Testimony of

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on behalf of the

American Benefits Council

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on Pension Funding and Its Impact on the Pension Benefit Guaranty Corporation (PBGC)

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Mr. Chairman and Members of the Subcommittee, thank you for the opportunity to appear today on this critically important topic. I am Kathy Cissna, Director of Retirement Plans for R.J. Reynolds. I am appearing on behalf of the American Benefits Council (the Council), where I serve on the board of directors. 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 covering more than 100 million Americans.

Like you, the American Benefits Council and its member companies are very concerned about the health of the voluntary, employer-sponsored defined benefit pension system. Today, defined benefit pensions face an unprecedented series of threats – many of which, even individually, present a significant danger of undermining our entire pension system. If prompt action is not taken to provide appropriate policy solutions, the erosion in pension coverage that we have witnessed in recent years will accelerate even further, calling into question the continued viability of the defined benefit pension system.

Fortunately, Congress and the Bush Administration can address many of these challenges in a positive manner that will enable employers to continue providing financially sound pension programs to their employees. Let me emphasize that the Council and its members believe that the health of our pension system is vitally important, both to the retirement security of millions of Americans and to the economic security of our nation, and we stand ready to work with you to find solutions to strengthen and preserve defined benefit pension plans. With that, I will attempt to provide some background on the defined benefit system and the current state of pension funding, and then discuss the current threats and opportunities.

Background on Defined Benefit Plans

While the defined benefit system helps millions of Americans achieve retirement income security, it is a system in which fewer and fewer employers participate. The total number of defined benefit plans has decreased from a high of approximately 170,000 in 1985 to about 56,000 in 1998 (the most recent year for which official Department of Labor statistics exist), and most analysts believe there are fewer than 50,000 plans in the U.S. today.[1] There has been a corresponding decline in the percentage of American workers with a defined benefit pension as their primary retirement plan from 38% in 1980 to 21% in 1997. Looking at this decline over just the past several years makes this unfortunate downward trend all the more stark. The Pension Benefit Guaranty Corporation (PBGC) reports that it insured 39,882 defined benefit plans in 1999 but only 32,321 plans in 2002. This is a decrease of over seven thousand, five hundred defined benefit plans, or 19 percent, in just three years.

These numbers reflect the unfortunate reality that today's environment is so challenging that more and more employers are concluding that they must terminate their pension programs. Even more disheartening, the statistics quoted above do not even take into account pension plans that have been frozen by employers (rather than terminated), an event that, like termination, results in no additional accruals for existing employees and no pension benefits whatsoever for new hires. If frozen plans were tracked, the tragic decline of our nation's defined benefit pension system would be even more apparent. And unfortunately, there is virtually no precedent for frozen plans "thawing out" such that benefits begin to accrue once again.

These numbers are sobering from a human and policy perspective because defined benefit plans offer a number of features critical for employees' retirement security – benefits are funded by the employer (and do not typically depend upon employees

[1] The decline in sponsorship of defined benefit plans is in stark contrast to the increase in sponsorship of defined contribution plans, such as 401(k)s. According to the same official Department of Labor statistics, the number of defined contribution plans has increased from 462,000 in 1985 to 661,000 in 1997.

making their own contributions to the plan), employers bear the investment risk in ensuring that earned benefits are paid, benefits are guaranteed by the federal government through the PBGC, and benefits are offered in the form of a life annuity assuring that participants and their spouses will not outlive their retirement income. The stock market conditions of recent years (and the corresponding decline in many individuals' 401(k) balances) have once again demonstrated to many the important role that defined benefit plans can play in an overall retirement strategy.

So, with these advantages for employees, what has led to the decline of the defined benefit system? We see several factors. First, we see a less than friendly statutory and regulatory environment for defined benefit plans and the companies that sponsor them. Throughout the 1980's and early 1990's, frequent changes were made to the statutes and regulations governing defined benefit pensions, sometimes in an effort to eliminate isolated or hypothetical abuses attributable to small employer pension plans. And yet, these rules were applied across the board to employers of every size. The result was that defined benefit pension plans became increasingly expensive and complicated to administer and plan funding and design flexibility was impaired. During this same period, Congress repeatedly reduced the benefits that could be earned and paid from defined benefit plans in order to increase federal tax revenues. Moreover, many companies have found the cost of maintaining a defined benefit plan more difficult in light of intense business competition from domestic and international competitors, many of which do not offer defined benefit plans to their employees and so do not have the corresponding pension expense.

