronic communications can enhance the disclosures for the majority of participants while protecting their rights and ensuring that those who still wish to receive paper notices are entitled to receive them upon request.

More specifically, we strongly believe that a current Department of Labor rule in effect with respect to benefit statements would work very well for all communications. Under that rule, a plan posts information on a secure website, informs participants by non-electronic means of the availability of the information on such website, and also informs participants of their right to receive paper notices. This structure is very protective of participant rights, is very efficient, and is very effective in offering participants the best way to find what they need whenever they need it.

In this regard, we believe that it is critical that all agencies whose rules affect plans adopt the secure website rule described above. I note that DOL's current regulation differs materially from the electronic delivery standards of other regulatory agencies, including the Internal Revenue Service (IRS) and the SEC which share oversight responsibility for employee benefit plans with DOL. These different standards can be very frustrating and burdensome for employers who must comply, for example, with one set of standards in furnishing DOL-required notices, another standard in providing IRS-required disclosures, and a third standard in distributing SEC-required disclosures. Under the President's Executive Order of January 18, discussed above, these standards should be harmonized. The Council recommends that the rules be harmonized by the uniform adoption of the secure website approach described above.

(c) Use of Swaps.

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. However, the proposed regulations issued by the Commodity Futures Trading Commission under Dodd-Frank would actually have devastating effects on plans.

The proposed business conduct standards would require swap dealers and MSPs to provide certain services to retirement plans and other plans governed by ERISA with respect to swaps (or potential swaps) with such plans. The required services would likely make the swap dealer or MSP a plan fiduciary under a regulatory definition of a fiduciary recently proposed by the Department of Labor (and under the current-law definition). For example, the proposed business conduct standards would require a swap dealer or MSP (1) to provide a plan with information about the risks of a swap, (2) to provide swap valuation services to a plan, and (3) to review a plan's advisor. Each of these services would likely make the swap dealer or MSP a plan fiduciary under the DOL's proposed regulations, and the third would make swap dealers or MSPs a fiduciary under current law. If a swap dealer or MSP is a plan fiduciary, it would be a prohibited transaction under ERISA for the swap dealer or MSP to enter into a swap with the plan. Thus, the proposed business conduct standards would likely require a swap dealer or MSP entering into a swap with an ERISA plan to violate ERISA. The only way to avoid this result is for all swaps with plans to cease, which would be devastating for plans, as discussed above.

The interaction of the business conduct standards and the DOL's definition of a fiduciary should be publicly and formally resolved in a legally binding way by the time the CFTC finalizes the business conduct standards. If the issue is not resolved before finalization of the business conduct standards, there would be an immediate chilling effect on all swap activity due to uncertainty regarding current and future DOL regulations. Accordingly, prior to finalization of either regulation, the CFTC and the DOL should jointly announce that no action required by the business conduct standards shall cause a swap dealer or MSP to be an ERISA fiduciary.

Furthermore, under the proposed business conduct standards, if a swap dealer or MSP "recommends" a swap to a plan, 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 – such as "this swap may fit your interest rate hedging needs" – would be a recommendation. In fact, it seems clear that the term "recommendation" would include information regarding plan risks that the business conduct standards *require* a swap dealer or MSP to provide to a plan. This means that swap dealers or MSPs acting solely as counterparties would be required to also act in the best interests of the plan. This is not possible and accordingly would likely cause all swaps with plans to cease. 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 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."

Finally, if a swap dealer or MSP is simply acting as a counterparty or potential counterparty with respect to a swap with a plan, the proposed business conduct standards require the swap dealer or MSP to carefully review the qualifications of the advisor advising the plan with respect to the swap, and to veto the advisor if appropriate. This rule is problematic for several reasons. First, there is no basis for this rule in the statute; under the statute, a swap dealer or MSP's duties are fulfilled with respect to a swap with an ERISA plan if the swap dealer or MSP determines that the entity advising the plan is an ERISA fiduciary. Second, if swap dealers or MSPs can veto plan advisors, plan advisors could potentially be reluctant to negotiate in a zealous manner against a dealer, thus severely hurting plans. Third, swap transactions often need to happen quickly to effectively hedge plan risks; there is no time for investigations of advisors. Last, reviewing a plan's advisor may well make a swap dealer or MSP a fiduciary of the plan, which, as discussed above, would in turn make the swap a prohibited transaction. If an ERISA plan represents to a swap dealer or MSP that the plan is being advised or will be advised by a fiduciary subject to the requirements of ERISA, the swap dealer or MSP should not be required, or permitted, to make any further inquiry to satisfy the statutory requirement.

These issues pose a serious threat to the ability of defined benefit plans to manage risk. At a time when plan sponsors face enormous financial and regulatory challenges in maintaining a plan, we must ensure that new swap rules do not create a further disincentive to maintaining the plan.

(d) <u>PBGC disruption of normal business activities</u>

We would also like to express deep concerns regarding the PBGC's proposed regulations under ERISA section 4062(e). First, the proposed regulations are not consistent with the statute. Under the statute, liability is triggered if "an employer ceases operations at a facility in any location". The proposed regulations do not follow the statute, which was clearly intended to be limited to situations where operations at a facility are shut down. Instead, under the proposed regulations, liability can be triggered where no operations are shut down and no employees are laid off, but rather operations are, for example, (1) transferred to another employer, (2) moved to another location, or (3) temporarily suspended for a few weeks to repair or improve a facility. The proposed regulations need to be revised to conform to the statute, so as not to disturb normal business transactions that are not within the intended scope of the statute and pose no risk to the PBGC.

