

PENSION RIGHTS CENTER

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STATEMENT OF
THE PENSION RIGHTS CENTER

BEFORE THE
ERISA ADVISORY COUNCIL
WORKING GROUP ON PARTICIPANT BENEFIT STATEMENTS

WASHINGTON, D.C.

SEPTEMBER 18, 2007

Good afternoon Chairman Rouse, Vice Chair Kennedy, and members of the Working Group. I am Rebecca Davis, Staff Attorney for the Pension Rights Center. On behalf of the Center, I thank you for inviting me here today to share our views on the critically important subject of individual benefit statements.

The Pension Rights Center is the nation's only consumer organization dedicated solely to protecting and promoting the pension rights of American workers, retirees and their families. For more than thirty years, both directly and through our National Pension Assistance Resource Center,¹ we have helped thousands of individuals understand their retirement rights. We know

¹ The Pension Rights Center's National Pension Assistance Resource Center provides legal training and technical assistance to the Administration on Aging's Pension Information and Counseling Program. Established in 1992 under the Older Americans Act, the program offers free, personalized pension assistance to individuals in 25 states through six regional counseling projects. The program has helped thousands of workers, retirees and surviving spouses collect over \$75 million in retirement benefits.

first-hand the importance of individual benefit statements to retirement plan participants and their families.

These statements affect participants' decisions on when to retire, whether to change jobs, and how much to save for retirement. When statements are confusing they cause anxiety. When they are misleading or inaccurate they can lead to disappointing, and often devastating, losses. When they are clear and correct they provide peace of mind.

The requirement that plans furnish their participants with individual benefit statements was one of the most significant reforms in ERISA. Congress provided for this "particularized form of reporting so that the individual participant knows exactly where he stands with respect to the plan – what benefits he may be entitled to [and] what circumstances may preclude him from obtaining benefits."²

Last year, as part of the Pension Protection Act, Congress amended ERISA's individual benefit statement requirements. Most importantly, the new law extended the right to receive these statements to the more than nine million Americans participating in multiemployer plans. In addition, the PPA, with one exception, requires benefit statements be provided automatically, and to include explanations of benefit-reducing offsets and of the value of diversification. The law also, importantly, requires that the Department of Labor promulgate model statements.

Our comments today address these very positive developments and other, less protective, provisions in the new law. They are divided into four parts: first, a description of the basic principles that we think should guide the Department in providing guidance to plan administrators; second, our views on issues related to the content of benefit statements; third, our views on the use of electronic transmission; and fourth, our views on the frequency of the statements and our concern about the alternative to automatic provision of statements for defined benefit plans.

² H.R. Rep No. 5333, 93d Cong., 1st Sess. 11, *reprinted in* 1974 U.S.C.C.A.N 4639

I. Basic Guiding Principles

From the perspective of participants, there are six basic principles that should guide the Working Group's recommendations on individual benefit statements. These are that

1. The statements should be straightforward in language and presentation.
2. The statements should be as short as possible.
3. The statements should be accurate.
4. The statements should be timely.
5. The statements should be self-contained and not cross-reference other documents.
6. The statements should be provided in a manner that assures they will be received.

Equally important, but more difficult to implement, are the principles that individuals should be able to rely on their individual benefit statements, and that the statements should not be costly to prepare or transmit, since administrative costs are ultimately paid by participants.

II. Issues Relating to the Content of Statements

Our comments on the contents of individual benefit statements are divided into three sections: issues related to defined contribution plans, issues related to traditional defined benefit plans, and issues related to cash balance and other hybrid plans.

A. Defined Contribution Plans

1. *Projections*

The statute is silent on whether an individual benefit statement should be permitted to include benefit projections. In our judgment, projections in defined contribution plans can be particularly misleading. Projections must necessarily reflect assumptions about interest rates, inflation, and future levels of contributions, which will inevitably give imprecise, and often inaccurate, views of the amounts that employees are likely to accumulate by retirement age. Inclusion of projections about future salary increases and, in some cases, the value of company

stock, compound the problem since such projections are speculative and dependent on the future productivity of the participant and the economic fortunes of the employer.

Although participants may find projections helpful in retirement planning, there is no need for these projections to be included in individual benefit statements. Instead, they can be provided on written request by the participant, by reference to one of the many online calculators, or in separate retirement planning or investment advice materials.

2. Model Diversification Language

The PPA requires that self-directed 401(k)-type plans include an explanation in benefit statements “that holding more than 20% of a portfolio in the security of any one entity (such as employer securities) may not be adequately diversified.” This requirement is surprising since few, if any, investment advisors would recommend that a meaningfully diversified portfolio tolerate such a large investment in the securities of a single firm.

