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EXAMINING CASH BALANCE PENSION PLANS: SEPARATING MYTH FROM FACT

HEARING

BEFORE THE

COMMITTEE ON EDUCATION
AND THE WORKFORCE
U.S. HOUSE OF REPRESENTATIVES

ONE HUNDRED EIGHTH CONGRESS

SECOND SESSION

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EXAMINING CASH BALANCE PENSION PLANS: SEPARATING MYTH FROM FACT

Wednesday, July 7, 2004
U.S. House of Representatives
Committee on Education and the Workforce
Washington, DC

The Committee met, pursuant to call, at 10:33 a.m., in room 2175, Rayburn House Office Building, Hon. John A. Boehner (Chairman of the Committee) presiding.

Present: Representatives Boehner, Johnson, Isakson, Osborne, Kline, Carter, Blackburn, Burns, Miller, Kildee, Payne, Andrews, Woolsey, Tierney, Kind, Wu, McCollum, Van Hollen, and Bishop.

Staff Present: Stacey Dion, Professional Staff Member; Kevin Frank, Professional Staff Member; Ed Gilroy, Director of Workforce Policy; Richard Hoar, Staff Assistant; Donald McIntosh, Staff Assistant; Alexa Marrero, Press Secretary; Greg Maurer, Coalitions Director for Workforce Policy; Jim Paretti, Workforce Policy Counsel; Deborah L. Samantar, Committee Clerk/Intern Coordinator; Kevin Smith, Communications Advisor; Jo-Marie St. Martin, General Counsel; Jody Calemine, Minority Counsel Employer-Employee Relations; Margo Hennigan, Minority Legislative Assistant/Labor; Marsha Renwanz, Minority Legislative Associate/Labor; and Michele Varnhagen, Minority Labor Counsel/Coordinator.

Chairman BOEHNER. A quorum being present, the Committee on Education and the Workforce will come to order.

We are holding this hearing today to hear testimony on "Examining Cash Balance Pension Plans: Separating Myth from Fact." under the Committee rules, opening statements are limited to the Chairman and Ranking Member. Therefore, if other Members have opening statements, they will be included in the hearing record.

With that, I ask unanimous consent that the hearing record remain open for 14 days to allow Members' statements and other extraneous material referenced during the hearing to be submitted in the official hearing record. Without objection, so ordered.

STATEMENT OF HON. JOHN A. BOEHNER, CHAIRMAN, COMMITTEE ON EDUCATION AND THE WORKFORCE

I want to thank everyone for coming to the eighth in our series of hearings on defined benefits pension plans, a topic that is fairly timely. Cash balance plans have received a lot of attention recently, producing rhetoric that has often been misleading, if not in

fact false. Today we hope to separate myth from fact about cash balance plans.

As we all know, the number of defined benefit plans has declined significantly over the last 20 years from 114,000 plans in 1985 to 31,000 plans last year, and the entire defined benefit system, I believe, remains at risk. Some experts have suggested that cash balance plans, which are types of defined benefit plans, offer today's workers the type of secure and portable benefit that can help save and preserve the overall system. Unfortunately, fewer and fewer companies are offering cash balance plans because of a recent wave of litigation.

Before I talk about this specifically, I would like to discuss some facts about how these plans work. Under cash balance plans, workers earn portable benefits through monthly pay and interest credits and benefits are earned more evenly over a career span, not just at the end of the worker's career. This can result in greater retirement savings for workers who do not remain with the same employer for their entire career. As a result, a broader group of employees, including lower income workers and women, earn greater benefits with shorter service under cash balance plans than traditional plans.

According to a study published by Watson Wyatt in 2000, more than 80 percent of participants fare better with a cash balance plan. The value of the benefit in a traditional plan spikes for workers who qualify for an early retirement subsidy, typically in their mid-50's, but then declines if they fail to retire at a specific age and keep working. As a result, traditional plans are advantageous only for the small proportion of employees who work for the same employer for 20 to 30 years and retire in their mid-50's.

Conversely, traditional plans are disadvantageous for younger employees, for workers who change jobs or interrupt their careers, and for older workers who continue working after early and normal retirement age.

The Employee Retirement Income Security Act, ERISA, prohibits employers from cutting back or reducing any pension benefits that have been earned by employees once they vest in their pension plan. Despite this current law protection, some critics have continued to express concern over cash balance conversions despite the fact that a large majority of them have been handled properly and legally.

The real issue here is about a small number of prospective retirees' expectation of receiving the full value of early retirement subsidies that have not yet been earned. This is not about normal retirement benefits. Rather, I am concerned that cash balance critics are focused not on providing meaningful retirement benefits to our overall workforce, but solely on protecting a small fraction of employees who could afford to retire early.

It is important to note that under the voluntary pension system, let me just repeat that one more time for everyone, under our voluntary pension system, all defined benefit plan sponsors may change benefit formulas prospectively to either enhance or reduce future benefits that have not yet been earned by an employee. All employers need the flexibility to determine what is appropriate for the needs of their workers and their business. If this flexibility is

taken away or if Congress were to unilaterally mandate certain pension benefits, employers would leave the voluntary pension system altogether and the defined benefit system would all but disappear.

The recent wave of litigation surrounding cash balance plans has raised concerns from employers, workers, and policymakers alike. One well-documented court case involves IBM, but the initial ruling runs counter to, in my opinion, existing law and a large body of other court decisions. In this case the judge found the cash balance plan design inherently age discriminatory because equal pay credits for younger workers have a longer period of time to earn interest and accrue benefits before retirement than the same pay credits for older workers. This interpretation essentially means it would be age discriminatory to make equal contributions on behalf of workers with different ages. This is inconsistent with every other pension design and this logic could make a basic savings account, 401(k) plans, and even Social Security benefits automatically age discriminatory. We are not here to debate the IBM case specifically, but we also need to make sure cash balance plans aren't forced into extinction at the expense of the interests of American workers.

Most courts have ruled no age discrimination occurs with cash balance plans if the pay and interest credits given to older employee accounts are equal to or greater than those of younger employees. The most recent ruling on this topic, issued just last month in the Tootle case, agrees that cash balance plans are not inherently age discriminatory.

I would like to dispel another myth about these plans. The switch to cash balance plans is not motivated by cost savings, but rather by pressures imposed by an increasingly mobile workforce as well as fierce competition. Under current law, employers can freeze or terminate their traditional plan without the complexity or expense of converting to a cash balance plan, and most actually spend more on retirement benefits after the conversion as they did before. In a world where most employees will not spend 20 to 30 years working for the same employer, the steady accrual of benefits under a cash balance plan provides greater retirement security than the distant accrual of back-loaded benefits under a traditional defined benefit plan.

Our ultimate goal here is to ensure cash balance plans remain a viable option for employers who want to remain in the defined benefit system, and I think most of the Members here would agree that defined benefit systems, defined benefit plans are an important components of a solid retirement security for American workers.

It is my hope that we can move forward with reforms to strengthen the cash balance plans for all workers as we craft a comprehensive proposal to reform and strengthen the defined benefit system.

With that, I look forward to hearing from our witnesses and working with my colleagues on this issue as we move ahead. With that, I yield to my friend and colleague the Ranking Member, Mr. Miller.

[The prepared statement of Chairman Boehner follows:]

Statement of Hon. John Boehner, Chairman, Committee on Education and the Workforce

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The value of the benefit in a traditional plan spikes for workers who qualify for an early retirement subsidy, typically in their mid–50s, but then declines if they fail to retire at a specific age and keep working. As a result, traditional plans are advantageous only for the small proportion of employees who work for the same employer for 20 to 30 years AND retire in their mid–50s. Conversely, traditional plans are disadvantageous for younger employees, for workers who change jobs or interrupt their careers, and for older workers who continue working after early and normal retirement age.

The Employee Retirement Income Security Act (ERISA) prohibits employers from cutting back or reducing any pension benefits that have been earned by employees once they vest in their pension plan. Despite this current law protection, some critics have continued to express concern over cash balance conversions despite the fact a large majority of them have been handled properly and legally.

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The recent wave of litigation surrounding cash balance plans has raised concerns from employers, workers, and policymakers alike. One well-documented court case involves IBM, but the initial ruling runs counter to existing law and a large body of other court decisions. In this case, the judge found the cash balance plan design inherently age discriminatory because equal pay credits for younger workers have a longer period of time to earn interest and accrue benefits before retirement than the same pay credits for older workers. This interpretation essentially means it would be age discriminatory to make equal contributions on behalf of workers with different ages. This is inconsistent with every other pension design and this logic would make a basic savings account, 401(k) plans, and even Social Security benefits automatically age discriminatory. We're not here to debate the IBM case, but we also need to make sure cash balance plans aren't forced into extinction at the expense of the interests of workers.

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Our ultimate goal is to ensure cash balance plans remain a viable option for employers who want to remain in the defined benefit system and workers who prefer the portable and secure benefit this option provides. It's my hope we can move forward with reforms to strengthen cash balance plans for all workers as we craft a comprehensive proposal to reform and strengthen the defined benefit pension system. With that, I look forward to hearing from our witnesses and working with my colleagues on this issue as we move ahead.

STATEMENT OF HON. GEORGE MILLER, RANKING MEMBER, COMMITTEE ON EDUCATION AND THE WORKFORCE

Mr. MILLER. Thank you, Mr. Chairman, and I want to thank you very much for holding this hearing. I think it is long overdue. In many ways today's economy is hard on American families. Blue collar and white collar employees alike are being fired, outsourced, and downsized. Their real wages are declining, and on top of that their health care and retirement benefits are being reduced while costs are going up.

People who work hard every day year after year have dreams about their retirement. They plan for it. But then with little warning their employers tear up those retirement plans. That is the context in which this hearing takes place.

For hard working middle-class families, our Nation's pension system is in crisis. We all know that an increasing number of employers are bailing out of the defined benefit plan. That is their decision. Companies used to believe it was the best way to attract and retain a qualified workforce. And while I personally believe that companies and workers alike benefit from a traditional benefit plan, Congress cannot require these companies to provide one. But Congress can and must require that companies abide by the law.

The question for Congress now is what exactly is the law going to be when it comes to the new world of changing pension plans. After the Enron debacle, the stock market downturn of 2000, 401(k) plans were no longer the golden child that we thought they were. With median account balances of approximately $13,000 it is highly unlikely that 401(k) plans will provide adequate retirement benefits for a majority of workers covered by them. But, then again, 401(k) plans were never originally designed as a retirement plan. They were designed to increase national savings.

There are many in Congress and the pension community who argue that hybrid pension plans like the cash balance plans can be the future of the retirement system. Congress needs to have that debate. This debate must be fact based and honest and we should begin by acknowledging that there is a lot we do and a lot we do not know about cash balance pension plans. We know that during the 1990's hundreds of large companies amended their traditional defined benefit plans and adopted cash balance pension plans instead. We know that over 8 million workers and retirees were af-

fected. We know that many workers lost pension benefits that they had every reason to expect to receive.

The General Accounting Office found that without transition protection, older workers, workers over 45, can lose up to 50 percent of their expected pension benefits. What we do not know, however, is whether all of these plans in these conversions comply with the laws protecting workers' pensions generally and are protecting them from age discrimination. ERISA, our governing Federal pension law, does not recognize cash balance plans since these plans did not exist when the law was enacted in 1974.

During the time the cash balance plans were being created no one ever came to Congress and asked us to amend ERISA to include these plans. Congress was mostly unaware of how they worked. The consultants who created cash balance plans sought the approval of the Treasury Department and the IRS in particular. The IRS approved most of these plans, although only as far as their adherence to existing tax code. The IRS did not examine the plans to see whether or not they were fair to older workers or whether they violated provisions of law against age discrimination in employee benefits. There was disagreement within the IRS on the legality of these plans, and then along came IBM, as you have noted, Mr. Chairman.

In 1999 IBM announced it intended to convert its traditional plan to cash balance. IBM only gave its workers a handful of weeks to prepare for that change. It only protected workers who were 5 years from retirement or with 25 years of service. IBM put a pension calculator on the company Web site and pulled it when workers started figuring out that they would lose benefits under the new plan.

The computer savvy workers that worked at IBM quickly used the Internet to mobilize a grass roots army to express their concerns to Congress and we ended up with a moratorium. In a callous move, which many believe proposed serious dangers to the retirement security of millions of employees, the Bush administration in 2001 tried to overcome the controversy surrounding the cash balance plans by issuing draft regulations lifting the moratorium. Older workers can't earn enough under cash balance plans and they don't have time to go to another company and start again, particularly in an economy that is producing too few jobs. These are the workers that Congress needs to protect, and that was the concern that was raised when the Bush plan was announced, that people would not have the ability to protect the retirement that they had come to expect upon. But the Congress on a bipartisan basis voted to stop the regulations and require Treasury to propose legislation that would protect older workers.

The administration finally relented to the congressional public opinion and withdrew the proposed regulations, and that is why we are here today. When the Treasury formally withdrew the rejected regulations in June, it announced it would work with Congress to achieve the legislation based upon the framework President Bush put forth in his 2005 budget. But the present proposal is still far off the mark when it comes to protecting older workers and their pensions. That is the challenge before us. How do we assure fair

protection for older workers and pension plans while allowing companies the flexibility and employees the flexibility that they need?

Most of these workers are too old to start over again. They may have given 20 or 30 years of their working life to the companies and they are stuck. I think that is the issue that we have tried to raise with Treasury, we tried to raise with the administration and found bipartisan support, and that really is that we have got to allow workers to have a choice in this and to make a determination about their pension benefit that will allow the company to change plans but at the same time protect these individuals.

In many instances these are not mom and pop low-profit margin companies when we discuss these issues. As you know, it is AT&T, American Express, Citicorp, Compaq, CSX, Georgia Pacific, Prudential and hundreds more. Congress needs to decide what the future of these cash balance plans should be.

Representative Bernie Sanders and I and 134 other Republicans and Democrats introduced legislation to require workers at age 40 or older with 10 or more years of service to be provided a choice between the old and new plans. Treasury Secretary Snow readily admits this was very similar to what he did when he was chief executive at CSX. CSX gave its workers a choice between plans. I think I quote him correctly when he said, I believe he was the director of Verizon when Verizon made the decision to finally, after much turmoil, to give its employees the choice.

It is what the Congress did when the Congress changed its pension plans for Members. Members went down, they sat down with an analyst, they decided which plan they thought would be better for them given their expectations of how long they would stay here, whether they would leave or what have you, and they made that choice. I think that that is the kind of fairness that we are seeking when we look forward to these changes in the pension plans.

