ASPPA
WORKING FOR AMERICA'S RETIREMENT

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Hearing on "Retirement Security: Strengthening Pension Plans"

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The American Society of Pension Professionals & Actuaries (ASPPA) appreciates this opportunity to testify before the House Committee on Education and Labor's Subcommittee on Health, Employment, Labor and Pensions on retirement security issues arising from the enactment of the Pension Protection Act of 2006 (PPA). Improving upon PPA is crucial to fulfilling Congress' intention of strengthening the retirement security of the millions of working Americans who participate in employer-sponsored qualified retirement plans.

I am Sal Tripodi, President-Elect of ASPPA and founder of TRI Pension Services, a nationally based employee benefits consulting practice that provides technical training in ERISA-related areas. Through my practice, I provide seminars around the country to groups involved in retirement plan services. I also author a five-volume reference book, aimed primarily at retirement plan service providers, consultants and advisors, regarding the legal and administrative requirements for retirement plans. In addition, I serve as an Adjunct Professor at the University of Denver Graduate Tax Program.

ASPPA is a national organization of over 6,000 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, administrators, actuaries, accountants and attorneys. Our large and broad-based membership gives ASPPA unusual insight into current practical problems with 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 private retirement plan system.

We understand this hearing is in anticipation of crafting a bill to correct technical and other problems with specific PPA provisions that have been identified since the enactment of PPA in August 2006. ASPPA applauds the committee's leadership in working to fashion

necessary corrections and improvements to PPA. We share the committee's commitment to make the PPA as effective as possible in strengthening the qualified retirement plan system, the fundamental mechanism used by millions of America's workers to achieve adequate retirement security. We stand ready and willing—and are uniquely qualified—to assist this committee in accomplishing our mutual goals as the PPA modification process moves forward.

There are, of course, many technical and other corrections needed to make PPA's operation smooth. Today, though, we would like to focus on ten specific issues that are of particular importance to the small and medium-sized businesses that do or will sponsor qualified plans for their employees. These ten issues are:

1. Duplicative and Burdensome Participant Disclosure Requirements under ERISA

The enactment of PPA resulted in what ASPPA describes as the "Great Flood of 2006," where, fortunately, there were no casualties. This flood was a result of the deluge of new disclosure requirements enacted by PPA, with the victims being millions of retirement plan participants already overwhelmed with information. As participants drown in this sea of disclosure, plan service providers paddle upstream to fulfill these new mandates, trying to make sure that the intent of the law is carried out.

ASPPA is committed to a strong, employer-sponsored retirement savings system. First and foremost in achieving such a goal is to have informed, engaged plan participants. We would argue, however, that the approach to disclosure under the Employee Retirement Income Security Act of 1974 (ERISA) hinders the furtherance of this goal. Plan participants are swimming in a sea of confusion, and they are being thrown life preservers in the form of cumbersome documents. The end result is more like a concrete anchor, dragging them into murkier waters, rather than a buoy keeping them afloat and providing a clear vision of the retirement horizon.

This is not to say that Congress should scrap all of the current disclosure rules and start anew. We need to first look at the big picture and identify the primary goals served by ERISA's disclosure requirements. No one would argue that an employee who is subject to automatic enrollment provisions in a 401(k) plan should not receive advanced communication of this feature, so that he or she will have time to set a savings goal that fits the employee's needs. An employer maintaining a safe harbor 401(k) plan, where meeting nondiscrimination testing rules are waived, should continue to communicate on a periodic basis with the plan participants to remind them of their right to contribute to the plan and, if applicable, to receive a matching contribution on those amounts. Employees who direct the investment of their account balances in a defined contribution plan have a need to receive periodic information about the value of their account and the current investment allocation in the account. Further, when the right to change investments will be blacked out for a period of time due to a change in the plan's investment options, we believe advance notice of that blackout period is in the best interest of the plan participants. When an employee is eligible for distribution of benefits, the law should require that the employee be adequately informed of his or her distribution options, and, if applicable, be informed of his or her right to postpone distribution to a later, more suitable, retirement age.