Perspective on Pension Plan Funding

The deterioration in the funding status of many defined benefit plans is attributable in large measure to the current unique combination of historically depressed asset values and historically low interest rates. And indeed, the statistics on plan funding levels can

appear bleak.[2] Yet we must maintain the proper perspective in evaluating the significance of today's numbers. We must recognize that many current measures of funded status use the obsolete 30-year Treasury bond rate to value liabilities. The use of this artificially low and discontinued rate, which I will discuss in more detail below, makes plan liabilities seem larger than they really are and consequently makes a plan's funding level seem more dire than it really is.

Finally, it is important to note that the swing from the abundant pension funding levels of the 1990's to the present state of increasing deficits for many plans is due in significant measure to the counterproductive pension funding rules adopted over the last few decades. Since the first enactment of pension funding rules in the Employee Retirement Income Security Act (ERISA) in 1974, Congress has alternated between strengthening the pension plan system and limiting the revenue loss from tax-deductible pension contributions. Beginning in 1986, Congress limited the ability of companies to contribute to their plans by imposing heavy penalties on withdrawals of surplus assets, lowering the maximum deductible contribution, and imposing a significant excise tax on nondeductible contributions. In 1997 and after, some limited relief was provided, but the overall result is that our laws and regulations strongly encourage employers to keep their plans as near as possible to the minimum funding level instead of providing a healthy financial cushion above that level.[3] As a result of these statutory changes, by 1995 only 18 percent of plans had a funded ratio of assets over accrued liabilities of 150 percent or more as compared with 45 percent in 1990.[4]

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[2] A January 2003 report from a national consulting firm found that the pension benefit obligation funded ratio – the ratio of market value of assets to pension benefit obligations for a benchmark plan – is near its lowest point in 13 years. *Capital Market Update*, Towers Perrin, January 2003.

[3] The Council strongly supports review and re-evaluation of the basic funding rules that prevent employers from funding their plans generously when economic times are good and then impose draconian funding obligations when economic times are bad.

[4] Table 11.2, *EBRI Databook on Employee Benefits*, 1997, 4th Edition, the Employee Benefit Research Institute, Washington, D.C.

Replacement of the Obsolete 30-Year Treasury Bond Rate

In our view, the need to replace the obsolete 30-year Treasury bond interest rate used for pension calculations is the most pressing issue facing the defined benefit pension system today. Immediate action is required to correct the problem and avoid further erosion in the retirement income security of American families.

Under current law, employers that sponsor defined benefit pension plans are required to use the 30-year Treasury bond rate for a variety of pension calculation purposes, including plan funding requirements, calculation of lump sum distributions, and liability for variable premium payments to the PBGC. The various provisions of federal law requiring use of the 30-year Treasury bond rate for pension calculations were enacted in 1987 and 1994 when there was a robust market in 30-year Treasury bonds and the yields on those bonds were an acceptable proxy for corporate bonds and other long-term debt instruments. While a variety of rates were discussed, it was believed at the time the 30-year Treasury rate was first selected in 1987 that use of the rate would result in companies setting aside appropriate assets to meet their long-term funding obligations. That assumption is no longer valid.

Beginning in 1998, the U.S. Treasury Department began a program of retiring federal debt by buying back 30-year Treasury bonds. In October 2001, the Treasury Department discontinued issuance of 30-year Treasury bonds altogether. With commencement of the buyback program, yields on 30-year Treasury bonds began to drop and to diverge from the rest of the long-term bond market – a divergence that increased precipitously after the October 2001 discontinuation. As a result of the shrinking supply of these bonds (particularly when coupled with continuing demand for the relative safety of U.S. government debt), the secondary market interest rate on existing 30-year Treasury bonds has reached historic lows and no longer correlates with the rates on other long-term bonds. The Treasury Department itself has concluded,

"[The] Treasury Department does not believe that using the 30-year Treasury bond rate produces an accurate measurement of pension liabilities."[5]

The result of these low rates is to artificially but substantially inflate pension liabilities and consequently increase required pension contributions and PBGC variable premiums. These inflated pension contributions (which can often be three or four times the normal funding contribution levels) exceed what is necessary to fund promised benefits, contributing perhaps more than any other factor to the spate of plan freezes and terminations in recent years. To illustrate, contributions by Fortune 1000 companies to defined benefit plans averaged $13.7 billion between 1999 and 2001. 2002 contributions by these same companies totaled $43.5 billion, and contributions in 2003 and 2004 are projected to be more than $80 billion per year under the current regime. More than half of these 2003 and 2004 projected contributions are attributable to the inflationary effect of the broken 30-year Treasury bond rate rather than representing cash needed to fund promised benefits.[6]