But it is important, Mr. Chairman, and I want to commend you for giving the time and attention and resources of this Committee to this issue, because it is absolutely fundamental to the economic well-being of our country and to our families.

I would add one final note, that I think while we consider whether or not people are going to make this choice and they make the decisions whether they go into a 401(k) and how that 401(k) is administered, we must also look at those components of it. We have seen too many headlines where there is a lack of transparency, there is a difference in practices on fees that are charged, the purpose of those fees. Again, this morning we see the SEC has renewed and asked additional questions about how 401(k) plans are put into different funds, to different investment instruments without transparency. What are the reasons for those fees they are paying? It adds up to about $10 billion a year that people are paying. Does it really, in fact, benefit the investors?

I think that as we think about the ability of employers and employees to utilize these other investment and retirement instruments we have got to make sure that there is transparency for the employer, for the employees, as they make those decisions. Because it appears that more and more families are going to be relying on their decisions about their retirement and even in the case where the employer helps them with, that we have got to make sure that

they are not influenced, as was reported in the paper today where they said there was substantial evidence that certain mutual funds because of payments they received from fund companies or their investor advisers as part of sales agreements, that people were placed in those investments to get high cost and poorly performing funds into a 401(k) or similar retirement plans.

I think we have got to question those activities, and employees and employers both have got to understand the risks that are involved here and insist upon that kind of transparency. Thank you.

Chairman BOEHNER. It is my pleasure to introduce our distinguished panel of witnesses today. Our first witness is Mr. James Delaplane, Jr., or as most of us know him, Jamie Delaplane. He is a partner in the law firm of Davis & Harman, LLP, where he serves as special counsel to the American Benefits Council, which is the national association representing the employee benefits interest of major U.S. employers. Mr. Delaplane also represents financial institutions, employers and employer coalitions, trade associations, and public policy organizations on a full range of legislative regulatory matters affecting employee benefits.

We will then hear from Ms. Ellen Collier. Ms. Collier is the Director of Benefits for Eaton Corporation. Eaton has 51,000 employees worldwide and sells products to customers in more than 100 countries. Ms. Collier is responsible for the strategy, design, communication, legal compliance and delivery of the employee benefits program for Eaton's 27,000 North American employees.

We will then hear from Dr. Robert Clark. Dr. Clark is a Professor of Economics and Business Management at North Carolina State University. Professor Clark has conducted research examining the retirement decisions, the choice between defined benefit and defined contribution plans, the impact of pension conversions to defined contribution and cash balance plans, the role of information and communications on 401(k) contributions, government regulation of pensions and Social Security.

Then we will hear from Mr. Robert Hill. Mr. Hill is an attorney in private practice in the Denver, Colorado, law firm of Hill & Robbins. Mr. Hill has represented employees in several lawsuits challenging the legality of conversions from traditional defined benefit plans to cash balance plans, including being the lead counsel for the plaintiffs in Cooper vs. IBM.

Then we will hear from Ms. Nancy Mitchell Pfotenhauer. Ms. Pfotenhauer joined the Independent Women's Forum as President in 2001 from her previous position at Cook Industries where she was Director of the Washington office. Ms. Pfotenhauer began her career in Washington, D.C., in 1987 as a Senior Economist at the Republican National Committee and was promoted to Chief Economist in 1988. She was also selected by the Bush transition team at age 24 where she served as the Economist for the Independent Agencies Task Force for President-Elect George Bush.

I want to welcome all of you, and I am sure someone has explained to you how the lights work down there.

With that, Mr. Delaplane, you may begin.

STATEMENT OF JAMES DELAPLANE, JR., ESQ., ATTORNEY, AMERICAN BENEFITS COUNCIL, WASHINGTON, D.C.

Mr. DELAPLANE. Thank you, Mr. Chairman, Ranking Member Miller, I appreciate the opportunity to appear today. The American Benefits Council is an organization representing Fortune 500 employers and other entities that assist employers in providing benefits to employees. Many of our members sponsor cash balance or other hybrid defined benefit plans.

Rather than merely summarize my written statement, let me ask all of you to put yourselves in the shoes of a chief executive facing today's pension environment. Your firm voluntarily sponsors a defined benefit plan even though most competitors do not. You fund these benefits, bear the investment risk, and pay insurance premiums to PBGC. You have retooled your company to stay competitive and your workforce has likewise changed. You have fewer career-long employees, you make more mid-career hires and you face worker shortages in several job categories. You realize that the company's traditional pension was not delivering meaningful benefits to this new workforce. As much as 75 percent of total benefits were going to the small share of workers that stayed for a full career.

In particular, you paid significant benefits to those who retired at 55 under the plan's rich early retirement subsidy. These subsidized benefits and the departures they encouraged aggravated your labor shortages. After much analysis you and your board decided to convert to cash balance and remove the early retirement subsidy from the plan.

While earned benefits are protected absolutely, these changes allowed you to reallocate dollars so that future benefits were delivered more equitably to workers of all tenures. The new plan offered the portability and transparency that employees wanted and was more attractive to recruits. The removal of additional early retirement incentives encouraged skilled workers to stay. Following the conversion, some of your workers experienced a plateau in their benefit levels for a period. This plateau, which some call wearaway, is a natural outgrowth of removing the early retirement subsidy. Any subsidy employees have earned in your prior plan is legally protected but you need not and did not include it in their cash balance accounts. So for some period of time, the value of the subsidized prior plan benefit exceeded the value of the new account. Since these employees were entitled to this higher benefit if they left, they experienced a benefit plateau until their cash balance account caught up.

You disclosed this plateau to employees as part of your comprehensive disclosure about the conversion. While they would have preferred their benefits to keep growing without interruption, they understood the plateau resulted from the rich subsidies in the prior plan and that continuing to pay productive workers to retire early made no sense.

They also understood you could have removed the subsidy from the traditional plan and this too would have produced a plateau. With your conversion successfully accomplished you were eager to return your focus to growing your business, but pension developments intervened. Despite significant legal authority to the con-

trary, a single Federal judge rules that the basic cash balance design is age discriminatory. Under this theory, each of the 1,200 hybrid plans in the country is illegal. Your general counsel tells you that damages in this lawsuit are expected to run between $1 and $6 billion, and that a growing list of companies faces copycat suits. You learn that Congress has prevented the regulatory agencies from addressing the age discrimination issues and is now considering legislation that would for the first time grant employees a legal entitlement to future benefits not yet earned.

Your company's board grows increasingly nervous. How can we risk so much liability on something unrelated to our core business, they ask. Why not have say a 401(k) plan only like many of our competitors? Will proposals guarantee employees pension expectations be extended to other benefit programs? You and the board feel you have little choice but to freeze the cash balance plan. New hires will get no pension benefits and current employees will earn no additional benefits.

Mr. Chairman and Members of the Committee, as policymakers dedicated to the retirement security of American families, we cannot imagine this is the result you want. Yet this is reality. Several clients of our firm have already frozen their hybrid plans and 41 percent of hybrid sponsors say they will do so within a year absent legal certainty. It is within your power, however, to change this result.

First, make clear that the basic hybrid designs do not violate age discrimination rules. Second, provide legal certainty for employers that convert hybrid plans in good faith. Third, avoid bans on benefit plateaus. And fourth, reject mandates for future conversions that will discourage employers from making new benefit commitments.

Thank you for the opportunity to appear today. I would be please today answer your questions.

[The prepared statement of Mr. Delaplane follows:]

Statement of James M. Delaplane, Jr.,Esq., Attorney, American Benefits Council, Washington, DC

Chairman Boehner, Ranking Member Miller, thank you very much for the opportunity to appear before you today. My name is James Delaplane and I am a partner with the Benefits Group of Davis and Harman LLP. I serve as Special Counsel to the American Benefits Council (Council), and I am appearing today on the Council's behalf. The Council is a public policy organization representing principally Fortune 500 companies and other organizations that assist employers of all sizes in providing benefits to employees. Collectively, the Council's members either sponsor directly or provide services to retirement and health plans covering more than 100 million Americans.

The Council is very pleased, Mr. Chairman, that you have called this hearing to examine the important policy issues involving hybrid defined benefit plans. Many of our members sponsor cash balance and pension equity plans and the Council believes that the legal uncertainty currently enveloping these hybrid defined benefit plans is the most significant and pressing retirement policy issue presently before Congress. Congressional action to provide legislative clarity and certainty for hybrid plans is urgently needed to prevent (1) the demise of these plans, (2) the resulting exit from the defined benefit system by a large number of American employers, and (3) the harm to the retirement income prospects of millions of American families that will unquestionably result.

Mr. Chairman, we believe it is absolutely critical that the effort to craft hybrid legislation be led by the congressional committees of jurisdiction and we thank you for spearheading this effort. As you are well aware, pension policy is a notoriously complex and technical area, one in which it is easy to produce unintended results,

such as disincentives for employers to remain in our voluntary pension system. The legislative process works best when those who are most knowledgeable about an area are the ones to tackle the complex issues. We applaud your commitment to avoid what has sometimes occurred in the past with respect to hybrid plans—a haphazard and incomplete debate pursued outside of the committees of jurisdiction and as part of the appropriations process.

In my testimony today, I hope to convey the value of the defined benefit system and hybrid plans specifically for millions of Americans and their families. I will describe the current legal and regulatory landscape that is endangering the continued existence of hybrid plans, and set forth why the Council and its members believe congressional action is urgently needed to prevent the extinction of these retirement programs. Lastly, I will describe the Council's recommendations for resolving this pension crisis.

The Value of the Defined Benefit System

The defined benefit pension system helps millions of Americans achieve retirement security. It does this by providing employer-funded retirement income that is guaranteed to last a lifetime. Employees are not typically required to make any contributions toward their benefits in these plans and the assets of the plan are managed by investment professionals. Employers, rather than employees, bear the investment risk of ensuring that plan assets are sufficient to pay promised benefits. And insurance from the Pension Benefit Guaranty Corporation means employees" retirement benefits are guaranteed even if the plan or the employer's business experiences financial trouble.

As of 1998 (the most recent year for which official Department of Labor statistics have been published), more than 18 million retirees were receiving benefits from defined benefit plans, with over $111 billion in benefits paid out in that year alone.[1] Given that America's personal savings rate remains one of the lowest among industrialized nations[2] and that average balances in 401(k) plans are quite modest,[3] there is no doubt that in the absence of defined benefit pensions fewer Americans would be financially prepared for retirement. Furthermore, the absence of defined benefit pensions would result in increased strain on federal entitlement and income support programs, not to mention an increase in the number of American seniors living in poverty.

Given these statistics, the value of defined benefit plans to many American families is undeniable. Yet we have seen an alarming decline in defined benefit plan sponsorship[4] and today is a particularly precarious time for the defined benefit system. Employers are increasingly exiting the defined benefit system for a variety of reasons, including uncertainty about how future pension liabilities will be measured, a flawed pension funding regime marked by complexity and volatility, potential changes to the rules governing pension accounting, and, most relevant for our discussion today, legal uncertainty surrounding hybrid defined benefit plans.[5] Objective observers agree that policymakers must take action to address these threats or

[1] U.S. Census Bureau, Statistical Abstract of the United States: 2002, No. 524 (Source: U.S. Department of Labor, Pension and Welfare Benefits Administration, Private Pension Plan Bulletin, Number 10 winter 2001, and unpublished data).

[2] The Organization for Economic Cooperation and Development, Main Economic Indicators (Paris: OECD, January 2004).

[3] In fact, data from the Employee Benefit Research Institute shows that in 2001 the average 401(k) account balance (net of all plan loans) was only $43,215 and the median (mid-point) 401(k) account balance was a mere $12,810. Facts from EBRI, 401(k) Plan Account Balances, Asset Allocation, and Loan Activity in 2001 (June 2003). Even when looking at 401(k) plan participants in their 60s who had been at their job for at least 30 years, the average account balance was only $162,042. This would translate into a relatively meager monthly lifetime annuity payment at retirement.

[4] The total number of PBGC-insured defined benefit plans has decreased from a high of more than 114,000 in 1985 to 32,321 in 2002. PBGC Pension Insurance Data Book 2002, 44 & 72. This downward trend becomes even more sobering if you look at just the past several years. Not taking into account pension plan freezes (which are also on the rise but not officially tracked by the government), the PBGC reported that the number of defined benefit plans it insures has decreased by 7,000 (or 18%) in just the last four years. Id.

[5] The Council recently released a white paper discussing in detail each of these threats to the defined benefit system, along with recommendations for ensuring that defined benefit pension plans remain a viable retirement plan design. See American Benefits Council, Pensions at the Precipice: The Multiple Threats Facing our Nation's Defined Benefit Pension System (May 2004), available at http://www.americanbenefitscouncil.org.

defined benefit plans and the income they provide to American retirees will become increasingly scarce.[6]

Before going on, Mr. Chairman, I want to thank you and the members of the Committee for enacting a temporary replacement for the 30-year Treasury bond interest rate used for pension calculations. As you know, one of the threats to the defined benefit system has been the required use of an obsolete interest rate, and we sincerely appreciate your leadership in enacting a corporate bond replacement rate for 2004 and 2005. The Council and its members look forward to working with you and the Committee to find an appropriate permanent replacement for the 30-year Treasury bond rate and enacting this replacement in the very near future.

The Specific Advantages of Hybrid Defined Benefit Plans

Hybrid plans are defined benefit pensions that also incorporate attractive features of defined contribution plans. The most popular hybrid plans are the "cash balance" design and the "pension equity" design. In a cash balance plan, employers provide annual "pay credits" to an employee's hypothetical account and "interest credits" on the balance in the account. In a pension equity plan, employers provide credits for each year of service and these credits are multiplied by an employee's final pay to produce a lump sum figure. Hybrid plans not only offer the security of employer funding and assumption of investment risk, federal guarantees and required lifetime and spousal benefit options, but also show account balances in lump sum format, are portable, and provide for a more even benefit accrual pattern across a worker's entire career.[7] Hybrid plan participants are able to reap these rewards typical of defined contribution plans without bearing any concomitant loss of security (i.e., a decline in account balance due to stock market conditions).

Employers like hybrid plans primarily because the benefits in the plans are so tangible to employees, resulting in greater appreciation of the pension program. In fact, a survey published in 2000 found that the dominant motives for employer conversions were employee appreciation of the plan, facilitating communication with employees, and the ability to show the benefit amount in a lump sum format.[8] Many assume that conversions are pursued to cut employer pension costs. While this has been the case for some companies, for most employers it is neither the rationale for the conversion nor the reality that results.[9] We trust you will agree that, when employers do conclude that costs must be reduced, it is better for them to retain an affordable defined benefit plan (and one that fits the realities of the modern workforce) than to not have one at all.

