



SMOOTHING RULES ARE NECESSARY TO MAKE FUNDING PREDICTABLE

PREDICTABLE FUNDING RULES ARE NEEDED TO MAKE INFORMED BUSINESS DECISIONS

- Future pension costs represent significant investments that employers must plan for in conjunction with product investments.
- Since pension obligations are long-term promises, stable and consistent funding is warranted and achievable.
- Rules that increase the risk of unpredictable or volatile pension contributions can result in inefficient funding that restricts an employer's ability to commit to capital investment and the hiring of new employees.

THE ADMINISTRATION'S PROPOSED USE OF SPOT RATES TO VALUE PENSION PLANS WOULD MAKE THE FUNDING RULES MORE VOLATILE AND UNPREDICTABLE, WITHOUT IMPROVING ACCURACY OR PLAN FUNDING

- The Administration's proposal to value pension liability based on interest rates for the preceding 90 days and to eliminate smoothing of asset valuations would dramatically increase volatility. During 2003, for example, applying this spot approach to long-term corporate bond rates could have produced a pension liability 10% to 20% higher or lower depending on when the valuation was done.
- Spot valuations are neither accurate nor meaningful for pension liabilities that span many years. The current weighted average of interest rates for the preceding 4 years is a more appropriate measure of liability for plans.
- Spot valuations do not mean tougher funding standards. Total funding remains the same; the spot or smoothed rate only affects when contributions are due.
- Over the short-term, however, the spot rate is likely to result in less funding. Interest rates have been at historic lows in recent years and are expected to rise at some point in the future. In such a rising interest rate environment, a spot rate will produce smaller liability valuations than a smoothed interest rate and therefore smaller required contributions.

SPOT VALUATIONS ARE "PROCYCLICAL" AND WOULD HAVE NEGATIVE IMPLICATIONS FOR THE US ECONOMY

- Spot valuations require larger contributions during economic downturns and smaller contributions during upturns. Larger contributions reduce capital spending and smaller contributions increase capital spending. This exaggerates downturns and upturns.
- Recent economic modeling indicates that the use of a spot rate relative to current law could have resulted in more than 300,000 lost jobs during the most recent economic downturn.

THE LACK OF PREDICTABILITY IN THE ADMINISTRATION'S PROPOSAL CANNOT BE REASONABLY MANAGED OR "HEDGED" BY INVESTING A PLAN ENTIRELY IN BONDS

- Hedging is very expensive and plans should not be effectively forced to incur this cost.
- Nearly \$2 trillion worth of pension assets are invested in equities as part of a diversified mix of investments. Any material move into bonds could be incredibly disruptive and still may not immunize plans from funded status volatility.
- The current market for bonds is too thin to support a material move towards bonds. It is not possible for even one large plan to invest predominantly in bonds. The market for derivatives is similarly thin and would concentrate risk in a few financial companies.