An explanation of this provision may be that there was concern that those 401(k) plans that provide matches in the form of company stock might exceed a more realistic limit such as the 10% diversification requirement for defined benefit plans. If this was the rationale, it would make sense for the individual benefit statement to also include the PPA notice that tells employees of their rights to divest their holdings of employer stock.

In addition, since the new law requires that benefit statements direct participants to the Department of Labor’s website for sources of information on investment and diversification, we suggest that the Department include information on the website that explains that inadequate diversification can occur well below the 20% level, and cautions against excessive investments in employer securities.

3. Alternate Statements

The PPA permits defined contribution plans to provide an alternative to the individual benefit statement: a plan can provide one statement that includes the participant’s accrued

benefit, and a separate statement that includes sufficient information to determine the non-forfeitable portion of that benefit.

We are concerned that plans utilizing this option could cause participant confusion, with the participant receiving non-uniform and complex statements. In our experience, a participant is less likely to review several pages than simply one, particularly if the pages are not uniform in presentation and easily understandable.

Our strong preference would be a single statement consolidated by the plan administrator, as proposed in the 401(k) Fair Disclosure for Retirement Act of 2007 (H.R. 3185) recently introduced by Congressman George Miller (D-CA). However where separate statements are permitted, we suggest that they be limited to two separate pages, one providing information on each of the mutual fund or other options in which the participant has invested, reflecting the account balance, and the second page providing the participant's vested percentage and a simple example showing how to apply the percentage to that portion of the account balances attributable to employer contributions. The second page should also indicate the information that the plan used in calculating the participant's vested percentage and should indicate how additional service will increase the participant's vested percentage.

B. Traditional Defined Benefit Plans

1. *Single Employer Plans*

a. Projected Benefits

Benefit projections in defined benefit plans can mislead and cause unrealistic expectations. Projections make assumptions that the plan will continue, that the plan sponsor will neither freeze benefits nor reduce future benefit accruals, that the employee's division will not be sold nor the employer go out of business, and that the employee will continue to work for the employer in covered employment until retirement age.

If the Working Group decides to recommend that Departmental guidance permit statements to include benefit projections, we suggest that benefit statements using projections be subject to two additional requirements: first, we think that benefit statements will be inherently misleading if they assume in the projections that a participant's compensation will increase, and fail to discount for the effects of inflation.

Second, benefit projections should make clear that the pension will be substantially less than projected if the plan is terminated, or benefits are frozen or future benefit accruals are decreased, or the employee's division is sold or the employer goes out of business, or the employee otherwise fails to remain in covered service.

b. Permitted Disparity and Other Offsets

The PPA requires plans to provide explanations of the impact of Social Security integration and floor-offset arrangements. Although the new law does not require plans to include actual dollar estimates of the effects of Social Security or other offsets, our understanding is that many plans routinely show the impact of Social Security offsets through estimates of Social Security benefits. We believe that this is the appropriate approach, and that the statement should also inform the participant that she may have her benefit recalculated based on her actual Social Security benefit at the time benefits commence.

Some plans also provide other types of offsets. The PPA does not explicitly require that a benefit statement disclose such an offset, but it is our view that a benefit statement for a plan that includes such an offset would be incomplete without such disclosure.

c. Joint and Survivor and Early Retirement Reductions

It is critical that plans show the dollar-and-cents impact of both joint and survivor and early retirement reductions. Without this information, the benefit statements are misleading, since the joint and survivor benefit is the normal form of benefit for a married participant, and many employees collect their benefits at early retirement ages.

In the case of joint and survivor benefits, wherever possible benefit statements should show the actual benefits of the employee and surviving spouse based on the actual age of the participant's spouse (and noting the birth date of the spouse on the statement so that if it is incorrect the participant can correct it). Where information about the spouse's age is unavailable, the benefit statement should show the life and survivor benefits assuming that the participant and spouse are the same age (and noting this assumption and including a statement indicating that the life and survivor benefits would be smaller if the spouse were younger than the participant and larger if the spouse were older than the participant.) The benefit statement should also provide information on how the participant can get a calculation based on the actual age of his or her spouse.

d. Subsidized Early Retirement and Joint and Survivor Benefits

One of the greatest sources of disappointment by participants is traceable to benefit statements that provide misleading information about subsidized early retirement benefits. Any statement including a reference to these benefits should fully explain the conditions of the subsidy, and also indicate circumstances under which the subsidy could be lost, including:

- i. the employee's division being sold or the employer going out of business;
- ii. the employee leaving employment prior to meeting age and service requirements;
- iii. the employer freezing the plan or otherwise amending the plan's benefit formula.

e. Reasonable Estimates of Benefits

The purpose of individual benefit statements is to ensure that participants have an accurate picture of their retirement situation so that they can make realistic life choices and plan adequately for retirement. Notwithstanding the need for accuracy, ERISA Section 105(a)(1)(B) permits defined benefit plans to base benefit statements on "reasonable estimates determined under regulations prescribed by the Secretary, in consultation with the PBGC."

