




# National Rural Electric Cooperative Association

A Touchstone Energy® Cooperative 

## NRECA CONCERNS REGARDING THE ADMINISTRATION'S PENSION FUNDING AND PREMIUM PROPOSAL

**Who We Are** – The National Rural Electric Cooperative Association (NRECA) is a not-for-profit national service organization representing approximately 930 not-for-profit, member-owned rural electric cooperatives that serve over 37 million Americans in 47 states. We remain committed to the consumers we serve as well as to the cooperative employees who ensure the consistent delivery of safe and affordable energy throughout rural America during this time of economic uncertainty.

In pursuit of this goal, the vast majority of our members provide their employees with the NRECA-sponsored and administered defined-benefit multiple-employer pension plan, the “RS Plan,” under § 413(c) of the Code. Approximately 900 individual rural electric cooperatives participate in R&S Program covering approximately 55,000 employees throughout the United States.

**Concerns with the Administration's Proposal** - The Administration has issued a proposal addressing defined benefit plan funding and premium issues. The National Rural Electric Cooperative Association (“NRECA”) believes that the Administration has raised very important issues that need to be addressed in order to strengthen the private retirement plan system. We support certain principles underlying the Administration's proposal, including the need to strengthen the funding requirements and improve disclosure. However, we have several concerns with respect to the proposal that we believe need to be addressed to avoid causing harm to the system.

1. **Lump Sum Distributions.** NRECA's RS Plan offers lump sums and approximately 92% of our participants elect a lump sum distribution. A very large number of those participants - - particularly the older participants - - roll over their lump sum distribution to an IRA and prudently manage their IRA savings during retirement. This lump sum option is a highly valued feature of our plan.

The Administration has proposed applying a yield curve to determine the amount of a lump sum distribution. We believe that this would result in artificially large lump sums that could threaten the ongoing viability of our plan. Moreover, this proposal makes very little sense. Since retirees with longer life expectancies are increasingly (and prudently) investing in equities, determining their lump sum benefits based on hypothetical bonds that they are not investing in is inappropriate. And it will be impossible to explain to employees working side by side that their lump sum benefits are calculated differently based on their age.

We strongly believe that after a significant transition period (i.e., five to seven years), lump sum distributions should be determined based on the long-term corporate bond rate.

**2. Predictability.** The Administration has proposed that a plan's funding and premium obligations be based on a spot valuation of assets and a near-spot valuation of interest rates. It can be shown based on historical data that such snapshot valuations are not accurate measures of a plan's funded status for the following year. Moreover, such snapshot valuations cause severe planning problems, as discussed below.

A critical issue for Cooperatives and all employers that sponsor defined benefit plans is predictability. This is especially true in the utility area, where Cooperatives need to be able to make cash flow and capital investment projections that are taken into account for purposes of setting rates. Under the Administration's spot valuation proposal, a plan's funded status could easily vary by over 10% during the last three months of a year, thereby dramatically altering the following year's funding and variable rate premium requirements. This is an unworkable situation for Cooperatives and will clearly hurt planning and growth, as well as cause many Cooperatives and other companies to leave the defined benefit plan system.

There are two ways to address the predictability concern. The first, which NRECA supports, is to retain the current-law rules that permit changes in asset values and interest rates to be recognized over time. The second, which NRECA opposes, is to "smooth" the application of the numerous rules that are based on a plan's funded status. We strongly believe that the latter approach would be quite complex and, in the end, unworkable.

**3. Liability Measurement.** The Administration has proposed using a near-spot yield curve to measure liabilities. NRECA has two major concerns with respect to this aspect of the proposal. First, as discussed above, preserving the current-law interest rate averaging rules is critical. Second, use of a yield curve should not have the effect of lowering the effective interest rate for the average plan.

We do not favor the yield curve, but if a yield curve is used, it needs to be based on a four-year weighted average of yield curve interest rates. The yield curve would also need to be based on rates both above and below the long-term corporate bond rate so that the effective rate for the average plan is the long-term corporate bond rate.

**4. Credit Rating.** Under the Administration's proposal, a plan's funding target or liability would be increased based on a company's credit rating, resulting in potentially dramatic increases in funding and premiums for companies in junk bond status.

As applied specifically to NRECA's plan, the Administration's credit rating proposal is simply unworkable. Our plan is a multiple employer plan (not a multiemployer plan) in which approximately 1,000 different cooperatives participate. Depending on how one interprets this unclear part of the Administration's proposal, either all 1,000 cooperatives would be rated by the Federal government or approximately 20 of the bigger ones would be rated. We strongly object to the Federal government getting into the business of evaluating the viability of our cooperatives. And if some cooperatives are rated as in junk bond status, and others are not, it begs the question - why should that affect our plan in any way since our plan is a single plan that does not terminate if a Cooperative goes out of business or otherwise leaves the Plan? Administration officials have publicly admitted that they never considered multiple employer plans in developing their proposal, which simply does not work in that context.

More generally, there are other serious problems with this credit rating proposal. First, this proposal is harmful to plans, companies, participants, and the PBGC. Effectively, the proposal puts severe additional pressures on companies experiencing a downturn in their business cycle. Those pressures will undermine companies' ability to recover, which adversely affects all parties, including the PBGC. Second, it is quite troubling for the Federal government to rate companies either indirectly through approval of the credit rating agencies or directly in the case of private companies. Third, downgrades in a company's ratings already trigger a downward spiral for the company; placing even more significance on the credit ratings would exacerbate that downward spiral. Fourth, the proposed credit rating structure is extremely volatile: for example, for a recovering company that had been in junk bond status for five years, the failure to be at investment grade on a certain day could mean a very large change in liabilities.

**5. Credit Balances.** Current law is carefully structured to be neutral with respect to advance funding. If a company pre-pays future funding obligations, the plan has a "credit balance" that can be used to offset future funding obligations.

The Administration has proposed eliminating credit balances. We see this as both unfair (with respect to existing credit balances) and ill-advised. It is ill-advised because it can be shown mathematically that the Administration's proposal will systematically discourage companies from contributing above the minimum amount required.

**6. Premiums.** The Administration has proposed more than a 50% increase in the flat-rate premium, and has proposed indexing the premium prospectively. The Administration has proposed that the PBGC's Board control the level of the variable rate premium (which is renamed the risk-based premium) to cover PBGC's expected losses and improve its financial condition.

We have the following concerns. First, we have serious questions about the size of PBGC's deficit, especially since the deficit number that PBGC has announced was determined based on a below-market interest rate. We also have questions about the extent to which small increases in interest rates and the equity markets would reduce the PBGC deficit. We strongly urge that no legislative action be taken on premiums until those fundamental issues are resolved.

In addition, we have grave concerns about the PBGC setting its own premiums. That is a Congressional function and should remain so.

The proposed increase in the flat-rate premium would unfairly burden employers that have stayed in the defined benefit plan system and have kept their plans well-funded through the perfect storm of low interest rates and low equity values.

A dramatic increase in the variable rate premium would inappropriately burden those Plans experiencing a downturn in its sponsor's business cycle, harming the Plan's ability to recover. This is contrary to the interests of the participants, the Plan sponsors, and the PBGC.

for more information  
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