So, we do not question that there is a need to disclose information to plan participants. Rather, it is the disclosure delivery requirements at issue. And by delivery, we mean the manner in which information is communicated, the frequency of the information and the usefulness of the information.

ASPPA respectfully asks Congress to consider adopting rules that will consolidate some of the disclosure requirements (where overlapping information can be confusing) so that a more concise, clear disclosure will enhance the purpose for which the disclosure is being required in the first place. To assist in this task, the ASPPA Government Affairs Committee has established a task force that is currently reviewing all of the disclosure requirements, as well as additional disclosures that represent the best practices of retirement plan advisors and third-party service providers. The task force has created a Participant Disclosure Chart (chart) identifying each disclosure item, which is attached to this document. The chart includes a brief description of the content required in the disclosure item; the due date for providing the disclosure; which plans are required to provide the disclosure; the typical length of the disclosure; the penalty for failure to comply; a citation to the law that requires the disclosure; the permissible methods of delivery; and the governmental agency with jurisdiction over the enforcement of the requirement. The chart currently addresses only the disclosure requirements that apply either to retirement plans in general, or specifically to defined contribution plans [including 401(k) plans]. The task force's next assignment is to add the additional disclosures that are unique to defined benefit plans. In addition, the task force will reorganize the items in the chart to distinguish between disclosures that must be provided on a regular basis (typically annually or quarterly), and those that are provided only under certain circumstances.

When ERISA was first enacted in 1974, the need for mandated participant disclosures was apparent. The enactment of the disclosure rules in Title I of ERISA was a watershed event in starting us on a path toward greater transparency for plan participants and their beneficiaries. One of the cornerstones of the new transparency was the summary plan description or SPD. The SPD was intended to be the central document through which plan participants would learn about the key features of the retirement plan established by their employer. In addition, when plan amendments were adopted that modified a participant's rights under the plan, information about that change had to be provided, either as an addendum to the SPD information, or in the form of an updated SPD. A periodic update of the SPD was also required so that participants wouldn't have to wade through a sea of separate documents to understand the plan. As the ERISA disclosure requirements were amended over the last three decades, and other disclosure requirements were added to the Internal Revenue Code (IRC) with respect to certain requirements that were required for tax code qualification but not for ERISA compliance, the SPD seems to have been relegated to a lesser stature. These additional requirements often ignore whether the information is already available to the participant through the SPD, necessitating duplicative information in often unnecessarily lengthy documents that should be aimed at very specific information. Notwithstanding this, admittedly, the typical SPD today has become somewhat burdensome due to the addition of legalese in response to various cost decisions since ERISA's enactment.

A typical reaction from many plan participants to a separate communication piece that is too long or too complex is to ignore the document altogether, completely eliminating the purpose of the disclosure requirement. For those that attempt to read each communication, the length of the document may cause the individual to lose interest and not finish reading, and the

complexity or sheer volume of the information contributes to confusion, misinterpretation and, probably worst of all, the loss of the primary message that was identified as creating a need for a particular disclosure requirement.

Part of solving this disclosure puzzle also requires focusing on the manner in which disclosures are prepared and delivered. The overwhelming majority of plans rely on third-party services to comply with many (if not all) of the legal requirements surrounding retirement plans. Third-party service providers have become responsible for compiling disclosures for thousands of retirement plans. The need for repetitive or lengthy disclosures makes it more difficult to ensure that each disclosure is appropriate for a particular plan and is suitable for the participants in such plan, taking into account the plan features, the participant demographics and the sophistication of the intended audience of the communication piece. All of these considerations also increase the cost of keeping up with the disclosure requirements, which often is passed on by employers to the plans they maintain. When fees are paid by the retirement plan, particularly a defined contribution plan, it is the participants who pay the price. Fees paid by retirement plans have become a hot topic, and ASPPA supports full disclosure of fees as an important step toward better transparency and increased awareness and understanding of the plan by plan participants. Where rules relating to the administration of plans contribute to the bottom-line costs incurred with respect to such administration, ASPPA also believes that there should be sensitivity to those costs.