In our view, the meaning of “reasonable estimate” must be developed in the context of the basic purpose of the individual benefit statement. For this reason, we urge the Working Group to recommend to the Department that no estimate should be considered to be “reasonable” if the plan has, or could easily obtain, sufficient information to provide a benefit statement that reflects the actual benefit. Except in unusual cases – such as single employer plans that recently absorbed new members following a corporate reorganization or plans in which records were recently damaged or rendered temporarily unavailable or multiemployer plans where precise data may not be easily available – individual benefit statements should provide the participant with information regarding the actual rather than estimated benefits. In situations where there is no alternative to using estimates, the benefit statement should specify the assumptions that the plan used in estimating the benefit, and explain the procedure for correcting the statement.³

2. Multiemployer Plans

The Pension Protection Act of 2006 for the first time requires that multiemployer plans provide individual benefit statements to participants. This requirement will help close a troubling communication gap that has led to countless misunderstandings and misinformation. All too often the Pension Rights Center receives phone calls from multiemployer plan participants on the eve of retirement who have just learned that the benefit they are entitled to receive is significantly lower than the benefit they had expected. Sometimes this is because the participant had never received a benefit statement and had miscalculated his benefits; and sometimes it is because the participant received a benefit statement that was inaccurate.

Let me provide an illustration of each of these problems.

No benefit statement.

³ In no instance should communications between a participant and plan about incorrect benefit statements start the running of a statute of limitations. The Department should clarify that statutes of limitation only begin to run after an individual who has been formally denied a benefit at retirement has exhausted a plan’s claims and appeal procedures.

I recently received a call from a member of a multiemployer plan who had not been able to obtain steady work from his union hiring hall for a period of time and was given permission by the union to work for a non-signatory employer. He had never received a benefit statement during his career and he assumed that he was receiving pension credit for the work the union gave him permission to accept. It was not until he applied for his pension that he learned that his ten years of work for the nonunion employer did not count toward his pension. He had believed that because he was paying union dues for the ten year period, he remained an active participant in the plan. Had this employee lived in a post-PPA world, he would have received benefit statements and would have been able to factor the effect of his outside employment on his pension benefits.

Inaccurate benefit statement.

Another recent case involved a retiree who in 1991 received a benefit statement showing that he would receive a benefit of \$399 per month. A decade later, when he applied for benefits at normal retirement age, he received a notice from the plan on how pleased it was to begin paying him his \$280 monthly benefit. There was no explanation for how the benefit was calculated and no mention of the wide discrepancy between his 1991 benefit statement and the benefit now calculated by the plan. The participant asked the plan to explain the discrepancy and what he received was the summary plan description and a page with columns of what would have appeared to be random and meaningless numbers to anyone but the plan's actuary. The PPA has given the Department the authority to shape rules for preparing benefit statements to prevent similar occurrences in the future.

Benefit statements will be a new experience for some multiemployer plans, although our understanding is that most large multiemployer plans provide benefit estimates if the participants know to request them. Our principal concern is the content of the statements. In particular it is

important that any estimates in benefit statements are realistic, and that possibly reductions or limitations in benefits be clearly stated. In appropriate situations, this information might include cancellation of past service credits if a participant's employer withdraws from the fund, reductions of accrued benefits in certain underfunded plan situations, and limitations on the types of benefits that are subject to reciprocity agreements. It is also important that the statements not include information that is unrelated to a participant's actual accrued benefit, such as the amount that the participant's employers have contributed on their behalf. Such information has no relevance to a benefit statement and can be extremely misleading.

C. Cash Balance and Other Hybrid Plans

Surprisingly, there has been little discussion of benefit statements for cash balance plans, which present some unique problems. There are at least three core issues that we think the Working Group should focus on:

1. *"Self-Directed" Cash Balance Plans*

A few cash balance plans provide participants with a menu of "investment" options, and thus resemble a self-directed defined contribution plan. As such, it may be desirable to require that participants in such plans receive more frequent automatic statements than once every three years and that they are given the same type of diversification notice that participants in self-directed defined contribution plans are given. These suggestions might require a technical legislative fix, although we think it within the Department's regulatory authority to treat such cash balance plans as self-directed defined contribution plans for purposes of the benefit statement.