Today's inflated funding requirements harm the economy since cash unnecessarily poured into pension plans diverts precious resources from investments that create jobs and contribute to economic growth. Facing pension contributions many times greater than they had anticipated, employers are having to defer steps such as hiring new workers, investing in job training, building new plants, and pursuing new research and development. Yet these are precisely the steps that would help lower our nation's unemployment rate, spur individual and corporate spending, and return the country to robust economic growth. Indeed, some employers may be forced to lay off employees in order to accumulate the required cash contributions. Moreover, financial analysts

[5] Testimony of Peter Fisher, Undersecretary for Domestic Finance, U.S. Department of Treasury, before the House Ways and Means Subcommittee on Select Revenue Measures (April 30, 2003).

[6] These figures and analysis were prepared by Ken Steiner of Watson Wyatt Worldwide, and are contained in his June 26, 2003 testimony on behalf of the Council delivered before the Working Group on Defined Benefit Plan Funding and Discount Rate Issues of the Labor Department's ERISA Advisory Council. *See* http://www.americanbenefitscouncil.org/documents/steinertestimony.pdf

and financial markets have penalized companies with defined benefit pension plans because of the unpredictable future pension liabilities that result from uncertainty as to what will replace the 30-year Treasury bond rate. The resulting pressure on credit ratings and drag on stock prices, which harms not only the company but also its shareholders, is a further impediment to strong economic growth.

Because of these problems and the fact that use of an obsolete interest rate for pension calculations makes no sense from a policy perspective, Congress acted in the March 2002 economic stimulus bill to provide a temporary interest rate adjustment that expires in 2003. Since 2002, the 30-year Treasury bond rate has only become progressively more obsolete, and the associated problems described above have become more grave. In short, the 30-year Treasury bond rate is a broken rate that must be replaced. To continue to base pension calculations on an obsolete interest rate undermines the very foundation of our pension laws and defined benefit plan system, which of course is essential to the financial integrity of the PBGC.

The Council strongly endorses replacing the broken 30-year Treasury rate for pension calculations with a rate based on a composite blend of the yields on high-quality corporate bonds. A corporate bond composite rate steers a conservative course that fairly and appropriately measures pension liability. High-quality corporate bond rates are known and understood in the marketplace, and are not subject to manipulation. Such rates would also provide the kind of predictability that is necessary for company planning of pension costs. Moreover, use of a corporate bond blend would achieve transparency given today's daily publication of corporate bond rates and instant access to market information through electronic means.

Use of such a conservative corporate bond blend would ensure that plans are funded responsibly. Moreover, the strict funding requirements that Congress adopted in 1987 and 1994 would continue to apply. Substitution of a corporate bond blend would

merely mean that companies are not forced to make the extra, artificially inflated contributions required by the obsolete 30-year Treasury rate. This is why stakeholders from across the ideological spectrum – from business to organized labor – agree that the 30-year Treasury rate should be replaced by a conservative, high-quality corporate bond blend.

Senator Judd Gregg, Chairman of the Health, Education, Labor, & Pensions (HELP) Committee, has introduced a bill (S. 1550) that replaces the obsolete 30-year Treasury bond rate with a corporate bond blend for five years. We urge members of this Subcommittee to co-sponsor S. 1550, and we recommend its prompt adoption by the Senate.

The Treasury Department has put forward a proposal to utilize a so-called "yield curve" concept in place of the 30-year Treasury rate, following a transition period during which a corporate bond rate would be used. While a fully developed yield curve proposal has not been issued and the specifics underlying the concept are not yet known, it appears that it would involve a significant change in our pension system to a volatile and complicated regime under which the interest rates used for measuring pension liability would vary with the schedule and duration of payments due to each plan's participants.

Although neither we nor the Congress yet have sufficient detail to fully analyze the Treasury Department's yield curve approach, it raises a large number of policy concerns and unanswered questions that have not been adequately studied or addressed. Based on our current understanding of the concept, we are concerned that the yield curve would:

- ***Exacerbate funding volatility*** by making liabilities dependent not only on fluctuations in interest rates, but also on changes in the shape of the yield curve

(caused when rates on bonds of different durations move independent of one another) and on changes in the duration of plan liabilities (which can occur as a result of layoffs, acquisitions, etc.). The "smoothing" techniques that allow employers to use the average of the relevant interest rate over several years to reduce funding volatility also would not be allowed.