Hybrid plans and their level benefit accrual pattern are also effective in helping employers attract and retain employees in today's fluid job market where few individuals plan or expect to stay with one employer for a career.[10] Employees likewise appreciate hybrid plans because they are more transparent, more portable, and de-

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[6] "Policymakers should take action sooner rather than later in order to create greater regulatory certainty for plan sponsors. Decisions are needed on the status of cash balance pension plans, permanent funding rules, and interest rates to be used in plan calculations, accounting treatment related to using smoothing versus mark-to-market for investment returns and interest rates, and rules and premiums under Title IV of ERISA and the Pension Benefit Guaranty Corporation. Until these kinds of policy decisions are made, further erosion of the defined benefit system can be expected to continue." Jack VanDerhei and Craig Copeland, Employee Benefit Research Institute, ERISA At 30: The Decline of Private–Sector Defined Benefit Promises and Annuity Payments? What Will It Mean?, Issue Brief No. 269 (May 2004).

[7] Traditional defined benefit plans tend to provide the bulk of earned benefits at the very end of a worker's career.

[8] Sylvester J. Schieber, et al., Watson Wyatt Worldwide, The Unfolding of a Predictable Surprise: A Comprehensive Analysis of the Shift from Traditional Pensions to Hybrid Plans 44 (February 2000) (96% of respondents indicated employees" appreciation of the plan was either very important or important in the decision to convert to a hybrid plan; 93% of respondents indicated facilitation of communication and the ability to show the benefit amount in a lump sum format were either very important or important in the decision to convert to a hybrid plan).

[9] Data released just this year shows that retirement plan costs have increased an average of 2.2% following a conversion, and when companies that were in severe financial distress were excluded from the pool, this figure increased to 5.9%. Watson Wyatt Worldwide, Hybrid Pension Conversions Post–1999: Meeting the Needs of a Mobile Workforce 3 (2004). In addition, conversions are often accompanied by improvements to other benefit programs, such as 401(k) plans, bonuses, and other post-retirement benefits. In fact, one recent survey found that when these improvements are taken into account, 65% of respondents expected the costs of providing retirement benefits following a cash balance conversion to increase or remain the same. Mellon Financial Corporation, 2004 Survey of Cash Balance Plans 15. Another survey, conducted in 2000, also found that overall costs following a conversion were expected to increase or remain the same in 67% of the cases. PricewaterhouseCoopers, Cash Balance Notes 4 (May 2000).

[10] Women rank promoting portable pensions as their top retirement policy priority. Center for Policy Alternatives and Lifetime Television, Survey: Women's Voices 2000.

liver benefits more equitably to short, medium and longer-service employees than traditional pensions, while also retaining the favorable security features of the defined benefit system.[11]

The unique value of hybrid plans in meeting employee retirement plan preferences is demonstrated in a new survey. The survey reveals that workers prefer two retirement plan attributes above all others—the portability of benefits and benefit guarantees.[12] It is only hybrid plans that can deliver both these advantages. Traditional defined benefit plans typically do not provide for portability, and benefits in 401(k) and other defined contribution plans are not guaranteed. Indeed, if policymakers were today working from a blank slate to produce the ideal retirement plan, it is a hybrid plan they would likely develop. Clearly, preserving hybrid plans as a viable pension design is critical if employers are to maintain retirement programs that meet employee needs and preferences.

Perhaps most important of all, studies show that nearly 80% of participants build higher retirement benefits under a hybrid plan than a traditional plan of equal cost.[13] Why? Traditional defined benefit plans tend to award disproportionate benefits (often as much as 75% of total benefits under the plan) to employees with extremely long service. Yet very few employees spend a career with a single employer.[14] Hybrid plans were designed to respond to this reality. The advantage of hybrid plans for most workers is confirmed by a recent study that shows that if an employee changes jobs just three times in the course of his career, she or he can expect to receive in excess of 17% more in retirement benefits from participating in cash balance plans than had his or her employers provided traditional plans instead.[15]

The advantages of the hybrid plan are not reserved for younger workers. Even longer-service workers often fare better under a hybrid plan.[16] One of the many ways in which hybrid plan sponsors address the needs of longer-service and older employees is by contributing pay credits that increase with the age and service of employees. Recent surveys show that 74% of cash balance plan sponsors provide pay credits that increase with age or service,[17] while 87% of pension equity plan sponsors do the same.[18]

Employers also devote significant energy and resources to developing transition assistance programs to help older and longer-service employees who may not accrue as much in benefits on a going forward basis under a hybrid plan as they would under the prior plan. Successful conversion assistance techniques vary, but generally include one or more of the following: grandfathering some or all current employees in the prior pension plan, allowing certain employees to choose whether to remain in the traditional plan or move to the hybrid plan, providing whichever benefit is greater under either the traditional or new formula, providing additional transition pay credits in an employee's account over some period of time, or making extra one-time contributions to employees" opening accounts. Employers draw from these varying techniques and apply them to smaller or larger groups of employees as appropriate to suit the needs of their workforce and carry out the goals of the conversion. Studies conducted within the last few years show that employers provide older and longer-service employees with these special transition benefits in

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[11] The Federal Reserve, Cash Balance Pension Plan Conversions and the New Economy 5 (Oct. 2003) ("[R]easons that workers may want pensions include the desire to earn tax-favored returns, or to realize economies of scale on the transaction costs of investment, although both of these goals can be realized in a [defined contribution] plan as well as a [defined benefit] plan. In a [defined benefit] plan workers may also realize the opportunity to insure to some degree against mortality, inflation, macroeconomic, and disability risks through inter-and intra-generational risk sharing.").

[12] Watson Wyatt Worldwide 2004, supra note 9 at 6.

[13] Watson Wyatt Worldwide 2000, supra note 8 at 24–25.

[14] Watson Wyatt Worldwide 2004, supra note 9 at 6 –7. In fact, only 9.5% of employees work in the same job for 20 years or more. Employee Benefit Research Institute.

[15] Watson Wyatt Worldwide 2004, supra note 9 at 6. The Federal Reserve has likewise reported that "conversions have generally been undertaken in competitive industries that are characterized by tight and highly mobile labor markets. Since mobile workers benefit most from such conversions, we conclude that this trend may have positive implications for the eventual retirement wealth of participants." The Federal Reserve, supra note 11 at 3.

[16] Watson Wyatt Worldwide 2000, supra note 8 at 23–25 (February 2000) (Among the 78 plans studied, on average a worker age 50 with 20 years of service would have earned benefits 1.48 times as great if he had participated in a cash balance plan rather than a traditional plan).

[17] Mellon Financial Corporation, supra note 9 at 12.

[18] Watson Wyatt Worldwide 2004, supra note 9 at 2.

nearly all conversions.[19] Indeed, employers" already significant focus on the needs of older workers has only increased in light of public and congressional interest in the effect of conversions.

As this data reveals, hybrid plans are proving extremely successful in delivering valuable, appreciated, and guaranteed retirement benefits to employees of all ages.

The Legal and Regulatory Landscape

Let me now turn to a discussion of the history of hybrid plans and how the current uncertainty in the legal and regulatory landscape came about. The first cash balance plan was adopted in 1985 and the first pension equity plan was adopted in 1993. For nearly fifteen years after adoption of the first cash balance plan, the Internal Revenue Service (IRS) regularly issued determination letters for hybrid plan conversions indicating that the plans and conversions satisfied all Internal Revenue Code requirements (including those related to age discrimination). In 1999, however, the IRS announced a moratorium on such letters partly in response to several high-profile conversions that were receiving significant congressional and media scrutiny. As a result of this scrutiny and after thorough review of the issues through numerous congressional hearings in the committees of jurisdiction, Congress in 2001 enacted legislation to require employers to provide a more detailed and more understandable advance notice to participants regarding any hybrid conversion (or any other defined benefit plan amendment) that significantly reduced future benefit accruals.[20] At the time, some in Congress proposed various benefit mandates and design restrictions as a response to cash balance conversions, but these proposals were all rejected. Congress concluded that the best response to the issues that had been raised was to ensure absolute transparency for employees about how their benefits would be affected by hybrid plan conversions.

Benefit Plateaus ("Wear–Away"). Let me now turn to a discussion of one of the conversion issues that has generated questions and concerns throughout the congressional review of hybrid plans—so called "wear-away." At the outset, it is important to understand that parallel rules in ERISA and the Internal Revenue Code protect all benefits that an employee has already earned for service to date.[21]

Thus, despite assertions to the contrary, existing benefits are never reduced in a hybrid plan conversion.

"Wear-away" is the term used for the benefit plateau effect that some employees can experience in conjunction with a cash balance conversion. When employers convert to a cash balance plan, they typically provide an opening balance in employees" cash balance account. A benefit plateau results if the value of the employee's cash balance account is less than the value of the benefit he or she accrued under the prior plan as of the date of the conversion. Until the value of the cash balance account catches up to the value of the previously accrued benefit, it is the higher accrued benefit to which the worker is entitled if he or she departs the company—hence the plateau.[22] We believe that the term "wear-away" is, in fact, confusing and even misleading, as the employee always receives the higher of the two benefit levels and nothing earned is taken away. Thus, we use the term benefit plateau throughout the discussion below.

There have been three leading causes of this plateau effect in the conversion context.

- First, the plateau can result simply from a change in the rate of interest on 30-year Treasury bonds. Our pension laws require that when benefits earned in a defined benefit plan are converted from an annuity payable at retirement into a lump sum present value, this calculation must be performed using the 30-year Treasury bond rate.[23] As interest rates on 30-year bonds fall, the lump

[19] Mellon Financial Corporation, supra note 9 at 11 (90% of conversions contain special transition benefits); Watson Wyatt Worldwide 2004, supra note 9 at 4 (89% of conversions contain special transition benefits). In those instances where these special transition benefits are not provided, it is usually because the business is in financial distress at the time of the conversion.

[20] ERISA section 204(h); Notice of Significant Reduction in the Rate of Future Benefit Accrual, 68 Fed. Reg. 17,277 (Apr. 9, 2003) (to be codified at 26 C.F.R. pts. 1, 54, and 602).

[21] ERISA section 204(g); Internal Revenue Code section 411(d)(6).

[22] It is worth noting that the use of benefit plateaus as a method of transitioning between benefit formulas has been expressly approved under IRS pension regulations for many years. Indeed, plateau periods can result from constructive and necessary plan changes, such as updating plan mortality assumptions to provide more accurate benefits, aligning the benefits of employees from different companies in the wake of business acquisitions and mergers, or revising a plan to meet new statutory requirements (such as legislative restrictions on the amount of benefits that may be paid under a plan).

[23] ERISA section 205(g); Internal Revenue Code section 417(e). This required use of the 30-year Treasury bond rate was not changed by the recently enacted legislation replacing the 30-year rate for pension funding calculations.

sum present value of the benefit earned by the employee prior to the conversion will increase.[24] The result can be that although a worker's previously earned benefit and opening cash balance account were both equal to $50,000 at the time of conversion, a decrease in 30-year bond interest rates can increase the value of the previously earned benefit to $55,000. Until the cash balance account reaches $55,000, this worker will experience a benefit plateau.

- Second, benefit plateaus can result when employers translate the previously accrued traditional benefit into an opening cash balance account using an interest rate higher than the 30-year bond rate. When this is done, the value of the opening cash balance account will be lower than what the employee would be eligible to take under the prior plan (since the present value of that benefit must be calculated using the 30-year bond rate). The result is that workers will plateau at the higher level until the cash balance account catches up. Employers generally use a higher interest rate when they believe the 30-year Treasury bond rate is historically low (which has been the case in recent years).[25] Yet because using a higher interest rate can produce benefit plateaus and plateaus have been of concern to employees, few employers have set opening balances in this way. The clear trend has been for employers to determine opening account balances using the Treasury rate or a rate more favorable for employees.[26] Thus, this use of higher interest rates is not a frequent cause of benefit plateaus today.
- Third, benefit plateaus can result when employers eliminate early retirement subsidies (on a prospective basis) from the pension.[27] A plateau can result in this instance because workers who have already earned a portion of an early retirement subsidy prior to a conversion will typically have a previously earned benefit under the prior plan that is higher than the opening cash balance account (which is typically based on the normal retirement age benefit earned under the prior plan as of the date of the conversion and does not include the value of any early retirement subsidy).[28] Elimination of the early retirement subsidies on a prospective basis is the primary cause of benefit plateaus in most conversion cases where plateaus are seen today. It should be noted that benefit plateaus can also occur in cases where early retirement subsidies are eliminated from traditional defined benefit plans.

While some may be concerned about the plateau effect resulting from subsidy removal, Mr. Chairman, we feel strongly that employers must maintain their flexibility to eliminate these early retirement subsidies on a going forward basis. Early retirement subsidies are certainly a preferable alternative to layoffs and can help a company manage its workforce in a humane way. But employers will never adopt such a feature of their plan if policymakers make it difficult or impossible to eliminate these subsidies prospectively when they no longer make sense. Today, for example, given the significant shortages that employers experience in certain job categories, it makes no sense for them to continue to offer highly-productive employees rich financial incentives to retire in their 50s. While current law protects any subsidy that employees have already earned for their service to date, it wisely allows employers to remove such incentives from their plan going forward.

Moreover, any legislative requirement that employers maintain ongoing early retirement subsidies in their pension plans—and this is what a ban on plateaus would

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[24] This is because one needs a larger pool of money today to grow to an equivalent benefit at age 65 if that pool will be earning less in interest.

[25] This is yet another reminder of how important it is for Congress to move quickly to enact a permanent replacement for the 30-year Treasury bond rate, including for calculations that determine lump sum benefits in defined benefit plans.

[26] In a 2000 study of cash balance conversions, Watson Wyatt reports that of the 24 plans it reviewed that converted to a hybrid design since 1994, 22 of them (92%) set opening account balances using the Treasury rate or a rate more beneficial to employees. Watson Wyatt Worldwide 2000, supra note 8 at 40; Mellon Financial Corporation, supra note 9 at 6 (77% of 101 cash balance conversions did the same).

[27] An early retirement subsidy provides an enhanced benefit if the employee leaves the company at a specified time prior to normal retirement age. For example, a fully subsidized early retirement benefit might provide an employee the same pension at age 55, say, $1,500 per month for life, which he would not normally receive until age 65. The ability to earn the higher pension without any actuarial discount for the additional 10 years of payments provides a strong financial incentive to retire at the earlier age. The value of such an early retirement subsidy decreases every year until normal retirement age, at which point no subsidy remains.

