

April 15, 2013

Filed electronically via e-mail to tax.reform@mail.house.gov.

The Honorable Pat Tiberi
U.S. House of Representatives
Washington, DC 20515

The Honorable Ron Kind
U.S. House of Representatives
Washington, DC 20515

Dear Representatives Tiberi and Kind,

Thank you for the time and effort you have dedicated over the past few months to explore the myriad of complex issues surrounding retirement policy and its impact on employees, plan sponsors and taxpayers in general. We greatly appreciate your attention to the issues and concerns faced by many companies as we modify our plans to meet the needs of our workforce and businesses.

Many companies are transitioning or have transitioned from a defined benefit (DB) plan to a defined contribution (DC) plan. In the context of such transitions, it is not unusual for companies to grandfather some or all of the existing employees under the benefit formula in effect. A common example is to close a traditional pension plan to new workers (who often receive an additional contribution under the company's DC plan), while allowing existing employees to continue to participate in the plan. This is typically known as a "soft freeze". This type of freeze can help those existing employees realize very significant benefits that are provided by a DB formula late in an employee's career.

Under current law, DB plans that cover non-union employees cannot benefit highly paid employees disproportionately. In order to determine whether such plans are in compliance, employers must perform what is known as nondiscrimination testing. However, since many employers have implemented a "soft freeze" in recent years but provide grandfathering arrangements to protect older, longer service employees, these plans are confronted with the prospect of failing nondiscrimination testing. Such failure is primarily due to the fact that, with attrition, the employees who remain covered under the DB plan become proportionately higher paid and, in general, have greater seniority within the company.

For example, assume that a DB plan is closed to new hires who receive an additional non-elective contribution under the company DC plan. In general, the DB plan and DC plan, if tested together on the basis of benefits provided, will satisfy all applicable coverage and nondiscrimination tests. However, over time, the participants in the DB plan can become disproportionately highly compensated. This happens not by design, but simply by reason of the fact that (1) turnover among non-highly compensated employees tends to be higher than among highly compensated employees, and (2) many grandfathered non-highly compensated employees over time become highly compensated employees by reason of seniority.

Under the non-discrimination rules, if participants in the DB plan become too disproportionately highly compensated, it may no longer be permitted for the two plans to be tested together on a benefits basis. Without such combined testing, the DB plan will likely fail to satisfy the applicable tests. Please note that if the plans were permitted to be tested together on a benefits basis, the plans generally pass. So the problem is not created by an arrangement that is discriminatory overall.

Unfortunately, as a practical matter, in the vast majority of cases, the most workable solution to the discrimination problem described above is to (1) remove some or all of the highly compensated employees from the DB plan, or (2) more likely, “hard freeze” the plan so that no further benefits are earned. This is an unfortunate result for DB plan participants who will lose the most beneficial years for accruing benefits. In fact, by losing such beneficial accruals, older, longer service participants could experience the “worst of both worlds” by also not benefiting from higher DC plan allocations earlier in their career.

However, there are alternatives that we would strongly encourage Congress to consider. Congress could direct the Department of Treasury to modify the nondiscrimination rules to allow plan sponsors to provide a meaningful transition period for its employees when transitioning from a DB to a DC plan structure or directly prescribe such modification to the rules applicable to qualified retirement plans.

Specifically, if a group of employees is grandfathered under a DB plan (*i.e.*, allowed to continue to accrue a benefit after a plan is closed to new entrants) and that plan is permitted to be tested together with the DC plan on a benefits basis when the DB plan was closed to new hires, the DB plan would continue to be permitted to be tested in the same way permanently (unless the group or the benefit formula applicable to the group is enhanced). This would prevent these frozen plans from unintentionally violating the rules prohibiting discrimination in favor of highly compensated employees and thus effectively forcing the employer to stop all pension benefits.

We also recommend that consideration be given to the provisions contained within section 407 of H.R. 4050, *The Retirement Plan Simplification and Enhancement Act*, introduced by Congressman Richard Neal in the 112th Congress, which further addresses additional concerns related to nondiscrimination testing with respect to grandfathered DB plan participants.

The undersigned organizations support the above proposals and greatly appreciate your consideration of this issue.

Sincerely,

Alcoa
American Benefits Council
Caterpillar Inc.
Eastman Chemical
Financial Executives International Committee
on Benefits Finance
National Association of Manufacturers
Principal Financial Group
Raytheon Company

The ERISA Industry Committee
The Boeing Company
The Committee on Investment of Employee
Benefit Assets
The Financial Services Roundtable
The Ford Motor Company
United Launch Alliance
United States Steel Corporation
U.S. Chamber of Commerce