This is particularly true with respect to small business plans, where participants bear a higher proportion of fixed administrative costs since there are fewer participants over which to spread these costs. For example, assume a 401(k) plan with ten participants. A single disclosure to such participants would easily cost $6 per participant. The PPA-mandated quarterly benefit statements plus an annual vesting statement—a total of five disclosures—would cost $30. If the plan uses the 401(k) nondiscrimination safe harbor, automatic enrollment and a qualified default investment alternative (three more disclosures), the cost would rise to $48 per participant. For a participant making $40,000 per year who saves 5% ($2,000) of his or her pay in a 401(k) plan, this adds up to almost a 2.5% charge for disclosures, not even including other administrative costs. Does that make sense?

This is not to say that we should eliminate disclosures that are essential for participants simply because there is a cost associated with compliance. But if there is a better way to provide disclosures that will preserve the core purpose for the disclosure and not compromise participant understanding, and that better way could reduce the costs of compliance, then that should be a goal as well. We strongly believe that, in fact, a more rational approach to required disclosures will actually enhance understanding of the plan by plan participants and make employees more engaged in the plans in which they participate.

In light of this, ASPPA recommends that, in reviewing the current state of the disclosure rules, Congress consider the development of a standard document—a plan operating manual (POM) that would be a single source for relevant information pertaining to the plan. The POM would contain all the information that an employee needs to effectively participate in the plan and would be written not in legalese, but in a way that could be easily understood by the average participant. When an issue necessitating notification to participants arose, participants would be notified and referred to the relevant sections of the POM for review, rather than being provided a full-blown duplicative notice. Each notification would be in very

simple terms highlighting the issue at hand and providing reference to the more substantial explanation in the POM. This, in turn, would help train employees to refer to the POM on a regular basis. To further reduce the cost of plan administration, ASPPA suggests that the Department of Labor (DOL) be directed to produce model POM language that most plans would use. We believe standardization of these disclosures would enormously reduce participant fees to the participant's benefit. We believe that this type of approach will lead to more user-friendly communicating, a better understanding of the plan by plan participants and a reduced chance of error and misunderstanding.

I would like to offer ASPPA's assistance in formulating legislative initiatives that will enhance the disclosure system. I have made this issue a central focus in my upcoming presidential year with ASPPA. We are hopeful that, as the flood waters recede, participants will be left with a clear vision of the retirement road ahead. And that's a win for the system.

2. PPA Effective Dates

PPA contains many provisions with specified effective dates. Given the need for comprehensive regulatory guidance in order to implement many of these PPA provisions, as well as time to assimilate the regulations and consult with plan sponsors, it is necessary to postpone the effective dates of some of the PPA provisions.

A perfect example is the funding rules. In order for actuaries and consultants to properly advise clients on the impact of the funding rules, the IRS must issue regulations detailing the application of the PPA changes for 2008 and beyond, as well as the application of the transition rules. The transition rules are based on the funded status of the plan for 2007 under the funding standards of PPA. Since 2007, valuations are not performed based on the PPA rules, but rather are still subject to the pre-PPA rules. Without IRS guidance, a plan cannot determine its eligibility for the transition rules. Further, employers cannot make informed decisions as to their 2007 contribution strategy without knowing its impact in 2008 and beyond. At this time, no guidance has been issued, and it is not clear that the Service will be able to issue the required regulations in advance of the 2008 plan year.

To make sure that employers have sufficient time to assess their alternatives, ASPPA recommends that the effective date of major provisions of PPA that impose additional restrictions or requirements on plan sponsors not be effective until the first day of the plan year beginning at least 180 days following the issuance of regulations by the IRS.