[28] Opening account balances do not typically include the value of early retirement subsidies because doing so would provide the value of the subsidy to a large number of workers who will work until normal retirement age and therefore not be entitled to the subsidized early retirement benefits. Those few employers that have included some or all of the subsidy in opening accounts have done so as a particular conversion assistance technique.

entail—would be out of step with congressional actions regarding our nation's public pension system, Social Security. With respect to Social Security, Congress has raised the retirement age and repealed the earnings test in order to encourage older Americans to work longer. Requiring employers to continue to offer private pension plan incentives to retire early would be flatly inconsistent with these actions.

Although we understand that benefit plateaus can be confusing and even upsetting to some employees, they result from interest rate anomalies and valid actions taken by employers to eliminate early retirement subsidies. Nonetheless, given the employee concern, many employers design their conversions to mitigate these plateaus or eliminate them altogether. Moreover, the disclosure requirements enacted by Congress in 2001 (and implemented by the Treasury Department through regulations) ensure that employees are fully aware of the possible benefit plateau effects of a conversion. The Council believes these steps appropriately respond to the concerns that have been raised about plateaus.

Age Discrimination Principles. Subsequent to Congress" enactment of disclosure legislation, the Treasury Department and IRS drafted proposed regulations in consultation with the Equal Employment Opportunity Commission addressing retirement plan design and age discrimination principles. These proposed regulations were issued in December 2002. Among other items, the proposed regulations established the validity of the cash balance design under the pension age discrimination statute and provided guidelines on how employers could convert from traditional to hybrid pension designs in an age-appropriate manner.

Disregarding the interpretation contained in the proposed regulations and other legal authorities, one federal district court judge dramatically shifted the focus of the debate surrounding hybrid plans by declaring in July 2003 in the case of Cooper v. IBM that hybrid plan designs were inherently age discriminatory.[29] According to the court's flawed logic, simple compound interest is illegal in the context of defined benefit pension plans.[30] Under the Cooper court's reasoning, a pension design is discriminatory even if the employer makes equal contributions to the plan on behalf of all its workers and, ironically, even in many instances where the design provides greater contributions for older workers. Such a conclusion flies in the face of common sense.[31] It would hold all 1,200 plus hybrid pension plans,[32] regardless of whether adopted as new plans or through conversion from traditional plans, to be in violation of the pension age discrimination laws.

The conclusion that all hybrid plan designs are inherently age discriminatory begs the question why the Internal Revenue Service issued favorable determination letters for fifteen years blessing hybrid plan designs and issued proposed regulations providing that the cash balance plan design is not inherently age discriminatory. It is surprising, at a minimum, that the Cooper decision completely ignored this history. Even more astonishing is the fact that the Cooper decision ignores the legislative history of the pension age discrimination statute adopted in 1986. That legislative history makes clear that the intent of Congress was limited to prohibiting the practice of ceasing pension accruals once participants attained normal retirement age.[33] Moreover, an example in the 1986 legislative history that clarifies a separate

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[29] Cooper v. IBM Pers. Pension Plan, 274 F. Supp. 2d 1010 (S.D. Ill. 2003). The pension age discrimination statute in question provides that the rate of a participant's benefit accrual may not decline on account of age. The district court interpreted this rule to mean that the amount of annuity benefit received at age 65 for a year of service cannot be less for an older worker than a younger worker. The defendants in the case argued that it is nonsensical from an economic perspective to compare the age 65 benefit accrual rate of a 25-year old and a 64-year old because the 64-year old will receive his or her benefit much sooner and have a much shorter period of time to accrue interest. In other words, the "time value" of money must be taken into account. The court itself acknowledges the strength of this argument, stating, "From an economist's perspective, Defendants have a good argument." Nonetheless, the court goes on to argue incorrectly that the age discrimination laws require rejection of basic economic common sense.

[30] The court's reading of the 1986 pension age discrimination statute would invalidate a broad range of long-standing pension designs, including contributory defined benefit plans (common in the state and local government sector and among multiemployer plans), plans that are integrated with Social Security and plans with pre-retirement indexation to help protect employees from the effect of inflation. These plans were all regarded as perfectly age appropriate when Congress enacted the pension age statute.

[31] If the Cooper court's reasoning were applied to the Social Security program, even it would be considered age discriminatory.

[32] The most recent government data indicates that as of the year 2000 there were 1,231 hybrid plans covering more than seven million participants. PBGC, supra note 4 at 3–6.

[33] H.R. Conf. Rep. No. 1012, 99th Cong., 2d Sess. at 376–379. A number of other federal district courts that have had the opportunity to review this issue have likewise concluded that the pension age discrimination statute is only applicable to benefit accruals after a participant has reached normal retirement age. See Tootle v. ARINC, Inc., Civ. Action No. CCB–03–1086 *15–

but related pension issue describes approvingly a type of plan (a "flat dollar" plan) that would be deemed age discriminatory under the Cooper decision.[34] It makes absolutely no sense that Congress would use as an example of a viable pension design one that would fail the age discrimination prohibition it was enacting at the very same time.[35] Lastly, prior to the Cooper decision, numerous other federal district courts addressed and rejected charges that the basic hybrid plan designs were age discriminatory.[36] These too were ignored in the Cooper decision. Importantly, another federal district court decision decided subsequent to Cooper has rejected its logic and concluded that the cash balance pension design is age appropriate.[37]

Spurred on by the Cooper decision, cash balance critics in Congress pushed through an appropriations prohibition preventing the Treasury Department from finalizing its age regulations addressing hybrid plan designs and conversions.[38] Congress at the same time directed the Treasury Department to make legislative recommendations regarding conversions from traditional to cash balance plans.[39] In the relevant legislative history, however, Congress did make clear that "[t]he purpose of this prohibition is not to call into question the validity of hybrid plan designs (cash balance and pension equity). The purpose of the prohibition is to preserve the status quo with respect to conversions through the entirety of fiscal year 2004 while the applicable committees of jurisdiction review the Treasury Department's legislative proposals."[40]

While the Cooper decision is an isolated one, and there is clear and significant authority to the contrary concluding that hybrid plans are age appropriate, Cooper is a high-profile case that has led to copycat class action lawsuits being filed against a number of employers for the alleged discriminatory nature of their plan design. Applying the rationale in the rulings to date in the Cooper case, ultimate damages against the defendants are estimated to be between $1 and $6 billion dollars. It is this range of figures that are required to overcome and "correct for" the natural operation of compound interest. Employers are understandably extremely anxious about the crippling effect of such lawsuits and potential damage awards, and are concerned that they will be the next on the growing list of companies targeted for class-action suits. While employers certainly expect the anomalous Cooper decision ultimately to be overturned on appeal, such a result is many years away and many hybrid plan sponsors may find the intervening risks unbearable.

The Need for Congressional Action

Mr. Chairman, the operation of the hybrid pension system is at a standstill. Employers cannot get determination letters from the IRS regarding the compliance of their plans with legal guidelines. The regulatory agencies that normally assist the smooth functioning of the system through issuance of periodic interpretive guidance have been told by Congress through the appropriations process not to do so. Any final resolution of the age discrimination question by appellate courts is years away at a minimum.

Moreover, the judicial system is not the appropriate forum for resolving an issue of this sort, which has far-reaching public policy ramifications. The very nature of the judicial process makes it difficult for these types of broad public policy issues to receive thorough examination much less appropriate handling. Not all stakeholders are present before the court and the system-wide ramifications are intentionally given less weight than the narrow legal issues.

Perhaps some are tempted to view this current legal uncertainty and regulatory standstill as a victory of sorts. Perhaps they will see the slowdown in the number

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16 (D. Md. June 10, 2004); Engers v. AT & T Corp., No. 98–3660, letter op. at 9 (D. N.J. June 6, 2001); Eaton v. Onan, 117 F. Supp. 2d 812, 827–29 (S.D. Ind. 2000).

[34] H.R. Conf. Rep. No. 1012, 99th Cong., 2d Sess. at 381.

[35] Eaton acknowledged this inconsistency and concluded it was illogical to read the pension age discrimination statute in such a way as to invalidate this example and with it a wide variety of defined benefit plans. 117 F. Supp. 2d at 830, 834.

[36] Campbell v. BankBoston, N.A., 206 F. Supp. 2d 70 (D. Mass. 2002) (rejecting the notion that hybrid plan designs are inherently age discriminatory, the court stated that a "claim based on the fact that older workers will have a smaller amount of time for interest to accrue on their retirement accounts—is not permitted under the [age discrimination laws]."), aff'd 327 F.3d 1 (1st Cir. 2003); Eaton v. Onan, 117 F. Supp. 2d 812, 826 (S.D. Ind. 2000) (in holding that the cash balance pension design is not age discriminatory the court stated: "Plaintiffs" proposed interpretation would produce strange results totally at odds with the intended goal of the OBRA 1986 pension age discrimination provisions.").

[37] Tootle v. ARINC, Inc., Civ. Action No. CCB–03–1086 (D. Md. June 10, 2004).

[38] See Section 205 of the fiscal year 2004 Omnibus Appropriations Act (PL 108–199).

[39] These recommendations were recently issued by the Treasury Department as part of the Bush Administration's fiscal year 2005 budget submission to Congress.

[40] H.R. Conf. Rep. No 401, 108th Cong., 1st Sess. at 1185 (2003).

of hybrid plan conversions as a positive development for employees. They should not. In a recent survey, 41% of hybrid plan sponsors said they would freeze their plans if the legal uncertainty was not resolved within a year.[41] As we noted earlier, other pressures in the defined benefit system are already prompting employers to consider freezes or terminations. The hostile climate for hybrid plans and the litigation risks and extreme damage potential are unfortunately starting to make this an easier and easier decision for corporate decision-makers.[42] If employers are pushed to abandon hybrid plans, we will lose a retirement vehicle that delivers higher benefits to the vast majority of employees and meets workers" key retirement plan needs—for portability and benefit guarantees—all while utilizing transition methods that protect older workers. How, exactly, is this good for employees and their families?

The prospect of hybrid plan freezes and terminations poses another risk—to the Pension Benefit Guaranty Corporation (PBGC). We must be mindful that many of the companies that sponsor hybrid plans are financially strong companies in healthy industries. These strong companies today pay insurance premiums to the PBGC. If these employers are forced to exit the defined benefit system, the loss of premiums could aggravate the long-term financial challenges faced by the agency. Hybrid plan participants comprise 21% of all plan participants protected by the PBGC insurance program. Hence employer insurance premiums on these participants comprise 21% of the revenue generated by the PBGC through its per-participant premium program.[43] If hybrid plans were removed from the defined benefit system, future premiums to the PBGC would be reduced significantly.

Mr. Chairman, the situation today is distressingly clear. The harms that result from today's legal uncertainty are unmistakable. The regulatory agencies and courts are unable to act effectively to prevent these harms. Only through prompt legislative action can Congress rescue hybrid defined benefit plans and prevent the damage to the retirement security of millions of American families that will unquestionably result from their demise.

Recommendations

Clarify the Age Appropriateness of the Hybrid Plan Designs. The first and most important step for Congress to take is to clarify that the cash balance and pension equity designs satisfy current age discrimination rules. Congress must make clear that the legal interpretation holding these designs discriminatory merely because the accounts of younger workers have more years to earn interest is unfounded. Rather, Congress must clarify that age discrimination in hybrid plans is measured by the pay credits contributed on workers" behalf. If the pay credits for older workers are the same, or greater, than the pay credits for younger workers, then the pension age discrimination rules are satisfied.[44] This clarification is consistent with the legal authorities and with plain common sense. It will end the needless legal jeopardy in which every hybrid plan sponsor today finds itself and will preserve the important benefits that millions of employees today earn under these plans.

Provide Legal Certainty for Past Hybrid Conversions. In addition to clarifying the age appropriateness of the hybrid plan designs, the Council believes it is essential for Congress to provide legal certainty for the hybrid plan conversions that have already taken place. These conversions were pursued in good faith and in reliance on the legal authorities in place at the time. Transition methods, such as benefit pla-

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[41] Hewitt Associates LLC, Current Retirement Plan Challenges: Employer Perspectives 2 (2003).

[42] A majority of companies have made it clear that if hybrid plans become untenable they will be offering only a 401(k)/defined contribution program going forward. They will not be reverting to a traditional defined benefit plan design. Deloitte Consulting LLP, Pension Crisis Prompting Majority of Surveyed Companies to Change or Consider Changing Their Plans 2 (2004). While defined contribution plans provide valuable retirement benefits, defined benefit plans provide unique retirement security features for employees and their families that are hard to replicate. Employees are typically best served by the ability to participate in both types of plans. The Council believes that our nation's retirement income policy should be crafted to promote maximum flexibility so that employers and employees can utilize the plan or plans that best suit their needs.

[43] This figure is derived from data collected by the PBGC indicating that, as of the year 2000, the PBGC protected 34,342,000 single-employer defined benefit plan participants, 7,155,000 of whom participate in hybrid plans. PBGC, supra note 4 at 6.

[44] The hybrid plan proposals made by the Treasury Department in the Bush Administration's fiscal year 05 budget contain a provision recognizing that this is the appropriate way to evaluate age discrimination for hybrid plans. However, this clarification regarding the hybrid plan designs is prospective only in the Treasury recommendations, leaving employers with hybrid plans already in existence open to legal suit regarding the legality of their plan designs.

teaus, that have not given rise to concerns about age discrimination in other contexts should not now do so merely because of the context of hybrid plan conversions.

Resolve Legal Uncertainties with Anti–Employee Effects. Beyond resolving the questions about the basic hybrid designs and the treatment of past conversions, the Council believes Congress should take a number of additional steps to provide legal clarity regarding hybrid plans. Addressing these additional issues will very concretely aid the employees who participate in hybrid plans.

- Whipsaw. First, we recommend that you make clear that, so long as a cash balance plan does not credit interest in excess of a market rate of return, the proper benefit payment to a departing employee is that employee's account balance. This will remedy the so-called "whipsaw" problem that has forced employers to reduce the rate of interest they pay on employees" cash balance accounts.[45]
- Inclusion of Early Retirement Subsidies. Second, we recommend that you make clear that employers may include some or all of the value of early retirement subsidies in employees" opening account balances. A number of employers have chosen to do this as a conversion technique to assist those nearing early retirement eligibility but some in the regulatory agencies are suggesting that to do so is problematic under our current pension age discrimination rules.
- Protection of "Greater Of" Transition Method. Third, we recommend that you make clear that employers that voluntarily choose to offer employees the greater of the benefits in the prior traditional or new hybrid plan do not run afoul of the pension back-loading rules. Some regulators have suggested this "greater of" conversion approach violates these rules.
- Protection of Employee–Friendly Transition Techniques. Fourth, some conversion approaches that employees and Members of Congress have praised (choice, greater of, grandfathering in the prior plan) are likely to violate the non-discrimination rules over time. Why? The group of typically older employees who remain under the prior plan formula will over time and very naturally have a greater and greater proportion of so-called highly-compensated employees (those making $90,000 and above) and may well be the only group eligible for continued accrual of benefit features exclusive to the prior traditional plan (e.g., early retirement subsidies). This creates a problem under the non-discrimination rules. We urge you to make clear that these employee-friendly conversion techniques can be pursued.