2. *Calculating the Accrued Annuity Benefit*

Presumably a cash balance plan must state benefits as a retirement annuity in a benefit statement. This requires resolution of two difficult issues:

(i) in a plan with a variable interest credit, how should the benefit statement project the account balance through normal retirement age, which is a necessary first step toward determining the annuity amount?

(ii) most cash balance plans convert account balances through methodologies that are sensitive to the interest rates in effect at the time the annuity commences. How are future interest rates to be projected, especially since even a small increase or decrease in rates can have a substantial effect on the amount of the annuity.

3. *Below- or Above-Market Interest Credits*

Cash balance plans are permitted to use a wide range of interest credits. If the interest credit is below-market,⁴ stating the account balance at its nominal value would be misleading, for it would reflect an inflated valuation unless the participant is eligible and elects to receive an immediate distribution.⁵ Similarly, if the interest rate is above-market, stating the account balance at its nominal value would be misleading because it would understate the actual value of the account, which includes the value of the above-market rate.⁶

III. Electronic Transmission

We understand that providing notices in electronic medium is the preferred method of receipt of benefit statements for *some* participants and that electronic transmission of benefit

⁴ For example, many participants would consider an interest credit below market if it is based on short-term Treasury instruments, especially given that the intermediary of the plan presents a plan default risk not present in the direct investment in such instruments.

⁵ The proper valuation would require the plan to project the below-market interest rate to the projected time of distribution and then discount to present value using a market interest rate.

⁶ The PPA prohibits use of an above-market interest rate, but Treasury has not yet defined what an above-market rate means. Some have argued that Congress intended that plans could use an interest rate equal to the greater of a stated interest rate and a market-based variable interest rate. If the Treasury accepts this position, it will be possible for a plan to use a real-world above-market interest rate, which would mean that a pre-retirement distribution would be worth less than the actual present value of the account balance.

statements can be less expensive for plans. On the other hand, we know from our experience with thousands of participants, that many, many participants are still not computer literate and will not be able to access their notices and that many participants who are computer literate are more likely to put off, sometimes indefinitely, review of electronically transmitted documents than of documents delivered in hard-copy form.

While we know that electronic transmission can be good for some employees and can reduce costs, we also know that the wide use of electronic rather than paper benefit statements will mean that many people will not receive or read their statements. This is a high cost and since it runs directly contrary to the purpose of the statute we hope that the Working Group will recommend measures that will help ensure that no participant is left behind. The most effective of these methods would be:

1. Requiring participants affirmatively to elect electronic transmission, leaving hard copy statements the default approach, and
2. Requiring that participants affirmatively renew their consents every three years either electronically or by mail.

Electronic benefit statements provided to participants should only be acceptable where the participant has a computer at his or her work station, and adequate time and privacy for accessing, downloading and printing the benefit statements.

We are also concerned that some participants will review electronically-transmitted benefit statements but not print or download them (and if they download them, may not back up their data and thus lose the benefit statement when their hard drive fails). Thus, it is imperative that employers using electronic transmission of benefit statements retain those statements for a significant period of time.

Finally, in regards to other forms of electronic communication, we recommend the Department use extreme caution in authorizing any communication that cannot be readily

retained in a permanent form for future reference. Under no circumstances should the Department permit a plan to provide benefit statements through automated audio recordings. The provision of statements through the automated phone call is rarely “reasonably accessible” because a participant is unlikely to have means to record the call for future reference and verification.

IV. Frequency of Statements

A. Defined Contribution Plans

The PPA provides that participants in defined contribution plans automatically receive benefit statements every year, unless their plan is participant-directed, in which case they are to receive such statements every three months. We think this is straightforward and the right approach. Our primary concern, as noted previously, is that cash balance plans should also be subject to these timetables, since they resemble defined contribution plans, rather than the looser frequency rules for defined benefit plans.

B. Traditional Defined Benefit Plans

For defined benefit plans, the PPA provides that statements must be automatically provided every three years to active employees with non-forfeitable accrued benefits or in the alternative an annual notice to participants that the statement is available upon written request.

It is our view that the annual notice is misguided and undermines the purpose of requiring benefit statements in the first place. If benefit statements are not automatically furnished, if participants have to take affirmative actions to receive benefit statements, fewer benefit statements will wind up in the hands of participants. The exception virtually guarantees that relatively few defined benefit plan participants will receive and read their benefit statements. We very much hope that the Working Group will consider recommending to the Secretary of Labor that she ask Congress to amend the statute to eliminate this exception.

Thank you for the opportunity to present our views on these important issues. I would be pleased to answer any questions you may have.