3. Trustee-Directed Plans—Benefit Statements within 45 Days [PPA §508(a)]

PPA §508(a) requires retirement plans to provide quarterly benefit statements to participants and their beneficiaries in participant-directed defined contribution (DC) plans, annually in the case of all other DC plans, and every three years in the case of defined benefit (DB) plans. PPA requires that the benefit statements be based on "the latest available information." DOL's Field Assistance Bulletin (FAB) 2006-3 stated that in order for plan sponsors to meet good faith compliance, the benefit statements must be provided within 45 days of the end of the relevant period in order to constitute good faith compliance.

The 45-day rule creates an impossible situation for trustee-directed DC plans where investment decisions are made without participant direction. In particular, many small employers (those with fewer than 100 participants) sponsor trustee-directed plans, such as profit-sharing plans, where the plan valuations and plan contributions are done at different points in the plan year. Allocation of earnings, on which many profit-sharing contributions are based, and independently appraised non-publicly traded plan assets, require more time than a 45-day deadline allows. Consequently, as these calculations are generally not available until after the employer's business tax return has been completed, it is literally impossible to value the plan's assets and prepare the benefits statement within 45 days of the relevant period.

To solve this problem, ASPPA recommends that the deadline for trustee-directed DC plan annual benefits statements be no later than the deadline (with extensions) for filing the plan sponsor's Form 5500 (*e.g.*, October 15 in the case of a calendar-year plan).

4. Participant-Directed Quarterly Benefit Statements—Calculation of Vested Benefits (PPA §508)

One of the requirements of the quarterly benefit statement requirement under PPA §508(a) requires the sponsors of self-directed 401(k) plans to provide quarterly benefit statements to plan participants on the value of their benefits, including the value of vested benefits. Under DOL FAB 2006-03, these quarterly reports are due within 45 days of the calendar quarter. Reporting timely quarterly vesting information creates an impossible burden on third-party administrators (TPAs), who most often do the administrative work for plan sponsors (especially for small plans with 100 or fewer participants). TPAs generally do not receive required contribution information from their plan sponsor clients until three weeks (or, most commonly, even later) after the close of the plan year, at which point they calculate vesting to make sure all contributions are properly allocated. This frequently entails extra discrimination testing (ADP and ACP) for both deferrals and matching contributions. The sheer volume of this work—remember, most TPAs are handling hundreds, thousands, even tens of thousands of plans—makes turning around reports and delivering them in what amounts to a week or two simply impossible.

These problems, real though they are, are largely administrative and are easily fixed. ASPPA recommends that the 45-day deadline be at least doubled to 90 days. A 180-day deadline following the end of the quarterly period would be even more realistic in light of the real-world workload to calculate vested benefits.

5. Benefit Restrictions—Plan Valuations (PPA §113)

PPA §113 provides that benefit restrictions will be triggered if a defined benefit plan's Adjusted Funding Target Attainment Percentage (AFTAP) falls below certain specified percentages. PPA requires that certain restrictions arise if the plan's AFTAP is less than 80 percent; other benefit restrictions apply if the plan's AFTAP is less than 60 percent. PPA §113(h) provides that if an actuary has not yet certified the plan's AFTAP, it is assumed to be the same as last year. It further provides that where the plan's AFTAP has not been certified by the first day of the fourth month of the plan year (April 1 for calendar-year plans), it is assumed to be 10 percent less than the prior year. Finally, where the plan's AFTAP is still not

certified by the first day of the tenth month of the plan year (October 1 for calendar-year plans), the plan is permanently deemed to have an AFTAP of less than 60 percent for the plan year. Accordingly, even where the AFTAP for the year is later determined to be greater than 60 percent, the less than 60 percent "deemed AFTAP" is still binding for the year. Thus, the resulting benefit accrual freeze remains in place until the next year's AFTAP is determined.