Reject Benefit Mandates That Prevent Employers from Modifying Benefit Programs. Some in Congress are seeking to impose specific benefit mandates when employers convert to hybrid pension plans. For example, some would require that employers pay retiring employees the greater of the benefits under the prior traditional or new hybrid plan.[46] Others would require employers to provide employees the choice at the time of conversion between staying in the prior traditional plan or moving to the new hybrid plan.[47] Pursuant to a directive from Congress, the Treasury Department has also made legislative recommendations regarding requirements for hybrid plan conversions undertaken in the future. The Treasury proposal would require employers to pay benefits at least as high as were provided under the prior traditional plan for a period of five years following the conversion.

These proposals may perhaps sound innocuous to some, and indeed some employers have voluntarily adopted the transition techniques that would be mandated under these proposals, but each of the proposals embraces a fundamental and truly radical shift in the rules of the game for our nation's voluntary employer-sponsored

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[45] Whipsaw is the term used to describe the anomaly that occurs when employers must project a departing employee's cash balance account forward to normal retirement age using the plan's interest crediting rate and then must discount the resulting amount back to a present value using the statutorily-mandated 30-year Treasury bond rate. When an employer's interest crediting rate is higher than the 30-year rate, this process results in a plan liability to the employee in an amount greater than the employee's actual account balance. The only way to avoid this "whipsaw" effect is to reduce a plan's interest crediting rate to the same 30-year rate the law requires for discounting future benefits into present value lump sums. In the wake of several court decisions mandating this whipsaw effect, this is what cash balance sponsors around the country have done to insulate themselves from liability. However, the unfortunate result is that employees in cash balance plans earn lower rates of interest on their accounts than would otherwise be the case. Even a modestly lower rate of interest earned on an account over the course of a career can translate into a significant reduction in the ultimate account balance at retirement. The Treasury Department helpfully included this same resolution of the whipsaw problem in its legislative recommendations contained in the Bush Administration's fiscal year 05 budget proposal. As with the provision regarding hybrid plan design, however, the recommended whipsaw fix was prospective only. This would require employers to continue to pay low interest rates on employees" existing cash balance accounts.

[46] See H.R. 1677, which has been introduced by Representative Bernie Sanders (I–VT).

[47] See H.R. 2101, which has been introduced by Representative George Miller (D–CA).

benefits system. Under these proposals, Congress would be (1) guaranteeing employees future retirement plan benefits for service that the employees have not yet performed, and (2) preventing employers from changing the benefit programs they voluntarily offer. Indeed, Congress would be converting the natural and understandable hopes and wishes of employees that their benefits will remain the same into concrete legal rights. Such enshrinement of expectations is a fundamental departure from the existing rules of the voluntary benefits system. The Council believes this would be an extremely unwise—and extremely counterproductive—step for Congress to take.

Under such regimes, it is unfortunately clear what actions employers will take. If they conclude that a traditional defined benefit plan is no longer meeting business and employee needs, they will not remain in the defined benefit system through conversion to a hybrid plan. They will exit the defined benefit system altogether knowing they can avoid these unprecedented mandates by simply utilizing a defined contribution plan going forward. As discussed above, this is typically not the response that best serves employees" retirement income needs.

Perhaps even more damaging than pushing employers from the defined benefit system is the dangerous precedent that would be set by these mandates that seek to enshrine expectations. Employers will naturally ask themselves whether, if other developments in the benefits and compensation landscape come in for heightened scrutiny, Congress will respond by preventing them from making changes to those programs (through imposition of greater of, mandated choice or hold-harmless requirements). Will employers be unable to redesign their health plans? Will they be unable to remove early retirement subsidies from their traditional defined benefit plans? Will they be unable to reduce cash bonuses? Will they be unable to shift from profit-sharing to matching contributions in their defined contribution plans? Will they be unable to reduce the degree of price discount in their stock purchase programs? Where exactly will it end? There appears to us to be no principled stopping point.

Given the extremely significant administrative burdens, financial costs and legal exposure that already accompany voluntary employer sponsorship of benefit programs today, we hope all who believe in employer-provided benefits as we do will see that these are not the questions you want stirring in the minds of corporate decision-makers. They can only result in a world where employees are offered fewer benefits.

Conclusion

The American Benefits Council believes that hybrid defined benefit plans play an invaluable role in delivering retirement income security to millions of Americans and their families. Nevertheless, hybrid plans are facing legal uncertainties that threaten their continued existence. Of these, the most pressing threat is a rogue judicial interpretation that declares all hybrid plans in the nation illegal. To prevent widespread abandonment of hybrid plans by employers and the resulting harm to employees, we hope Congress will provide the legislative certainty and clarity for hybrid pension plans we have recommended above.

Thank you again, Mr. Chairman and Ranking Member Miller, for the opportunity to appear today. I would be pleased to answer any questions you may have.

Chairman BOEHNER. Ms. Collier.

STATEMENT OF ELLEN COLLIER, DIRECTOR OF BENEFITS, EATON CORPORATION, CLEVELAND, OHIO

Ms. COLLIER. Chairman Boehner, Ranking Member Miller, thank you for the opportunity to appear here today. My name is Ellen Collier, and I am the Director of Benefits for Eaton Corporation. Eaton is a diversified industrial manufacturer with world headquarters in Cleveland, Ohio. We have over 51,000 employees worldwide, including 27,000 employees in more than 40 States.

I am appearing today on behalf of the Coalition to Preserve the Defined Benefit System, a broad based employer coalition that works exclusively on legislative and regulatory issues related to hybrid pension designs.

This is a critical time for defined benefit pension plans and hybrid plans in particular. Congressional action is urgently needed to confirm the validity of cash balance and pension equity designs. If Congress does not clarify the current legal uncertainty, employers facing the threat of class action lawsuits will increasingly be forced to abandon these retirement programs. Given the success of hybrid plans in delivering meaningful guaranteed retirement benefits to today's workers, abandonment of these programs would be disastrous for employees and for our Nation's retirement system. Employees will not win if the current uncertainty persists.

Let me now discuss why we at Eaton concluded that a cash balance plan was right for us. Eaton's diverse business nature and acquisition activity created a challenge for our retirement programs. Our challenge is to continually attract and retain high level talent and to reduce the confusion resulting from multiple pension structures.

Eaton began to examine pension plan alternatives in the mid-90's. While this was under way, we acquired Aeroquip Vickers, a company with about 5,000 nonrepresented employees. These employees had no defined benefit pension plan, making the development of a new pension design even more urgent.

We considered several options for a new pension design, but in the end we decided that a cash balance plan was best for Eaton and our employees. Why? The simplicity, visibility, portability and ease in integrating acquired companies into Eaton. Once we settled on an ongoing design we had to make sure we responded to the needs of employees that were already in existing pension designs. All new hires would enter the cash balance plan on 1/1/02 as would the Aeroquip Vickers employees. Fifteen thousand nonrepresented employees would get an informed choice effective 1/1/03 between remaining in their existing traditional plan and switching to the cash balance pension plan.

Employee reaction to our cash balance design was overwhelmingly positive. It is important to note that choice may not make sense for all employers. Companies need to have flexibility to modify their retirement plans to meet their individual business needs.

Let me emphasize Eaton did not introduce a cash balance plan to reduce costs. In fact, the cash balance design has increased costs. Although the choice process required a significant amount of money and resources, the cost of congressional inaction would be far greater. If certain proposed judicial remedies were applied to Eaton, the cost to modify our plan could curtail discretionary spending in vital areas like research and development. Furthermore, there would be increased litigation, confusion and complexity if we were forced to modify or freeze our plan at this time. The resulting damage to employee morale and trust would greatly disrupt Eaton's day-to-day manufacturing operations. Without legislative action, the efforts to align our benefit structure with our business needs will have been wasted.

Legislation is the only effective way to address today's uncertainties surrounding the hybrid pension designs. Why? Congress has indicated through the appropriations process that it does not want these important policy issues being determined by the agencies, and final resolution of the age discrimination question by appellate

courts is years away at a minimum. This will be too late to address the litigation risks that are already beginning to drive employers from the system. In the meantime, the retirement security of millions of American families will remain in limbo.

To prevent widespread abandonment of pension plans by employers, Congress must clarify the legality of hybrid plans. Thank you again for the opportunity to appear today. I would be pleased to answer any questions.

[The prepared statement of Ms. Collier follows:]

Statement of Ellen Collier, Director of Benefits, Eaton Corporation, Cleveland, OH

Chairman Boehner, Ranking Member Miller, thank you for the opportunity to appear today. My name is Ellen Collier and I am the Director of Benefits at Eaton Corporation. Eaton Corporation is a diversified industrial manufacturer headquartered in Cleveland, Ohio. We have over 50,000 employees worldwide, including over 27,000 employees in 100 locations in the U.S. The states with our greatest concentration of employees are Michigan, Ohio, Pennsylvania, North Carolina and South Carolina. In total, we have employees in over 40 states.

Eaton has four main business groups that manufacture highly-engineered components: Fluid Power, which manufactures hydraulic components, hoses and connectors, and Aerospace products; Electrical, which manufactures residential and commercial power distribution equipment; Automotive, which manufactures engine valves, lifters and superchargers; and Truck, which manufactures transmissions for heavy and medium duty trucks.

Our 2003 sales topped $8 billion, with sales in over 100 countries. The business mix of the company has evolved significantly in the past 10 years as a result of over 50 acquisitions and 48 divestitures.

I am appearing today on behalf of the Coalition to Preserve the Defined Benefit System, a broad-based employer coalition that works exclusively on legislative and regulatory issues related to hybrid plans. The Coalition's nearly 70 member companies, which range from modest-size organizations to some of the largest corporations in the U.S., sponsor hybrid defined benefit plans covering more than one million participants.

Before I turn to the specifics of the hybrid issue, I want to thank you Chairman Boehner, Ranking Member Miller and other members of the Committee for your hard work earlier this year to enact a corporate bond replacement for the obsolete 30-year Treasury bond rate. As you know, we defined benefit plan sponsors face a range of challenges today and having an appropriate replacement rate was critical to the functioning of the pension system.

The Need for Legislative Action

I want to thank you for calling this hearing to address what is the most pressing challenge today in the defined benefit system—the legal uncertainty surrounding hybrid plans, and in particular the radical judgment by a single court that hybrid plans are age discriminatory. Congressional action is urgently needed to confirm the dominant view—expressed by all other legal authorities—that the cash balance and pension equity designs satisfy current age discrimination rules.[1] Absent such action by Congress to clarify the current legal environment, employers facing the threat of copycat class action lawsuits over the validity of their plan designs will increasingly be forced to abandon these important retirement programs. Given the success of hybrid plans in delivering meaningful, guaranteed retirement benefits to today's workers,[2] abandonment of these programs would be a disastrous result for employees and for our nation's retirement system. None of us should kid ourselves that

[1] The Treasury Department recently withdrew proposed regulations addressing hybrid plans and age discrimination, which had the potential to provide the needed clarity. The Treasury acted in response to clear indications—expressed through the congressional appropriations process—that Congress did not want these issues definitively addressed by the regulatory agencies. I.R.S. Announcement 2004–57, I.R.B. 2004–27.

[2] Nearly 80% of employees earn higher benefits under a hybrid plan than a traditional plan of equal cost. Watson Wyatt Worldwide, The Unfolding of a Predictable Surprise: A Comprehensive Analysis of the Shift from Traditional Pensions to Hybrid Plans 24–25 (February 2000). As discussed below, those employees who do better under a traditional defined benefit plan are typically granted transition assistance and/or remain under the traditional formula after the hybrid plan is introduced.

somehow employees win if the current uncertainty persists. Nor should any of us assume that a retreat from hybrid plans will be accompanied by a return to traditional defined benefit plans. Indeed, it is far more likely that employers will abandon defined benefit plans altogether.

To give you a feel for the valuable role hybrid plans play, let me now discuss why we at Eaton concluded that a cash balance plan was right for us. Our experience is comparable to those of many other companies in our Coalition.

The Need for a New Pension Design

Eaton's presence in various lines of business, and our substantial acquisition activity, created a challenge for our retirement programs: We needed to continue to attract and retain high-level talent to remain competitive and continue our growth, and we also needed to reduce the confusion and administrative cost resulting from multiple pension structures inherited through various acquisitions. Through different acquisitions and across different lines of business we had 6 ongoing pension designs for 15,000 non-union represented employees. These included two final average pay designs, one Social Security offset design, two flat-dollar multiplier designs, and one cash balance design. Based on employee survey results, we also knew we needed to make our pension plans easier for employees to understand.[3]

Eaton began to examine pension plan alternatives in the mid–1990's. We knew the resulting design would need to be attractive to high-skills talent, easy to understand, and suitable to a mobile workforce. This attention to mobility was important—not only in the labor marketplace, but also within Eaton, as we do have employees that transfer between business groups with different pension plans. Under our existing traditional designs, one employee could have benefits from two pension plans, simply by transferring from Pittsburgh (headquarters of our Electrical group) to Minneapolis (headquarters of our Fluid Power group). Finally, any new retirement program would have to permit seamless integration of new employees brought on as a result of acquisitions. This was necessary in order to provide equitable and uniform benefits across our workforce and to enhance Eaton's ability to grow.

While the examination of pension plan alternatives was underway, Eaton acquired Aeroquip Vickers, a company with about 5,000 non-union represented employees. These employees had a defined contribution plan from the prior owner, but no ongoing defined benefit plan—their pension plan had been frozen many years before. We at Eaton felt strongly that we wanted to provide these employees once again with the security of a defined benefit plan—in addition to Eaton's 401(k) plan (which has an employer match). We knew that employer funding and assumption of investment risk, professional investment management and federal insurance guarantees translated into tangible retirement income and significant peace of mind for employees. Thus, the need to integrate the Aeroquip Vickers employees into Eaton's benefit structure made the development of a new pension design even more urgent.

Key Considerations

We considered several options for a new pension design, including a final average pay plan, a pension equity plan, and a cash balance plan. We even considered a defined contribution-only program (which we did not prefer, since it lacked the security of a defined benefit plan). In the end, the simplicity, visibility, portability, and ease with which an acquired company could be integrated led us to choose a cash balance design.[4] Along the way, we kept abreast of all regulatory and judicial developments to ensure we were designing a plan that would meet the relevant legal standards. Like most other companies that consider switching to a cash balance plan, Eaton engaged the top legal, actuarial, and human resources consulting available to help with this process.

