



AMERICAN ACADEMY *of* ACTUARIES

June 30, 1999

The Honorable William V. Roth, Jr.
Chairman
Committee on Finance
United States Senate
Washington, DC 20510

Re: Disclosure Rules for Conversions to Cash Balance Plans

Dear Chairman Roth:

I am writing on behalf of the American Academy of Actuaries (the Academy)¹ to provide some thoughts on how to improve the information pension plan participants receive from their employers when their traditional defined benefit plan is changed. As you know, there has been considerable controversy recently about cash balance and other pension plan conversions and disclosures to plan participants. The Academy strongly believes that employees should have meaningful information about changes to their pension plan. We are concerned that proposed legislation could inadvertently lead to more confusion among employees and further discourage the continuance and formation of defined benefit plans. In this letter, we offer some suggestions for ways to disclose information about pension plan changes that we believe satisfies the need for more meaningful information, without unduly burdening the private pension system.

Background

Sections 104(b) and 204(h) of the Employee Retirement Income Security Act (ERISA) of 1974, provide the only requirements under present law regarding disclosure of the terms of a pension plan to its participants:

¹The American Academy of Actuaries is the public policy organization for actuaries of all specialties within the United States. The Academy is nonpartisan and assists the public policy process through the presentation of clear actuarial analysis. The Academy regularly prepares testimony for Congress, provides information to federal elected officials, regulators and congressional staff, comments on proposed federal regulations, and works closely with state officials on issues related to insurance.

- ERISA §104(b)(1) requires the employer to provide all plan participants with a Summary Plan Description (or SPD) that describes the terms of the plan in a manner, “calculated to be understood by the average plan participant.” This normally must be done within 90 days of the time an employee becomes a plan participant.

Whenever there is a material modification in the terms of a pension plan, §104(b)(1) requires the employer to provide participants with a summary of the changes (i.e., a Summary of Material Modifications or SMM) no later than 210 days after the end of the plan year in which they are adopted. The SMM must also be written in a manner, “calculated to be understood by the average plan participant.”

- Under ERISA §204(h), defined benefit plans that are amended and are expected to significantly reduce the rate of future benefit accrual for some or all active plan participants must provide a written notice to each participant and beneficiary of the plan notifying them that the plan has been amended and its effective date. Employers are required to provide the notice no less than 15 days before the effective date of the plan amendment². An employer can satisfy the notice requirement by providing a summary of the amendment or a copy of the amendment language.

The communications provided to employees under these requirements may not adequately describe changes made to the plan, or identify the types of employees who could be adversely affected. For example, when copies of the actual plan amendment are provided as part of the 204(h) notice, the language is often too technical for the average participant to understand. Providing a brief summary of the plan amendment in the 204(h) notice also may not properly convey the total effect of the revised plan. Moreover, the revised SPD notice or SMM notice may not be furnished for up to 19 months after amendments to the plan were adopted and—even then—may not provide sufficient information on the effect of the new plan on different categories of employees.

For this reason, many employers go beyond these legal requirements and voluntarily provide extensive information to their employees in order to facilitate a better understanding of the retirement plan. For example, many employers provide Summary Plan Descriptions, or SMMs, that contain multiple illustrations of how benefits are calculated, in addition to the required description of the plan’s benefit provisions. This information is usually sufficient for the average participant to project his or her current and future retirement benefit.

²§204(h) of ERISA prohibits any reduction in the benefits a plan participant has accrued; §204(h) allows the future rate of accruals to be reduced so long as the notice requirement is met.

This is particularly true if there is a significant change in the plan's benefit provisions – as occurs when a traditional defined benefit plan is changed to a cash balance plan³. Such conversions can lead to a “significant reduction in the rate of future benefit accruals” for some employees, thereby triggering the §204(h) requirement.

Many employers who have converted to a cash balance plan have voluntarily provided their employees with extensive information regarding details of the changes, describing who might be positively or negatively affected by the plan amendment and identifying any special transition rules adopted to eliminate (or minimize) negative impacts on future benefit accruals.

Other employers adopting cash balance plans provide a minimum amount of information (i.e., a brief summary of the plan amendment and its effective date) within the required 15-day time period to satisfy 204(h), although additional explanations are generally provided after the effective date.

The Moynihan Proposal

Senator Moynihan has introduced legislation (S.659, The Pension Right to Know Act) that is intended to address the issue of disclosure when certain types of amendments to defined benefit pension plans, particularly conversions to cash balance plans, are adopted. The stated goal of Senator Moynihan's proposal is to provide meaningful information to participants without placing burdensome requirements on employers who sponsor pension plans. The proposed legislation requires medium and large size employers to provide each employee with a detailed, personalized statement that estimates the effect of the amendment on each participant. This statement would be required at least 15 days before the plan amendment becomes effective.