- ***Increase pension plan complexity*** (already a significant impediment to defined benefit plan sponsorship) by moving from a system based on a single interest rate to a much more complex system that relies on a multiplicity of instruments with widely differing durations and rates.[7]
- ***Make it difficult for employers to plan and predict their pension funding obligations*** (another significant impediment to defined benefit plan sponsorship today).
- ***Result in less ability for a plan sponsor to fund pension plans*** while participants are younger because it would delay the ability to deduct contributions to periods when the workforce is more mature. In addition, important flexibility would be lost by removing the corridor surrounding the interest rate (historically 90% to 105% of the averaged rate). The loss of such flexibility would make it harder for employers to fund their plans in times when corporate resources are more plentiful.
- ***Require use of bonds of durations with very thin markets*** (because few such bonds are being issued). As a result, single events (e.g., the bankruptcy of a single company unrelated to the employer sponsoring the pension) could affect the rate of a given bond index dramatically, thereby leading to distortions in pension calculations and even potential manipulation.
- ***Involve a considerable delegation of policy authority*** by Congress to the Executive Branch since the entirety of the construction and application of the yield curve would apparently be left to the regulatory process.

[7] Although statements have been made that the yield curve adjustment would be simple and easy, the fact that the Treasury Department has failed to provide full details on the proposal, even after months of study, belies the simplicity of the proposal.

- ***Not necessarily result in a more accurate measure of liabilities***, since the theoretically more "precise" plan-by-plan yield curve interest rate would not be accompanied by other similar plan-specific assumptions.

There are many additional unanswered questions created by the Administration's yield curve concept. For example, it is unclear how such a concept would apply to issues such as the calculation of lump sums, the valuation of contingent forms of distribution, the payment of interest on – and conversion to annuity values – of employee contributions to defined benefit plans, the payment of interest credits under hybrid pension plans, and the calculation of PBGC variable premium obligations.

It is unrealistic to believe that all of these outstanding issues and concerns raised by the yield curve concept could be addressed in the short time in which Congress must act on a replacement for the 30-year Treasury rate. Such an untested change would require a complete reevaluation of our pension funding rules. In addition, it is unclear from the limited information available how the very significant issues of transitioning from a system based on corridors and averaging to a less flexible system would be resolved. At a minimum, to the extent that this type of major overhaul of our pension funding rules is considered, it should be done in the context of a more fundamental review through deliberative Congressional study and the regular legislative process.
This type of more fundamental review would be possible if S. 1550 is enacted since it replaces the 30-year Treasury rate only through 2008. This window of time would allow Congress to decide whether additional changes are warranted.

Administration Proposals Regarding Disclosure and Other Requirements for Certain Plans

The Administration has also come forward with other proposals related to pension funding – namely additional disclosure of pension information and a new idea that would mandate freezes in certain private-sector pension plans – which I also want to

touch on briefly. First, while we certainly support the goal of transparency of pension information, it is important that any required disclosure be responsible and serve a clearly defined need. Disclosure that provides a misleading picture of pension plan finances or that is unnecessary or duplicative of other disclosures could be counter-productive. For example, the Administration's proposal to key disclosure off of a plan's termination liability could provide a misleading depiction of plan finances for ongoing plans that are reasonably well funded because these plans are not in any danger of terminating. This type of misleading disclosure could unnecessarily and falsely alarm plan participants, financial markets, and shareholders. Moreover, termination calculations of the type being proposed are among the most costly and administratively burdensome calculations a plan can be asked to perform. Similarly, the Administration's proposal to allow publication of certain information that today is provided on a strictly confidential basis to the PBGC whenever a plan is underfunded by more than $50 million would provide yet another impediment to companies' willingness to sponsor defined benefit plans, and ignores the size of the plan and its assets and liabilities. For many pension plans with billions of dollars in assets and obligations, such a relatively modest amount of underfunding is often quite normal and appropriate. It should not be cause to trigger publication of information on an ad hoc basis that could again sound unnecessary alarm bells.

We also believe that the Administration's proposal that would freeze private-sector pension plans and remove lump sum rights when a company reaches a certain level of underfunding and receives a junk bond credit rating requires careful review. While we appreciate (and share) the Administration's concerns about PBGC guarantees of benefit promises that are made by financially troubled companies, this proposal raises technical and policy issues that require further examination. For example, there is no definition of "junk bond" status provided, and there is a question of whether it is appropriate to mandate a cutback in participants' benefits based on a third-party's determination of

credit rating. Moreover, it is not clear why employees should lose their rights to certain forms of benefit when their company experiences financial trouble.