Now that the basic hybrid designs have been called into question, employers facing a set of circumstances similar to ours would have far fewer options. One choice would be to stay with the traditional pension design, which tends to deliver meaningful benefits to a relatively small number of career-long workers, has limited value as a recruitment device in today's marketplace and makes integration of new employees difficult. The other alternative would be to exit the defined benefit system and provide only a defined contribution plan, which while an important and popular benefit offering, provides none of the security guarantees inherent in de-

[3] This correlates with the general experience of other employers. Surveys show that improving communication about and employee appreciation of the pension plan, as well as being able to show benefits in a lump sum format, are the most important factors underlying employer conversions to hybrid plans. Watson Wyatt Worldwide 2000, supra note 1 at 44.

[4] Once again, Eaton's reasons are consistent with those of other employers that move to hybrid plans. Watson Wyatt Worldwide 2000, supra note 2 at 44.

fined benefit plans. Clearly, it is employees that lose out as a result of today's uncertainty surrounding hybrid plans.

As we at Eaton analyzed our specific situation, we took into account the needs of employees that were already in our other pension designs. We knew that a cash balance design might not meet the needs of every current employee in our existing traditional plans. However, we also knew that forcing current workers to remain in their existing traditional defined benefit plan, while working side-by-side with new workers who earned what might be perceived as a more valuable benefit under the new cash balance design, was also not desirable.

Once we settled on cash balance as our ongoing design, we focused on the particular transition approach we would adopt. We were aware of the diversity of transition approaches and knew that each of these transition techniques had proven successful at addressing the needs of particular companies" older workers. Such approaches include grandfathering employees in the prior traditional plan, offering employees the choice between the prior and new hybrid formulas, providing the "greater of" the benefits under the prior or hybrid plan, providing transition pay credits or making one-time additions to employees" opening cash balance accounts.

These special transition techniques are used in the vast majority of conversions and the variety of approaches provides the flexibility companies need to address their unique circumstances and employee demographics.[5] Indeed, congressional concerns about how older and longer-service workers are treated during conversions have been successfully addressed by employers through the use of the variety of transition protections.[6]

The absence of determination letters harms both employers and employees. The determination letter process works as a partnership between employers and the government to ensure that plans are maintained in accordance with our nation's very complex pension statutes and regulations. The fact that this process has broken down means plans are not getting the definitive guidance they rely upon to operate their plans in full compliance with the law.

We decided that all 15,000 current non-union employees—regardless of age or service—would be able to choose whether to remain in their existing traditional plan or earn a pension benefit under the cash balance formula. This choice would be effective 01/01/03. All of the recently acquired non-union Aeroquip Vickers employees would enter the new cash balance plan on 01/01/02, and all non-union Eaton employees hired on or after 01/01/02 would enter the new cash balance plan.

We should emphasize that Eaton did not introduce a cash balance plan to reduce cost, and in fact the new plan increased costs in the short-term, and will slightly increase plan costs in the long term. This is described in more detail below.

Description of Plan Design

Our new cash balance design—the Eaton Personal Pension Account, or EPPA—consists of several important features. Each participant earns monthly pay credits based on the sum of their age and years of service (including any service with an acquired company). These credits range from 5% of pay up to 8%, increasing as the sum of age and years of service increases. To reiterate, we contribute higher pay credits to the cash balance account of older employees and those with longer service. Indeed, providing pay credits that increase with age or service is the typical approach in hybrid plans.[7] Under Eaton's plan, the pay credits accumulate, with inter-

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[5] Mellon Financial Corporation, supra note 4 at 11 (90% of employers provide special transition benefits); Watson Wyatt Worldwide, Hybrid Pension Conversions Post–1999: Meeting the Needs of a Mobile Workforce 4 (2004) (89% of employers provide special transition benefits). Those employers that do not (and that solely convert the prior accrued benefit into an opening account balance without additional transition techniques) are typically experiencing financial distress at the time of the conversions. Yet despite their financial challenges, they are interested in retaining a defined benefit plan that delivers meaningful benefits across their workforce.

[6] This discussion of conversions highlights another reason why legislative action is so urgently needed. Many employers that have converted to hybrid plans using these successful and generous conversion methods have nonetheless been unable to obtain a determination letter from the Internal Revenue Service (IRS) stating that their plan complies with the requirements of the Internal Revenue Code. This is due to the fact that the IRS announced a moratorium on issuance of such letters for hybrid conversions in September 1999 pending review of some of the hybrid issues by the IRS national office. Memorandum from the Internal Revenue Service, to the EP/EO Division Chiefs (Sept. 15, 1999). It has become clear that the IRS will not begin issuing determination letters (for either past conversions caught up in the moratorium or new conversions) until Congress resolves the legal uncertainty surrounding hybrid plans.

[7] Seventy-four percent of 146 employer respondents to a Mellon survey provided pay credits in their cash balance plans that increased with age or service. Mellon Financial Corporation, 2004 Survey of Cash Balance Plans 9. Eighty-seven percent of pension equity plans analyzed

est based on the rate of interest for 30-year Treasury bonds, to create the "personal pension account." This design benefits employees of a company acquired by Eaton since it recognizes past service with that company when calculating pay credits. The cash balance design is also helpful in recruiting mid-career talent, since age (and not just service) is a component in the calculation of pay credits. Note that we received an IRS determination letter for this basic cash balance design in November of 2002 as it applied to the new Eaton hires and the Aeroquip Vickers employees (none of whom experienced a conversion).[8] We have also received determination letters for our other active cash balance plan, and another cash balance plan that has since been frozen due to a spin-off.

An employee who chose to switch to the new Eaton Personal Pension Account would start with an opening account balance, equal to the value of their pension benefit under the existing traditional pension plan—including any early retirement subsidies or supplements.[9] Since one of our goals with the new design was to make our pension plan easier for employees to understand, we felt that using an opening balance approach, as opposed to using the existing traditional formula for past benefits and a cash balance formula for future benefits (the so-called "A+B" approach), was appropriate. To calculate these opening balances, we assumed a retirement date of the later of age 62 or 01/01/06. Employees whose prior pension formula was tied to their final pay (this included the vast majority of the employees eligible for making an informed pension choice) also received indexing credits on the opening balance amount for as long as they remained active employees. These indexing credits were based on annual changes in the Consumer Price Index (CPI) to mimic the effect that pay increases would have had on the employees" prior pension benefit. These indexing credits were in addition to the ongoing interest and pay credits mentioned above. So, each month a participant's balance would increase by pay credits, interest credits on the prior balance (including any past pay credits), and indexing credits (on the opening balance only).

A final, but important, note regarding this plan design change is that we made several costly changes to the existing traditional plans as well. Our intention was to remove certain differences in the plan designs in order make the choice process even more equitable. For instance, we added a non-spousal death benefit and an enhanced disability pension provision to the traditional plans—both were features of the new cash balance design—to ensure that an employee's choice would not be skewed by concerns over unexpected death or disability. We had concluded that the existing "spouse-only" death benefit in our traditional plans was not meeting the needs of single parents working at Eaton.

Along with changes in our pension plan, we also made important changes in our 401(k) savings plan. These changes included permitting diversification of the company stock matching contribution. The decision to permit diversification had been made prior to news reports of troubled company savings plans, such as Enron. Under the changes we have adopted, all company stock matching amounts will be fully diversifiable by the end of 2004.

Informed Choice Process

After deciding on the design, and to give existing employees choice, we had to ensure that the new plan, and the choice, were communicated clearly to all affected

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in a recent Watson Wyatt study provided pay credits that increased with age or service. Watson Wyatt Worldwide 2004, supra note 4 at 2.

[8] Due to the IRS moratorium on determination letters discussed above, we do not have a determination letter for our core cash balance conversion affecting Eaton employees as of 1/1/03.

[9] An early retirement subsidy in a pension plan provides a financial bonus for employees to retire early. To provide a simple example of a fully subsidized benefit, a worker retiring at age 55 might receive the full $1,000 per month pension benefit he would normally only be entitled to at age 65. In other words, there is no actuarial reduction in benefits for the early retirement date. One thousand dollars per month for life beginning at age 55 is more valuable than $1,000 per month for life beginning at age 65; hence the subsidy. The subsidy declines in value if the employee remains at the company beyond age 55 and has no remaining value if the employee works until 65. In contrast, early retirement supplements are additional temporary benefits payable until Social Security normal retirement age. Employers have taken a variety of approaches to the question of whether to include early retirement subsidies in employees" opening account balances. Some have chosen not to do so since it is impossible to know at the time of conversion whether an employee will actually leave the company at a time in the future when they would have qualified for the subsidy. Others, like Eaton, have included some or all of the value of the subsidy in the opening cash balance account as one technique to minimize the effect of the conversion for employees nearing early retirement eligibility. It is important to note that current law protects any subsidy that an employee may have already earned at the time of a conversion. To qualify for this subsidy, the employee must of course retire at the retirement eligibility age. Of equal importance, current law also allows employers to remove such incentives from their plans on a going forward basis.

participants. For the recently acquired Aeroquip Vickers employees, who would be receiving a new pension for the first time since joining Eaton, we issued Summary Plan Descriptions, held on-site meetings, and created a website where employees could model future EPPA benefits under a variety of economic assumptions.

For the choice process, we drafted written communication materials with the intent of satisfying—and, in fact, exceeding—ERISA section 204(h).[10] Each employee received a detailed Decision Guide, an individualized Personal Choice Statement, and an easy-to-read Quick Comparison Chart. In developing these materials, we kept in mind the high standard that had been set by Kodak—whom Senator Moynihan publicly cited as the "gold standard" for hybrid conversion communications—during its choice process, and strived to meet or exceed it. In addition, we made continual use of employee focus group feedback to refine these materials.

The Decision Guide explained, in detail, the features of the participant's existing traditional plan and the EPPA, including details regarding the calculation of the opening balance. This document displayed charts of both options—the current plan and the EPPA—and how they compared at future ages under a certain set of assumptions, using hypothetical examples. In addition, we explained the concept of wear-away,[11] and graphically described the effect it could have on employees. The Quick Comparison Chart was a side-by-side comparison of the main provisions of each option. We should note that Eaton's approach minimized the effect of wear-away. The inclusion of early retirement supplements and subsidies, as well as the effect of indexing credits, mitigated the effect of, and shortened the duration of, wear-away in most cases. In fact, often it was the inclusion of early retirement supplements in the value of the protected benefit under the existing current design—which is not required by law—that caused an appearance of wear-away.[12]

The Personal Choice Statement used actual individualized participant data so that each employee could compare their estimated future benefit accruals under each option, under a certain set of assumptions. The data used for these statements was audited in advance of, and in anticipation of, this project. In particular, each of the 15,000 eligible employees was asked to review and confirm or correct their work history so that accurate service data was used for any estimate.

After the written materials were sent out, we held over 250 educational meetings and web casts at all 100 U.S. and Puerto Rico locations. Spouses and financial advisors of employees were also invited to attend these meetings, which were led by independent third-party pension experts.

We also developed a website where employees could model individualized scenarios based on their own differing economic assumptions, including salary increases and interest rate assumptions. In addition, the Choice Website contained all the educational information that was included in the written materials.

If employees had questions, they could call the Pension Choice Helpline, where independent third-party pension experts answered questions about the different plans and ran individualized comparisons on the spot. If there was a question that the Pension Choice Helpline representatives could not answer, we made sure the employee was connected to someone at Eaton who could answer his or her question.

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[10] Section 204(h) of ERISA requires employers to provide advance notice of amendments to defined benefit plans that provide for a significant reduction in the rate of future benefit accrual. Congress amended section 204(h) as part of the Economic Growth and Tax Relief Reconciliation Act of 2001 to require employers to provide a more detailed and more understandable notice of any hybrid conversion or other plan amendment that significantly reduces future accruals. This reflected Congress" view that the appropriate response to the issues that had been raised about cash balance conversions was to ensure transparency rather than to impose benefit mandates on employers. The Treasury Department has subsequently issued regulations carrying out this expanded notice requirement. Notice of Significant Reduction in the Rate of Future Benefit Accrual, 68 Fed. Reg. 17,277 (Apr. 9, 2003) (to be codified at 26 C.F.R. pts. 1, 54, and 602).

[11] Wear-away is the benefit plateau effect that some employees can experience incident to a cash balance conversion. When employers change to a cash balance plan, they typically provide an opening account balance in the cash balance account. A benefit plateau results if the value of the employee's cash balance account is less than the value of the benefit he accrued under the prior plan as of the time of the conversion. Until the value of the cash balance account catches up to the value of the previously accrued benefit, it is the higher accrued benefit to which the worker is entitled—hence, the term "plateau." This benefit plateau typically results from the fact that the prior accrued benefit includes an early retirement subsidy while the opening account balance does not. It should be noted that wear-away has long been approved by the regulatory agencies as a valid method for transitioning between benefit formulas.

[12] Those employees who experienced a wear-away as part of the conversion process did so only because they chose the new cash balance formula, concluding that even with some period of wear-away the new cash balance design was best for them.

If an employee did not make a choice, he or she remained in his or her existing traditional plan. In addition, we permitted employees to make a one-time change in their initial choice during a "grace period."

The Reception

At the end of the day, we wanted to make sure that all participants had enough information to make an informed choice. Based on the overwhelmingly positive reaction we received from employees, we believe we accomplished that goal.

Across the board, employee reaction was very positive regarding the pension choice process. The vast majority of employees said that the materials provided helped them make an informed decision. In fact, employee feedback indicates that this process helped employees understand their existing traditional pension plan as well as the new cash balance option. In addition, we received many comments that this process only strengthened the trust that existed between Eaton and its employees. We received no letters of complaint, and encountered no disruption in daily business operations during the conversion process.

In the end, about one-third of eligible employees chose the EPPA. The breakdown by age and service went as expected. Of the employees more than 20 years away from retirement, over 60% elected to switch to the EPPA. Of the employees at retirement age, or within 10 years of retirement, over 80% elected to remain in their existing traditional pension plan. However, there were several instances where, after modeling personalized scenarios and reviewing examples in the Decision Guide, employees close to or at retirement eligibility chose the EPPA. It was not unusual for the EPPA to provide a greater benefit for a retirement eligible employee some years in the future, largely due to the inclusion of early retirement supplements and subsidies in the opening balance and the application of indexing credits. Had we kept these employees in their current pension design, we would have deprived them of a chance to increase their pension benefit, even at a point late in their careers. Of the employees between 10 and 20 years from retirement, over 40% switched to the EPPA.