These requirements present particular problems for end-of-year plan valuations. First, the plan's AFTAP cannot be determined until the valuation date. The demographic and financial data used to determine the plan's valuation and funding level for a plan year is not available until the last day of the plan year and, thus, cannot be determined in time to avoid the "deemed AFTAP" of less than 60 percent and the resulting benefit accrual freeze. In addition, the AFTAP cannot be estimated effectively since the interest rates to determine the AFTAP on December 31 are not yet published as of October 1.

ASPPA recommends a "lookback rule" to correct this problem. Under the suggested lookback rule, the plan's AFTAP for purposes of the PPA's benefit restrictions would be determined as of the plan valuation date, coincident with or immediately preceding the first day of the plan year.

6. Combined Plan Limit (PPA §803)

PPA §803 creates an exemption from the limit under IRC §404(a)(7) on the deductibility of employer contributions when an employer maintains both a defined benefit (DB) and a defined contribution (DC) plan. The exemption eliminates the combined plan limit deduction requirement when the employer contributes six percent or less of aggregate compensation to the DC plan. In Notice 2007-28, Treasury interpreted this relief to apply only to the operation of the limit on the DC plan. The result is that many combined plan sponsors will not get the benefit of the combined plan limit relief with respect to their DB plan contributions, particularly with respect to the PPA-provided ability to fund the DB plan up to150 percent of unfunded current liability. Affected plan sponsors and Congressional staff involved in the PPA conference negotiations believe PPA §803 was intended to apply to both the DB and DC portions of the plan.

The solution to this problem is a clarification of PPA §803. ASPPA recommends that §803 be modified to clarify that the exemption from the combined plan deduction limit for employers who sponsor both DB and DC plans apply to both the DB and DC plan contributions. To clarify the congressional intent of §803 of PPA, the following technical correction should be made:

> IRC §404(a)(7)(C)(iii) should be amended by striking all the words preceding the word "exceed" in the first sentence thereof, and replacing such words with the following:
>
> > "Subparagraph (A) shall only apply with respect to any defined contribution plans and defined benefit plans if and to the extent that contributions to 1 or more defined contributions plans".

This technical correction should be effective as if included in PPA.

7. Fixed Rate for Computing Section 415 Limit on Lump Sum Payments (PPA §303)

PPA §303 sets the interest rate for determining a lump sum benefit payment as subject to the benefit limitations in IRC §415. Under PPA, the rate will be the greater of a fixed 5.5 percent rate, a rate that produces a benefit of not more than 105 percent of the benefit provided from the applicable interest rate (as determined under the yield curve rules), or the plan rate. Prior to PPA, the Pension Funding Equity Act of 2004 (PFEA) enacted a temporary rate of the greater of 5.5 percent or the plan rate.

The purpose of the fixed 5.5 percent rate enacted under PFEA was to give small plan sponsors simplicity and predictability in calculating their funding requirements for purposes of their lump sum payment liabilities, particularly when business owners or key employees approach retirement age and commence the payment of plan benefits. Inclusion of the "105 percent" prong of the "greater of" test functionally eliminates this certainty. The fixed 5.5 percent rate is a conservative approximation of historically applicable rates and is necessary for small plan sponsors to plan and fund for their liabilities as their key workers retire.

To provide the necessary certainty that will allow small business plan sponsors to establish a plan with the confidence of knowing they can calculate their funding obligations, ASPPA urges Congress to amend PPA §303 so that IRC §415(b)(2)(E) reflects the PFEA language and requires the §415 lump sum calculation to be the greater of 5.5 percent or the plan rate. The end result would be provision of a fixed 5.5 percent rate to be used in calculating the contribution required to fund a lump sum payment as limited by §415. This rate ensures planning consistency by existing defined benefit plans, encourages the establishment of new defined benefit plans by small businesses, and is no more generous than recent law.