Financial Status of the PBGC

Because of concerns about the overall funded status of private-sector pension plans, some have also raised the specter of the PBGC needing to take over more of these plans. This, in turn, has raised some concern regarding the financial condition of the PBGC, and indeed the PBGC has moved from a net surplus to a net deficit in recent years. We believe, however, that the long-term financial position of the PBGC is strong and that while this issue should be addressed, it would be inappropriate to be alarmed and overreact.

At the outset, I want to underscore that the Council has always predominantly represented companies with very well-funded plans. Indeed, the Council has been at the forefront of past Congressional efforts promoting strong funding standards to ensure that the weakest plans would not be able to terminate their plans and impose their liabilities on other PBGC premium payers. Simply stated, the Council has no incentive to trivialize any problems at the PBGC that will come back to haunt us if other companies are not able to keep their promises to retirees.

Nonetheless, while the PBGC's deficit is certainly to be considered very seriously, we do not believe it indicates an urgent threat to the PBGC's viability. Indeed, the PBGC has operated in a deficit position throughout much of its history. Nor does the shift from surplus to deficit over the course of one year suggest the need to change the pension funding or premium rules in order to safeguard the health of the PBGC. Today, the PBGC has total assets in excess of $25 billion, and it earns money from investments on those assets. While liabilities are approximately $29 billion, the annuity pension obligations underlying those liabilities come due over many decades, during which time the PBGC can be expected to experience investment gains to offset any

"paper" deficit that exists today. It is also important to remember that when the PBGC takes over a plan, it assumes all of the plan's assets, but not all of its liabilities. Instead, the PBGC insures a maximum guaranteed normal retirement age benefit for each participant ($43,977 for 2003). While this limits the benefits of some pensioners, it also serves to limit the maximum exposure of the PBGC. The substantial assets that the PBGC holds and the relatively modest size of its deficit when viewed in the context of its capped and long-term liabilities ensures that the PBGC will remain solvent far into the future even under current rules and economic conditions – a point that the PBGC itself has acknowledged repeatedly.

Some have attempted to draw an analogy between the PBGC's financial condition and other financial threats such as the savings and loan (S&L) crisis. We believe that such comments are seriously misplaced. Most important, as just discussed, the PBGC's long-term financial position is strong. Moreover, the PBGC is an entirely different entity than an S&L. S&L depositors had the ability to demand the full amount of their deposits at any time, raising a genuine risk of lack of sufficient funds and creating a fertile ground for financial panic. When assets were insufficient to meet customer demand for deposits, the government was forced to step in and make up the difference. Because pensioners insured by the PBGC have no right to demand their full benefits at a given point in time, rather the benefits are paid out over decades, there is no comparable risk to the government of having to step in to compensate for insufficient funds.

Thus, at this point in time, we do not believe that the PBGC's finances should be cause for alarm. In times of economic hardship, more pension plans (and the companies that sponsor them) confront economic difficulty (including bankruptcy), more pension plans suffer declines in asset values, and more pension liabilities are assumed by the PBGC. At the same time, the PBGC may enjoy sub-par investment gains on its assets while

finding itself responsible for more troubled plans. As the economy improves, this cycle reverses itself, returning the PBGC to robust financial health.

During such periods of hardship, the best protection for the PBGC is to encourage healthy companies to remain in the defined benefit system – not to generate fear with talk of financial crises and potentially detrimental changes to the pension premium and funding rules. The urgently needed policy changes we are advocating today will help achieve this aim and ensure that the PBGC continues to receive a steady stream of premium income from defined benefit plan sponsors.

Simply stated, an important ingredient for a stable PBGC is a healthy and vibrant defined benefit pension system.

Threats Facing Hybrid Pension Plans

Hybrid pension plans (such as cash balance and pension equity) have been a rare source of vitality within our defined benefit system, and have been popular with employers and employees alike. Hybrid plans were developed in part to correct a mismatch between the traditional pension design and the needs of today's mobile workers. The traditional pension design disproportionately awards benefits to employees with very long service relative to employees with less than career-long employment at their firm. Yet we know that today most employees change jobs frequently. Indeed, in today's mobile workforce, numerous studies show that the more even benefit accrual formula of hybrid pension plans delivers higher benefit levels to the vast majority of workers. At the same time, hybrid plans include the features that make traditional defined benefit pension plans popular with employees – namely, an insured, employer-funded benefit for which the employer bears the investment risk. Today, according to the PBGC, there are more than 1,200 hybrid pension plans in the U.S., covering more than 7 million employees.