I was in the "in-between" group mentioned above, and although I chose to remain in the existing traditional plan, both benefit designs had distinct advantages depending on my expectations regarding my future career path. Before joining Eaton I worked at a company where I participated in a cash balance plan for 12 years. As a mid-career hire at Eaton, and as a full-time working mother, it's important to me to have retirement benefits that fit my needs. The employee reaction to Eaton's decision to implement a cash balance plan and provide an informed choice was overwhelmingly positive. This, along with similar data from numerous surveys, indicates that employees understand and appreciate the need for companies to have flexible retirement programs that fit the needs of today's workforce.

All in all, the choice process set a new standard at Eaton for communicating change throughout the company. However, we recognize that choice may not be the right answer for other businesses and other employee populations and, under different circumstances, it might have been the wrong answer for Eaton. Some employers, for example, have focused on grandfathering employees or pursuing a "greater of" approach rather than asking their employees to choose between the plans. Other companies, while scrupulously protecting benefits already earned (as current law requires), have been limited by economic circumstances in the degree of special transition benefits they can provide.

Our Coalition believes it would be extremely unwise to mandate particular transition techniques for future conversions, as some in Congress have proposed to do, since a broad range of methods is available to ensure that employees are treated fairly in the transition process. One mandated conversion method—or even several—would deny employers needed flexibility to customize their transition approaches to their particular workforce. Such conversion mandates—to pay the greater of the traditional or hybrid benefits or to offer choice, for example—also provide employees with a guaranteed right to future benefits that have not yet been earned.

These mandates would represent a disturbing shift in the basic norms of American industrial relations. Employee hopes or expectations as to future benefits would be converted into explicit legal entitlements. This profound change from existing principles suggests that the terms and conditions of a worker's employment may not be revised from those in existence at the time the employee is hired. Such a regime would rob employers of the ability to adapt to changed circumstances and would undermine the business flexibility on which America's prosperity and robust employment are built. Presumably, policymakers would not restrict employers from being able to alter—on a prospective basis—their 401(k) match level or the design of their health plan—but this is exactly the kind of restriction that mandated conversion techniques impose. Our Coalition sees no end to the harm if Congress goes down

the path of converting expectations into legal rights. Certainly, employers will be extremely reluctant to institute any new benefit program in the future, and those employers that today do not offer pension or health plan coverage for their employees will be extremely unlikely to do so.

The Cost

It is very important to note that Eaton did not introduce a cash balance plan to reduce costs. In fact, the long-term ongoing cost of the EPPA is slightly higher than the steady-state costs of the prior plan designs. In addition, we incurred higher short-term costs due to the fact that most participants maximized their benefits, and therefore the cost to Eaton, when they made their individual pension choice. Outside of plan-related costs, Eaton spent several million dollars in the overall choice effort, including consulting fees, communication materials and pension modeling tools, as well as lost work hours due to employee meetings.

Based on press accounts about cash balance conversions, one might expect that Eaton's cost experience is atypical. This is not the case. Recent surveys confirm that conversions to hybrid plans typically increase costs. Recent data from a Watson Wyatt Worldwide study examining 55 large companies that have recently converted from traditional defined benefit plans to hybrid plans shows that retirement plan costs increased by an average of 2.2% following a conversion.[14] This figure further increased to 5.9% when seven companies that were in severe financial distress were excluded from the pool.[15]

The Ramifications if Congress Does Not Provide Clarity

If Congress does not move quickly to provide legal certainty for hybrid plans, many Americans may soon lose valuable retirement benefits. The current legal landscape is ominous. One rogue judicial decision has made the threat of age discrimination class action litigation a very real concern for employers.[16] Potential damage awards from such suits could reach astronomical figures—into the hundreds of millions or even billions of dollars—and the potential amounts of these awards continue to grow the longer the plans remain in effect. In Eaton's case, the cost to modify our plan for alleged "age discrimination" in its design could curtail our ability to commit funds for other important functions, such as for research and development—and this is for a plan that has not yet been in existence for 3 years!

Beyond the cost in dollars, there would be increased complexity in the administration of our benefit programs and the programs would be harder to understand should we have to "correct" for the natural effect of compound interest. Moreover, any change to our well-received conversion process would greatly disrupt our day-to-day business operations. If a remedy would require Eaton to redo the choice process, there would be even more confusion, complexity and business disruption. Worst

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[14] Watson Wyatt Worldwide 2004, supra note 4 at 3.

[15] Id. In addition, conversions are often accompanied by improvements to other benefit programs, such as 401(k) plans, bonuses, and other post-retirement benefits. In fact, one very recent survey found that when these improvements are taken into account, 65% of respondents expected the costs of providing retirement benefits following a cash balance conversion to increase or remain the same. Mellon Financial Corporation, supra note 4 at 15. Another survey, conducted in 2000, also found that overall costs following a conversion were expected to increase or remain the same in 67% of the cases. PricewaterhouseCoopers, Cash Balance Notes 4 (May 2000).

[16] This decision, Cooper v. IBM Pers. Pension Plan, 274 F. Supp. 2d 1010 (S.D. IL 2003), held that the cash balance and pension equity hybrid designs were inherently age discriminatory. The court concluded that such pension designs violate the pension age discrimination statute which provides that the rate of a participant's benefit accrual may not decline on account of age. The court interpreted the pension age discrimination statute to mean that the amount of annuity benefit received at normal retirement age for a period of service (e.g., 1 year) cannot be less for an older worker than a younger worker. Such a conclusion is clearly contrary to the basic "time value of money" principle that a younger worker will have a longer period of time to accrue interest, and thus will have a larger benefit amount at retirement based on an equal contribution today. Under this decision, any pension plan that contains a compound interest feature is inherently age discriminatory. This misguided logic not only impugns hybrid plans, but also contributory defined benefit plans (common among state and local government employers), plans that are integrated with social security and plans that provide indexing of benefits to guard against inflation. All other federal courts that have addressed this issue, including those decided subsequent to the Cooper case, have reached the opposite conclusion and indicated that the cash balance design is age appropriate. Tootle v. ARINC, Inc., Civ. Action No. CCB–03–1086 (D. MD June 10, 2004); Campbell v. BankBoston, N.A., 206 F. Supp. 2d 70 (D. MA 2002); Eaton v. Onan, 117 F. Supp. 2d 812 (S.D. IN 2000). See also Godinez v. CBS Corp., 31 Employee Benefits Cas. (BNA) 2218 (C.D. CA 2002), afff'd, No. 02–56148, 2003 U.S. App. LEXIS 23923 (9th Cir. 2003); Engers v. AT&T, No. 98–3660 (D. NJ June 6, 2001). Nonetheless, a number of employers have now been sued for the alleged discriminatory nature of their plan design based on the Cooper decision.

of all, there would be a huge impact on employee morale and employee trust. Eaton prides itself on building trust with its employees, and we believe that the cash balance conversion experience strengthened that trust.

Like the majority of other employers who switch to a cash balance design, Eaton made every effort to act in "good faith" during this conversion. As opposed to adopting a less costly, less secure and less controversial defined contribution design, Eaton incurred additional cost through the conversion process, provided a variety of communications materials and tools, used a fair conversion method, and minimized the effects of wear-away. While Eaton was able to provide a generous "choice" conversion, it is by no means the only suitable method by which employers can change benefit designs, and does not reflect the business realities for all companies. Without legislative clarification that our cash balance design is age appropriate, the efforts we made to align our benefit structure with our business needs, while at the same time enhancing benefits for and strengthening trust with our employees, will have been wasted.

In today's economic climate, prudent business leaders seek to minimize corporate risks not associated with the company's core business. Absent congressional action to mitigate such risks associated with hybrid plan sponsorship, these leaders will likely be forced to terminate or freeze hybrid pension plans in order to limit exposure to class-action litigation with 9 or 10 figure damage awards. In an October 2003 survey, 41% of hybrid plan sponsors said they would freeze their plans if the legal uncertainty surrounding hybrid plans was not resolved within a year.[17] Based on the most recent government data available, this translates into approximately 506 hybrid plan terminations or freezes, which could affect as many as 3 million participants and their families.[18] It should be noted that the bulk of these employers have concluded that the traditional pension design no longer meets the needs of large numbers of their current and future employees. Thus, these employers are extremely unlikely to return to a traditional defined benefit plan after freezing or terminating their hybrid plan. This unfortunate reality of widespread freezes and terminations will only become more stark should legislative resolution take longer.

Why must Congress be the one to act to clarify the validity of the hybrid designs? First, Congress has indicated through the appropriations process that it does not want these important policy issues being determined by the regulatory agencies. As a result, the Treasury Department has withdrawn its proposed regulations addressing hybrid plans and age discrimination principles, which had the potential to settle the open issues regarding hybrid plans. Second, final resolution of the age discrimination question by appellate courts is years away at a minimum, too late to address the litigation risks that are beginning to drive employers from hybrid plans and the defined benefit system. Neither are the courts the appropriate forum to consider the broad public-policy ramifications (for employees and their families, for employers, and for our nation's retirement policy) of holding the cash balance and pension equity designs to be age discriminatory.

In order to prevent widespread abandonment of hybrid plans by employers—and the loss of retirement security this would produce for millions of American families—Congress must clarify that the cash balance and pension equity designs are age appropriate under current law. Congress should also provide legal protection for the hybrid plan conversions that have already taken place in good faith reliance on the legal authorities operative at that time. Finally, should Congress decide to establish rules to govern future conversions, our Coalition strongly recommends that it avoid the mandates guaranteeing future benefits that will merely accelerate employers" departure from the defined benefit system.

Conclusion

Mr. Chairman, I want to thank you once again for calling this hearing. Legislation is the only effective way to address today's uncertainty surrounding hybrid pension designs and prevent further erosion of the retirement benefits of American families. Our Coalition looks forward to working with you and members of the Committee to achieve this objective.

Thank you, again, for the opportunity to appear today. I would be pleased to answer any questions you may have.

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[17] Hewitt Associates LLC, Current Retirement Plan Challenges: Employer Perspectives 2 (2003).

[18] These figures are based on data from the Pension Benefit Guaranty Corporation (PBGC) indicating that, as of the year 2000, there were 1,231 hybrid plans in existence with 7,155,000 participants. PBGC, Pension Insurance Data Book 2002, at 5–6.

Chairman BOEHNER. Professor Clark.

STATEMENT OF DR. ROBERT L. CLARK, PROFESSOR, COLLEGE OF MANAGEMENT, NORTH CAROLINA STATE UNIVERSITY, RALEIGH, NORTH CAROLINA

Dr. CLARK. Mr. Chairman, Members of the Committee, ladies and gentlemen, I appreciate the opportunity to testify today on characteristics of cash balance plans. Over the past 5 years I have written a series of papers examining advantages and disadvantages of hybrid plans and the impact of the transition from traditional defined benefit plans to cash balance plans. The Committee staff has reviewed many of these papers.

My comments today will focus on three important issues that form the basis of the current policy debate on cash balance plans. First, starting a new cash balance plan where there was none previous to that, what are the primary issues and are there concerns; second, converting a traditional defined benefit plan to a cash balance plan; and, third, the presence of the present value of pension benefits, how does it change with continued work and what is this wear-away issue?

First, starting a new pension plan, Table 1, which is in the testimony I think available to all the Members, illustrates the different characteristics of defined benefit plans, defined contribution plans, and hybrid plans. By looking at this, even a cursory review of these characteristics would convince us that most workers, some workers, and some firms are likely to prefer traditional defined benefit plans. Other workers and other firms are likely to prefer defined contribution plans. And some other workers will prefer cash balance or their hybrid plans. It is this choice that makes our system work in many regards.

Cash balance plans, for example, do not have some of the characteristics of defined contribution plans that worry many policy analysts. Cash balance plans tend to cover all workers, participation is not voluntary. Investment risk is primarily borne by the firm and not individual workers. They provide an annuity option. In addition, cash balance plans provide the portability that is lacking in most traditional defined benefit plans. So workers in firms can choose what kind of pension plan most directly fits their own preferences and needs.

Thus, I do not see any social policy reason for excluding cash balance plans as an option for firms and workers when they are first considering the adoption of their plans.

Second, converting existing defined benefit plans. In fact most of the adverse reaction to cash balance plans has come not from new startup plans but from conversion of traditional plans and the potential loss expected by senior workers. I would just reiterate the comments of Mr. Miller, who used very carefully the words "can lose unexpected benefits." these are not earned benefits, they are not promised benefits, as he must well know, instead the potential to gain these benefits.

In a series of papers I have examined the change in pension wealth associated with plan conversions. Virtually all of these studies show that plan conversions are likely to increase the lifetime pension wealth of most workers covered by pension plans on their

current jobs. This finding is due primarily to the portability or the various lack of portability inherent in defined benefit plans.

In contrast, traditional defined benefit plans also subsidize the long tenured senior workers while penalizing mobile workers. As a result of this subsidy most senior workers who expect to remain with the company until early retirement will, in fact, face a decline in potential retirement benefits. Please note I use the word "potential."

It is important to consider what relevant comparisons should be used in assessing the impact of plan conversions. Most discussion has assumed that the relevant counter-factual is that the worker would remain with the firm, the old pension would remain in place, and wage growth would continue. This perception is in part due to some of the ways that companies have in the past communicated their information to their workers.

Again, Mr. Miller mentioned the pension calculators that companies use, that actually assume, make those assumptions. But are these assumptions consistent with the reality that we face today? Again Mr. Miller went through a long list of problems in our economy today that make those assumptions seem less reasonable or less likely.

First, a worker could be fired or laid off from their job. Second, the plant could close. Third, the company could be facing difficult financial problems and terminate a plan without starting a new plan. Fourth, the company could be facing difficult financial problems and reduce the rate of growth of earnings. Fifth, the company could terminate the defined benefit plan and start a defined contribution plan. Sixth, the worker could leave for personal reasons. If any of these events were to happen, they would have essentially the same impact as the company converting from a traditional defined benefit plan to a cash balance plan.

So one would have to then question why would you pick out one of these options and have legislation restricting it when all of these other events would have essentially the same effect.

In several papers I have shown that the potential loss in pension wealth is basically the same as the early retirement subsidy in these plans. And as Mr. Delaplane pointed out, this is certainly a key in the future with population aging, concern about Social Security financing, and other issues related to our slowly growing labor force. The idea that companies want to restrict or encourage workers to leave is going to be less important. They may actually be trying to encourage them to stay in the traditional defined benefit plan when the early retirement subsidies are certainly not consistent with that.