8. DB(k) Plans (PPA §903)

PPA §903 creates a new plan design called an "eligible combined plan" [commonly referred to as a "DB(k)"] available to employers with 500 or fewer participants beginning in 2010. The DB(k) plan design allows a qualifying employer to establish a combined DB and 401(k) plan, using one plan document, one summary plan description, one Form 5500 and one audit (if required). The DB(k) would be deemed not top-heavy or subject to non-discrimination testing where it meets specific safe harbor formulas for both the DB and the 401(k) elements of the plan. The DB component is either a 1% of final average pay formula for up to 20 years of service, or a cash balance formula that increases with the participant's age. The 401(k) component would include an automatic enrollment feature (using 4% as the automatic enrollment rate), and provide for a fully vested match of 50% on the first 4% deferred.

ASPPA is concerned that PPA §903 restricts the availability of the DB(k) plan option to situations where the employer is willing/able to contribute amounts to the DB and 401(k) component other than specified under the safe harbor and be willing to meets its antidiscrimination obligations through general nondiscrimination rules (ADP/ACP) and top-heavy testing procedures. Because of unique workforce demographics or other reasons, some small employers will prefer to use the usual discrimination rules, which could result in even more generous contributions on behalf of rank-and-file workers. The required use of the safe

harbor could prevent these employers from offering the DB(k) plan option, which combines the best elements of the DB and 401(k) plan designs.

Safe harbors provide ease of administration for small business plan sponsors, but those who wish to sponsor DB(k) plans and customize their plans for the benefit of all their workers should be allowed to do so by being subject to ADP/ACP and top-heavy testing, while still being able to offer the unique DB(k) plan design. ASPPA recommends that PPA §903 be amended to make clear that a DB(k) plan sponsor may choose to use either the provided safe harbor or the regular nondiscrimination rules and top-heavy testing rules when testing the DB and DC components of the DB(k) plan.

9. Automatic Enrollment—ERISA Preemption (PPA §902)

PPA §902 amends ERISA to preempt state wage withholding laws that might otherwise interfere with establishment of an automatic enrollment 401(k) plan. Unlike other preemption provisions of ERISA, the provision relating to automatic enrollment plans includes specific definitional requirements to qualify the plan for preemption. In particular, §514(e)(1) of ERISA authorizes the DOL to issue regulations that would establish minimum standards for an automatic enrollment plan to be eligible for preemption. In addition, §514(e)(2)(C) of ERISA requires an automatic enrollment plan to satisfy the DOL's default investment regulations in order to qualify for preemption.

ASPPA recommends that PPA §902 be clarified to provide that the ERISA preemption provision should apply without regard to whether a plan satisfies specific definitional requirements in the statute or regulations, including any requirement to meet default investment regulations. This would be consistent with how ERISA preemption works in other contexts.

10. Tribal Plans Treated as Governmental Plans (PPA §906)

PPA §906 imposes new restrictions on the treatment of qualified retirement plans maintained by Indian Tribes as governmental plans for purposes of ERISA. PPA limits the governmental plan treatment of tribal plans to situations where the sponsoring tribes earn no income from "commercial activity." As drafted, the "commercial activity" language is very broad. Further, Treasury's Notice 2006-89 adopts such a broad definition of "commercial activity" as to make it very difficult for a tribal government to sponsor a qualified plan under ERISA governmental plan rules. The result is to eliminate government plan treatment for any tribal government that engages in any income-producing activity, no matter how small or no matter how related that activity is to the tribal government's core functions.

ASPPA recommends PPA §906 be amended to treat all retirement plans maintained by Indian tribes as governmental plans. Indian tribes are, in fact, governments in all respects. Their plans can and should be adequately governed under the usual governmental plan rules in both ERISA and the Internal Revenue Code.

Conclusion

Thank you for this opportunity to testify before your subcommittee on these very important issues. ASPPA pledges to you its full support in creating the best possible PPA corrections legislation. I will be happy to answer any questions you may have.