

**Testimony of Deborah Tully
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**Before the
House Committee on Ways and Means
Subcommittee on Select Revenue Measures**

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Good morning, Chairman Tiberi, Ranking Member Neal, and committee members.

I am Deborah Tully, Director of Compensation, Benefits Finance and Accounting Analysis at Raytheon Company. I am responsible for reporting, compliance, and financial analysis for Raytheon's benefits programs, including our defined benefit and defined contribution retirement plans. I am also a Fellow of the Society of Actuaries and an Enrolled Actuary. Thank you for the opportunity to address the subcommittee on pension matters, specifically the nondiscrimination testing regulations as they apply to closed plans.

Before I do so, let me give some background on Raytheon and our retirement programs. Raytheon is a technology and innovation leader specializing in defense, security, and civil markets throughout the world. Founded in 1922, Raytheon is headquartered in Waltham, Massachusetts and has 61,000 employees. Our 2013 net sales were \$24 billion. Raytheon has maintained defined benefit retirement plans since 1950 and defined contribution retirement plans since 1984. Raytheon's defined benefit plans cover approximately 172,000 people, including 44,000 active employees; 65,000 terminated vested employees entitled to future benefits; and 63,000 retirees and beneficiaries currently receiving benefits. Consistent with many other employers and market trends, Raytheon closed its defined benefit plan to employees hired on or after January 1, 2007. Raytheon's defined contribution plan covers approximately 92,000 current and former employees and is made up of two components: a 401(k) plan with a 4%

company match; and a supplemental defined contribution plan for employees hired on or after January 1, 2007 (to replace the defined benefit plan) where automatic company contributions ranging from 2.5% to 9% are made to individual accounts based on age and service.

Like many companies, we have been transitioning from a predominantly defined benefit retirement model to a defined contribution model, most notably by closing our defined benefit plan to new employees beginning in 2007, while continuing to provide a defined benefit plan to employees hired before 2007. This gradual change minimizes the impact to existing employees while providing the greatest opportunity for new employees who are enrolled in the defined contribution plan to maximize their retirement benefit since they will generally have a longer time to save and earn investment returns under the defined contribution plan.

Nondiscrimination Requirements for Defined Benefit Plans

Under the Internal Revenue Code, defined benefit pension plans must meet certain nondiscrimination testing standards to ensure that they do not discriminate in favor of highly compensated employees. IRS rules generally define highly compensated employees as employees earning more than \$115,000 annually (indexed for inflation). To satisfy nondiscrimination testing requirements, a defined benefit plan must pass three types of tests. The first test compares the percentage of an employer's non-highly compensated employees covered by a defined benefit plan to the percentage of highly compensated employees covered. The second test compares the level of benefits provided by the defined benefit plan to non-highly compensated employees to the benefits provided to highly compensated employees. In most cases, to pass this test, employers must demonstrate that their defined benefit plan is nondiscriminatory by itself, without considering the benefits being provided in defined

contribution plans through cross testing. The third test requires that each benefit, right, and feature of a plan is available to the nondiscriminatory group of employees. These three tests often involve complex actuarial calculations to ensure that a plan is not discriminatory.

Nondiscrimination Issues with Closed Defined Benefit Plans

For a plan that is closed to new participants, each of these tests gets more difficult to pass over time, which ultimately could jeopardize the tax-qualified status of the plan unless the employer makes changes. This occurs because the group of employees earning benefits under a closed plan will gradually have longer service and will have earned compensation increases over their careers due to promotions, seniority, or cost of living increases. Over time, those compensation increases will cause many employees to be treated as highly compensated for purposes of nondiscrimination testing. The result is that plans that have historically covered a nondiscriminatory group risk failing these tests simply because of the aging of the plan population. Each year, more and more employers are facing this issue as the demographic profile of their closed defined benefit plan evolves. In contrast, when a plan is open to new entrants, this does not usually present a problem as new employees continue to enter the defined benefit plan, often at lower compensation levels because they are at the beginning of their careers. These newer, non-highly compensated employees tend to balance out the demographics of the defined benefit plan for nondiscrimination testing purposes.

How Companies Fix the Problem Today

Under current regulations, an employer has limited practical options to ensure compliance if its closed plan is at risk of nondiscrimination testing failure. While some employers take interim steps to modify their plans to pass nondiscrimination testing in the near

term, such as removing some highly compensated employees from the plan or changing certain features of the plan, these fixes are only temporary solutions to a long-term problem. Ultimately, many employers choose to fully freeze their plans, since this is the only permanent solution to the problem. A full plan freeze means that employees will no longer earn benefits in the defined benefit plan. This negatively impacts mid- to late-career employees who are about to earn the most significant portion of their retirement benefit, since the most valuable accruals under a defined benefit plan typically occur towards the end of an employee's career. These unintended consequences of the existing nondiscrimination rules are forcing many employers to make design and structural decisions to their plans that they would otherwise not make, often to the detriment of the very employees the employer was trying to protect.

Another potential, yet impractical option to avoid testing noncompliance is to re-open the pension plan to employees who are not in the plan. While every company has to evaluate their plan design, demographics, and financial situation based on their specific circumstances, this is an unlikely choice for most employers given the trend away from defined benefit plans and toward defined contribution plans. This trend is driven in part by the nature of today's workforce environment, where employees typically do not remain with one company for the majority of their career and tend to change jobs multiple times. Furthermore, it is unrealistic to expect an employer to re-open its plan in the current market environment, where many competitors do not offer a defined benefit plan to new employees.

Temporary Relief from U.S. Treasury Department

In December of 2013, the U.S. Treasury Department issued temporary nondiscrimination relief through 2015 for certain closed defined benefit plans, allowing employers to combine their

defined benefit and their defined contribution plans for nondiscrimination testing (referred to as “cross testing”) as long as the plan satisfied certain criteria before the end of 2013. This allows employers to take the defined contribution benefits offered to all employees into consideration when evaluating the level of benefits being provided. This temporary relief is very much appreciated and reflects progress; however, it is not a complete solution since it is short-term in nature and does not address all of the testing requirements. The relief does not address the nondiscrimination requirements for benefits, rights, and features and the inability to use the matching contribution component of the defined contribution plan for cross testing purpose. As a result, many employers could still face nondiscrimination testing failure, even with this temporary relief.

Recommended Solutions

Employers who have chosen to maintain their defined benefit plans for some employees as they transition to a defined contribution model for other employees will face nondiscrimination issues at one point or another under the current regulations. While employers may have near-term options to avoid failure, a long-term solution is needed in order to allow employees to continue to earn benefits under the defined benefit plan. A viable long-term solution would include changes that satisfy all of the testing requirements to avoid future unintended consequences for closed defined benefit plans. We believe that H.R. 5381, introduced by Chairman Tiberi and Ranking Member Neal, addresses many of these nondiscrimination testing concerns by liberalizing the rules under which employers use cross testing for their closed plans, and by allowing the benefits, rights and features that are available only to a closed group of employees to be considered nondiscriminatory if the group was nondiscriminatory at the time the plan was closed.

The current regulations penalize employers who have chosen to make a gradual transition from defined benefit to defined contribution retirement programs rather than taking a more abrupt approach. Without a long-term solution, the nondiscrimination regulations will further drive employers to exit the defined benefit system at the expense of the participants that the regulations were intended to protect.

Thank you for the opportunity to speak today and I look forward to answering any questions you may have.