Nonetheless, these plans also face serious threats that endanger their continued existence. Unfortunately, the rules applicable to defined benefit plans have not been updated to reflect the development and adoption of hybrid pension plans, leaving unresolved a number of pressing compliance issues regarding hybrid plans. Pending at the regulatory agencies are several projects to provide needed guidance to address these unresolved issues. These pending regulatory projects need to be completed, but there have been efforts to use the current appropriations process to deny funding for such projects by some who believe that traditional defined benefit plans are the only type of pension design that should be allowed for certain employees. In the House, some of these opponents have used the Transportation-Treasury appropriations bill (H.R. 2989) as a vehicle to express both their support for a recent federal district court decision addressing pension age discrimination that is out of step with other legal authority, and their opposition to completion of the pending regulatory projects on hybrid plans. These types of efforts to affect complex pension policy through the appropriations process should be rejected, and are strongly opposed by the Council. If the Treasury Department and IRS are prevented from resolving the outstanding legal issues involving hybrid pension plans, the resulting uncertainty will lead many employers to abandon these plans, further eroding Americans' retirement income security.

We are also concerned about legislative proposals (S. 825 in the Senate and H.R. 1677 in the House) that would mandate that employers converting a traditional defined benefit plan to a hybrid pension plan allow employees to elect at retirement whether they wish to receive their hybrid pension plan benefit or a benefit equal to what they would have received if their traditional defined benefit plan had remained in existence. Our voluntary pension system is premised on the idea embodied in current law that benefits already earned are absolutely protected (the "anti-cutback" rule) but that employers have flexibility to adjust to changing circumstances by increasing or decreasing benefits that will be earned in the future. Under the mandated choice legislation however,

businesses would be unable to alter future benefit levels in conjunction with a conversion as employees could simply choose to receive benefits under the prior formula. Yet business circumstances – such as increased international competition, the presence of competitor firms with lower or no pension expense, possible company bankruptcy, the need to attract new workers, or employee preference for a reallocation of benefit dollars – sometimes necessitate adjustments to pension plans.

In no other area do we prevent employers from altering employment conditions in such a manner. Employers may cease employing individuals, change pay levels, alter working conditions, revise health coverage, even drop or freeze a pension program. Yet under the mandated choice proposals, employers that adopt a hybrid pension must keep the prior traditional pension forever for current employees. This would radically depart not only from the norms of our voluntary pension system but indeed from basic American workplace principles, forcing prudent businesspeople – who will be unable to make these unalterable benefit commitments – to depart the defined benefit system as quickly as possible.

Additional Defined Benefit Issues of Importance

I also want to mention briefly two other policy issues of importance to the defined benefit system.

- *Making the 2001 Pension Reforms Permanent.* The 2001 tax act contained a number of very positive changes to the rules governing defined benefit plans. These included repeal of artificial funding caps, increases in the benefits that can be paid and earned from defined benefit plans, and simplifications to a number of defined benefit plan regulations. We support making the 2001 retirement savings reforms, which are scheduled to sunset at the end of 2010, permanent so that employees and employers can have the long-term certainty so necessary for pension planning purposes.

- *Pension Accounting.* The Council is very concerned about some ominous developments concerning the accounting standards for pension plans. Accounting standard-setters, led by those in the United Kingdom, are pushing to require companies to reflect the full fluctuation in pension asset gains and losses on the firm's financial statements *each year*, thereby prohibiting companies from amortizing such results over a period of years as they do under today's accounting standards. This new "mark-to-market" approach is inconsistent with the long-term nature of pension obligations, produces extreme volatility in annual corporate income, and has prompted 75 percent of British pension sponsors to consider terminating their plans. Given the many other challenges faced by sponsors of defined benefit plans, abandonment of current U.S. accounting standards for this "mark-to-market" approach would be devastating.

Conclusion

We thank you for the opportunity to present our views on what the Council believes are some of the most important retirement policy questions facing our nation. Defined benefit plans offer many unique advantages for employees, and the employers such as R.J. Reynolds that sponsor these pension plans sincerely believe in their value. Without prompt action by Congress and the Administration however, we fear these plans will increasingly disappear from the American pension landscape.

I would be pleased to answer whatever questions you may have. Thank you.