The Academy agrees with the stated objectives of S.659. However, we believe that S.659—as currently drafted—would **not** provide meaningful information to most participants, but more likely would provide misleading information. In addition, collection of the data necessary to provide accurate personalized statements within the time period specified by the proposal would place an undue burden on many employers. We would be happy to discuss with you in detail our specific concerns with the Moynihan proposal. The remainder of this letter describes an alternative to the Moynihan approach that we believe would be more beneficial to plan participants and less likely to jeopardize employer-sponsored defined benefit plans.

Disclosure Principles

³This is quite similar to the very common situation of an employer terminating a traditional defined benefit plan and establishing a new defined contribution plan - such as a 401(k) plan, which—absent meaningful transition arrangements—could negatively impact older, longer service employees. The sole distinction between the two situations is that a defined benefit conversion to a cash balance plan can be accomplished by amending the existing defined benefit plan, while a change from a defined benefit plan to a defined contribution plan typically requires a plan termination. In considering the need for additional disclosure, this second category warrants consideration.

The Academy believes that certain basic principles should underlie any disclosure rules:

- Employees should have access to clear and understandable information about their retirement benefits.
- Employees should have timely information about changes to their retirement benefits.
- Participants should be informed as to whether and how a change to their retirement plan will likely affect them.
- Participants should have the opportunity to request relevant information about their specific situations.
- If employees are given a choice of plans, they should be provided the necessary information for comparing the choices and understanding the consequences of their decision.
- The employer-sponsored retirement system is voluntary and already subject to expensive and complex requirements. Thus, any new disclosure requirement should consider its administrative feasibility and costs.

Alternative Approach

The Academy believes the following approach would satisfy the above principles:

- **Strengthen Section 204(h)** – This section of ERISA could be modified to require plans to clearly describe how the plan is being amended. The new requirement would also call for a written description of which types or groups of employees might be expected to have lower future benefit accruals under the amended plan. The 204(h) notice would be required to inform participants that they can receive more information (beyond that specified later in our letter) on their individual situation under the amended plan within six months of the new plan's effective date. Section 204(h) could be expanded to also apply whenever an amendment is expected to significantly reduce early retirement benefits. Current law only requires a notice whenever a plan amendment will result in a significant reduction in the accrual rate for normal retirement benefits. The 204(h) notice would still be required no less than 15 days before the effective date of the plan amendment.
- **Accelerate the Release of SMMs** - In addition to stronger, more meaningful 204(h) disclosure, Congress could accelerate the deadline for distribution of the Summary of Material Modifications. Instead of 210 days after the end of the plan year, as current law requires, employers could be required to furnish their employees with SMMs within 30 days of the effective date of the plan amendment. This would give employees meaningful information about their retirement plan in a timely manner.
- **Require Certain Information on the Amended Plan.** Employers could be required to provide the following information to each participant within a reasonable period of time after the effective date. This would provide employers with adequate time to gather the appropriate information and do the necessary calculations. Taken together, this information should give participants a clear description of their amended plan's initial

value and how that compares to the actuarial equivalent value of the accrued benefit under the prior plan as of the effective date of the amendment. Each active participant would receive the following information:

1. The estimated accrued benefit payable at normal retirement age under the prior plan as of the effective date of the amendment.
 2. The actuarial equivalent lump sum value of the prior plan accrued benefit as of the effective date of the new plan using the assumptions required under Internal Revenue Code section 417(e) (assuming the new plan provides for such distribution if the participant were to cease employment as of the new plan effective date).
 3. If benefits under the amended plan are based on a “cash balance,” the participant’s initial account balance (if any) under the amended plan with a description of how it was determined and the assumptions used to develop the initial account balance.
 4. An estimate of the annuity that would be provided by the initial account balance payable in the normal form of payment (e.g. life annuity, subsidized joint and survivor annuity or a 10-year certain and life form of payment) under the old plan at the old plan normal retirement age using 417(e) assumptions as of the new plan’s effective date. In order for the participant to make an “apples to apples” comparison between the old plan accrued benefit and the annuity that could be provided by the initial account balance, the forms of payment should be the same.
- **Require Comparisons of Old and New Plans** - Employers could be required to provide a more extensive comparison between the benefits under the old and new benefit formulas for those participants who are given a choice between plans and request such a comparison.

Pension disclosures involve actuarial concepts that can be difficult to communicate without being misleading. Whether or not our proposed alternative is determined to be feasible, our assistance is available for the development of meaningful disclosure standards. If you or your staff would like to discuss this issue further, I can be reached at 212/251-5317 or you may contact David Rivera, Assistant Director of Public Policy, at the Academy offices (202/785-7869).

Sincerely,

Donald J. Segal, FSA, MAAA
Chair
Pension Committee

cc:
Committee on Finance
Stan Fendley, Minority Tax Counsel, Committee on Finance
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