Moreover, the liability created by the proposed regulations can be vastly out of proportion with the transactions that give rise to the liability. For example, where a plan has been frozen for many years, a de minimis business transaction affecting far less than 1% of an employer's employees can trigger hundreds of millions or billions of dollars of liability. This needs to be addressed. In addition, as noted, the proposed regulations would impose enormous liabilities on plan sponsors even in situations where a plan poses no real risk to the PBGC. There should be exemptions for small plans and for well-funded plans. The exemption for well-funded plans should be based on a plan's funded status for funding purposes. If a company has, for example, little or no funding obligation with respect to a plan under the funding rules, it is inappropriate to impose large obligations on such company based on a theory that the obligations are needed to protect the PBGC.

These proposed regulations would clearly hasten the demise of that system. By placing an enormous toll charge on plan sponsors that engage in normal business transactions, these proposed regulations would send a powerful negative message to those left in the defined benefit plan system.

(e) <u>PBGC premium filings</u>

We are also very concerned about a pattern that seems to be developing with respect to the PBGC's review of premium filings. We are receiving repeated reports from our members that filings are being rejected and penalties are being imposed for reasons that seem unnecessarily rigid.

In our view, the relationship between the PBGC and defined benefit plan sponsors should be a cooperative one that furthers the mission of the PBGC. The PBGC's mission includes "encourag[ing] the continuation and maintenance of voluntary private pension plans for the benefit of their participants." In that context, imposing large premium increases and penalties seems inappropriate in the case of conscientious sponsors that are trying to comply with the rules.

Based on our members' experience, we have numerous examples of this concern, but we will only highlight one here today. In the case of one of our members, the premium was paid on October 14th, the day before the deadline. The plan sponsor contacted the PBGC on October 15th to ensure that the payment had been received; a PBGC representative confirmed orally that the payment had been made. Then on October 19th, the PBGC contacted the plan sponsor and said that the payment had been returned. Apparently, the plan sponsor had made a clerical error with respect to the account number. On the same day – October 19th – the plan sponsor made the full premium payment.

This plan sponsor was assessed a large penalty and all of its requests for reconsideration have been denied. The PBGC stated in its second denial: "the payment failure was the result of a clerical error by the Plan and therefore does not meet reasonable cause. An oversight is not in keeping with ordinary business care and prudence."

It is very disturbing that the PBGC's current position is that <u>any</u> oversight affecting timely payment is a cause for penalties. Regardless of the care used by the plan sponsor, any error apparently triggers penalties. We agree that there need to be incentives for plan sponsors to be conscientious and careful. But in order to be true to its mission, PBGC needs to balance that objective with the need not to act in a punitive way with respect to plan sponsors that make inadvertent errors despite clear evidence of an intent to comply.

The above facts clearly demonstrate the plan sponsor's conscientiousness does not matter under PBGC's penalty system. If a plan sponsor makes <u>any</u> mistake affecting timely payment, penalties apply under PBGC's current system. This is not the right answer. We strongly believe that inadvertent errors, such as clerical errors, that are made despite a clear intent to comply should not give rise to penalties. Any other position would simply be punitive and inconsistent with the PBGC's mission.

PBGC needs to review its filing program to ensure that filings are not rejected or subjected to penalties inappropriately. A failure to do so would just be one more reason -- and a very preventable reason -- for companies to leave the defined benefit system.

(3) <u>Essential tax incentives</u>.

The U.S. retirement savings system successfully encourages individuals to save for retirement by providing tax incentives – typically income tax exclusions or deductions – for contributions to employer-sponsored defined contribution plans and IRAs, up to certain limits. This tax incentive structure is a fundamental pillar of our successful private retirement savings system. It provides a strong incentive for individuals at all income levels to save for retirement and encourages employers to sponsor plans that deliver meaningful benefits to Americans up and down the income scale.

The current pre-tax treatment of retirement savings is a powerful incentive for individuals. It is viewed by taxpayers as the core of our retirement savings regime and allows them to save more on a paycheck-by-paycheck basis than would be the case with after-tax contributions. This financially efficient approach is particularly important for low- and middle-income families trying to make the most of scarce dollars. The payroll tax savings on employer contributions provides another significant advantage for modest-income households, as does the deferral on gains that spares families from annual tax bills on their accumulating savings.

And current incentives efficiently produce retirement benefits. Repeated analyses have shown that, for every dollar of federal tax expenditure devoted to tax-preferred workplace retirement plans, four to five dollars in ultimate retirement benefits result. This extremely efficient catalyst produces a remarkable amount of benefits for workers and their families – in 2008, private employer retirement plans paid out $462 billion in benefits.

Because the employer-sponsored retirement system is premised on its voluntary nature, tax incentives for contributions by employees are important in encouraging plan sponsorship. A move to a capped tax credit that provides a reduced tax benefit could discourage plan sponsorship. If sponsorship declines and more employees are forced to save on their own, they would not receive the many protections and benefits associated with employer-sponsored plans (from ERISA protection to fiduciary oversight – especially of investments and fees – to employer contributions).

* * *

Employers play an important role in helping to facilitate the accumulation of retirement savings and income by American workers. We are proud of the role we have played and the unique advantages we can bring to bear when it comes to retirement savings and income. And we urge policymakers to support our role as employers in facilitating and, where feasible, financing retirement income for employees.

Thank you for this opportunity to testify.

* * *