Thank you, Mr. Chairman.

[The prepared statement of Dr. Clark follows:]

Statement of Dr. Robert L. Clark, Professor, College of Management, North Carolina State University, Raleigh, NC

INTRODUCTION

Coverage of employees by traditional defined benefit plans has been declining for almost three decades. Initially, the shift was away from traditional defined benefit plans to greater coverage by defined contribution plans, especially 401 (k) plans. This trend was most prominent among small employers (Clark and McDermed, 1990). Beginning in the 1980s, many large employers began converting their tradi-

tional defined benefit plans to hybrid plans, primarily cash balance plans. Interestingly, the conversion to cash balance plans has generated a major policy debate while the more comprehensive shift to defined contribution plans has continued with relatively little controversy.

In my testimony today, I will address key aspects of the plan conversion process and why changes in pension plans are being made. In addition, I will review the policy issues associated with these conversions and place them in the broader context of labor market policies in the U.S. Two questions seem paramount. First, should federal regulations allow traditional defined benefit plans, defined contribution plans, and cash balance plans to continue to exist? Second, are new regulations needed to deter plan conversions for workers covered by an existing defined benefit plan or at least to compensate these workers for potential loses incurred by the plan conversion? Given the current discussion in Congress and the on-going judicial review, it is important to understand the pros and cons of each type of pension plan and to determine whether these plans help working Americans to achieve an adequate retirement income.

CHOOSING A PENSION PLAN TYPE

The value of participation in any type of pension plan is a function of lifetime working patterns, rates of growth in annual earnings, risk preferences, tax rates, and retirement ages. Employers offer pensions to help attract, retain, motivate, and then retire workers. Both employers and employees are interested in the cost of providing a dollar of pension benefits. In a free labor market, workers search for the firm and the compensation package that best meets their preferences while companies use pensions (or the lack their of) to entice individuals with the desired employment characteristics to become part of their workforce.

Workers who expect to change employers frequently will desire jobs that have a higher percentage of total compensation in earnings and pensions that are portable. Employees who believe that they will remain with a company for their entire career will be satisfied with pensions that penalize turnover and are based on their final earnings. Companies that offer noncompetitive compensation packages will tend to have more difficulty hiring and retaining quality workers. Employers must attempt to provide the compensation package that provides the greatest value to workers per dollar of cost.

Over time, events can change the pension plan that workers and firms find most desirable. Changes in regulatory costs, shifts in labor demand, and the changing composition of the labor force will affect the type of pension that provides the highest value per dollar of cost to workers. In response, companies may (1) transform traditional defined benefit plans to cash balance plans, (2) terminate the defined benefit plan and establish a defined contribution plan, or (3) terminate the defined benefit plan and offer no pension plan. Any of these changes will have an impact on current workers and in general, a change in pension plan will make some workers better off while potentially having an adverse impact on others. My testimony today examines the three basic choices of pension plans that are currently available in the U.S. labor market. The basic premise is that some workers and some firms will prefer traditional defined benefit plans while other workers and firms will find greater value in defined contribution and cash balance plans.

Employers offer pension plans to their employees because they help in the management of human resources. Retirement policies are integral components of employment contracts. Some individuals will seek out firms that provide pension plans and alter their careers to remain with these employers, while other workers have a higher preference for current income and will select employers who do not provide deferred compensation. Traditional defined benefit plans impose financial penalties on workers who leave "too early" and thus these firms will tend to have lower turnover rates than companies with defined contribution and cash balance plans.

Most traditional defined benefit plans also provide substantial early retirement subsidies. These subsidies to retire at ages as early as 50 or 55 have been a major determinants of retirement ages in these firms. Early retirement subsidies are one of the major differences between traditional defined benefit plans and cash balance plans and it is the elimination of these subsidies that is often at the core of the debate over plan conversions.

TYPES OF PENSION PLANS

Pension plans have traditionally been divided into two basic types: defined benefit and defined contribution plans; however, in the past decade many large employers have converted their traditional defined benefit plans into cash balance plans. These three plan types differ substantially in the manner in which benefits are determined, their methods of funding, who bears the investment risk associated with the

pension portfolio, the portability of benefits from one company to another, and the regulatory status of the two types of plans. The basic characteristics of defined benefit plans, defined contribution plans, and cash balance plans are shown in Table 1.

In general, defined benefit plans promise a specified benefit based on years of service, average earnings over the last three or five years of employment, and a generosity parameter chosen by the firm.[1] These plans typically provide significant retirement benefits to career employees but award much smaller benefits to employees who remain with the company for a shorter period. In defined contribution plans, employers and employees make periodic contributions into individual accounts for each worker. Workers often determine the size of their annual contributions and they decide how their pension funds will be invested. Cash balance plans are legally defined benefit plans but have many characteristics of defined contribution plans. The benefit in these plans is specified as a lump sum that workers may claim when they leave the firm.

Each type of plan has advantages and disadvantages for workers and for the plan sponsor. Which plan type is best for employees? The highest value plan for a worker will depend on individual risk preferences and expected lifetime work patterns. None of the three plan types dominates the other two for all workers. Some workers and firms will be better off with traditional defined benefit plans while others will have greater lifetime income if they participate in a defined contribution or cash balance plan.

The major disadvantage to workers of participation in defined benefit plans is the lack of portability of the pension benefits. Workers who change jobs frequently will have significantly lower benefits than those that remain with a single firm throughout their careers. Lower total retirement benefits are the result of final pay benefit formulas. Final earnings for workers who leave before retirement are not indexed to prices or future wage growth. Individuals who leave a pension-covered job relatively early in their careers will have retirement benefits from their first job based on average earnings many years in the past.

A key point for policy makers to understand is that defined benefit plans systematically provide greater benefits to senior workers with long years of service while providing only minimal benefits to mobile workers who expect to remain with the company for only a few years. Advocates that argue that traditional defined benefit plans are the "best" type of pension tend to ignore the limited benefits that these plans provide to short-term workers. The more frequent transitions of working women means that they are most vulnerable to suffering repeated losses in potential pension wealth throughout their working careers.

Another disadvantage of defined benefit plans is that the method of benefit accrual and the value of benefits are more difficult to understand compared to the value of individual accounts under defined contribution plans. Managers report that workers often do not understand the difference between the current and future value of these pensions, the annual gain in value or cost associated with the plans, and the impact of job changes on ultimate retirement benefits (Clark and Munzenmaier, 2000). The difficulty in communicating the value of defined benefit plans has led many employers to conclude that their employees do not give them sufficient credit for the costs of defined benefit pensions. This implies that workers do not correctly assess the cost and value of defined benefit plans. Managers often give this as a reason for converting traditional defined benefit plans to cash balance plans with individual accounts that are easier to explain to their workers (Clark, Haley, and Schieber, 2001).

The retirement benefit for participants in defined contribution plans depends on the size of employer and employee contributions throughout the work life and the returns to the investments made with the pension funds. Under these plans, the value of the pension at any point in time is the account balance. If contributions are made at a relatively even rate throughout a worker's career, the value of the account will grow more proportionately than under a defined benefit plan of comparable generosity. An important advantage of these pension plans is that the benefits are portable and can be taken with the workers when they change jobs.

Potential disadvantages of defined contribution plans for employees are contributions are often voluntary, workers bear the investment risk of these plans, and the benefits are typically paid in the form of lump sum distributions. Many defined contribution plans require workers to decide if they will make a pension contribution. Employer contributions may be contingent on employee contributions. Workers who are myopic may decide not to make pension contributions early in their careers and will therefore accumulate relatively low retirement accounts. In defined contribution plans, workers generally must make decisions concerning how to invest their funds.

Some participants may invest too conservatively while others may make more risky choices that affect the size of their ultimate retirement accounts.

Primary policy concerns with the growing incidence of defined contribution plans include their reliance on worker decisions on when to participate and the level of contributions, the financial market risk that the worker must bear, and use of lump sum distributions. Thus, workers may start contributing late in their working lives and accumulate relatively low retirement benefits, they may contribute too little and thus have only small retirement accounts, or they may make bad investment choices that could dramatically lower retirement benefits. The lack of annuitization also raises the possibility that workers and spouses could outlive their retirement income.

In the past decade, many large employers have increasingly converted traditional defined benefit plans into cash balance plans (Brown, et al, 2000). In many regards, the conversion of traditional defined benefit plans into cash balance plans by employers is an attempt to offer workers a pension plan that combines desirable features of both defined benefit and defined contribution plans. Cash balance plans are legally defined benefit plans but they contain many of the features of defined contribution plans that workers seem to prefer.

In cash balance plans, all qualified workers are covered by the plan and the firm typically makes all of the contributions into the pension fund. The firm is responsible for insuring that sufficient monies are in the pension account to pay all promised benefits and the plans are regulated as defined benefit plans. Benefits are specified as an account balance similar to defined contribution plans. Upon leaving the firm, the worker receives the full value of the pension account. The account grows each year from new contributions and from the crediting of a specified return on the existing monies in the account. In addition, cash balance plans tend to be more age neutral in their retirement incentives compared to defined benefit plans.

Compared to traditional defined benefit plans, cash balance plans provide the advantage of distributing benefits more equally across years of service, are easier to explain to workers, and provide portable benefits to mobile workers. Compared to defined contribution plans, cash balance plans typically provide universal coverage to qualified workers, keep the investment risk with the employer, and offer a choice of an annuity or a lump sum distribution.

Given the differences in plan characteristics and how they affect ultimate retirement benefits, it is easy to see why some workers and firms will prefer each type of pension plan. Consider an economy where employer-based pensions were previously banned. Now let this legal restriction be eliminated and assume that firms could choose to establish a traditional defined benefit plan, a cash balance plan or a defined contribution plan. It is likely that we would observe a distribution of plan types that would reflect the human resource objectives of firms and the preferences of their workers. Plan choices would maximize the well being of workers and their employers.

ESTABLISHING NEW PENSION PLANS

Based on this analysis, it is difficult to understand why anyone would oppose limiting the choice of pension plan types that are available to workers and firms provided that they are consistent with broad national retirement objectives and federal regulations. Each of the three plan options provides value to workers; however, workers with different characteristics will benefit more or less under various plan options. Individuals who remain with a single firm for many years, especially those that stay with the company until they retire are the big winners in traditional defined benefit plans. In contrast, more mobile workers accumulate far less benefits and are the big losers in defined benefit plans.

The trend toward greater use of defined contribution plans and the transition toward cash balance plans clearly indicates changes in the composition of the labor force and the emergence of workers who do not expect to remain with the same company over their entire career. In addition, workers are now leery about accepting the implicit promise of lifetime employment that many larger firms formerly offered. In the past, many workers employed by large industrial corporations thought they had lifetime jobs and were willing to accept benefits that were based on that premise. With the recent history of significant layoffs of senior workers, many of these corporate giants have lost their traditional aura as companies where workers, even highly productive ones, can expect to spend an entire career. Thus, workers are much less willing to participate in defined benefit plans and are much more likely to demand cash balance plans or defined contribution plans.

Thus, in answer to my first question, I believe that a reasonable public policy is one that allows employers and employees to choose from among these three types of retirement plans when first considering the establishment of a pension. This

range of choices should be good for employers and allow workers to select the type of pension plans that maximizes their chances of saving for retirement.

In fact, it is not the establishment of new cash balance plans that has spawned the rebellion against these plans. Instead, worker criticism and the demand for policy actions to restrict the use of cash balance plans has been the result of companies converting existing defined benefit plans into cash balance plans. It is in the conversions where winners and losers are most clearly identified. One can only wonder why critics have focused on conversions to cash balance plans while devoting much less attention to the much large trend of terminating defined benefit plans and establishing defined contribution plans. All of the issues are the same concerning the lost opportunities to earn future pension benefits based on final earnings and how starting values or termination benefits are determined. Yet for almost 30 years, the trend away from defined benefit plans toward defined contribution plans went basically unchallenged while the more recent movement toward cash balance plans has been aggressively opposed.

Consider an economy much like that prevailing in the United States prior to 1975 in which defined benefit plans dominated. Now allow the economic, demographic, and regulatory environments to change. Other changes follow. Congress imposes significant new government regulations, there are major changes in the composition and growth rate of the labor force, and domestic employers face increased global competition. In response to these new conditions, turnover rates increase and job tenure declines. In such a changing economic environment, it is not surprising that workers and firms consider amending their pension plans. These shifts provide choices to workers just entering the labor market but also have important implications for current employees who have been participants in existing defined benefit plans. Current employees, especially senior workers who are nearing early and normal retirement ages face the potential of reductions in future pension benefits. It is these potential adverse affects that are now considered.

ACCUMULATING PENSION BENEFITS IN DEFINED BENEFIT PLANS

A defined benefit pension plan promises a stream of future income in exchange for the current labor of plan participants. When employees leave the firm or the company terminates a pension plan, the plan sponsor is legally required to pay workers the value of all vested benefits based on the existing benefit formula, earnings to date, and their years of service. This is the benefit that would be paid when the worker reaches the normal retirement if she were to quit the company today. In the case of a plan termination, this is the benefit that the firm is legally required to pay the worker at the normal retirement age.

The present value of vested benefits beginning at the normal retirement age discounted back to the current age or the termination date can be found. This is the present value of the legally vested pension accrued to date. Changes in this value with continued employment represent annual benefit accruals. It is easily shown that the accrued benefit rises with increases in years of service, increases in annual earnings, and as the age of retirement approaches (Kotlikoff and Wise, 1985, 1989). The present value of vested benefits increases as a proportion of earnings as the individual remains with the firm and approaches retirement. A worker who remains with the firm with a traditional defined benefit plan will see pension wealth and pension compensation grow rapidly with continued employment. A worker who quits loses the opportunity to achieve this higher pension at older ages.

Most defined benefit plans offer early retirement benefits. Typically, the there is a sharp increase in the value of pension benefits when the worker reaches the early retirement age. This occurs because plans usually do not actuarially reduce benefits when they are started between the early and normal retirement ages. Instead these benefits provide a higher level of lifetime pension benefits than if the receipt of benefits was delayed until the normal retirement age. This early retirement subside provide a strong incentive for workers to retire at the earliest possible age and many employees choose to retire at that time.

Prior to reaching the age of early retirement, each additional year of service produces increases in future benefits that progressively increase in absolute value and as a percent of annual compensation. The present value of benefits is also increasing with additional years of employment. This pattern of benefit accrual is often called "backloading" and is the reason that defined benefit plans provide higher benefits to workers who remain with a single company compared to more mobile workers who change jobs throughout their careers. If the worker continues to work after the early retirement, the gain in future benefits is substantially reduced in a form of wear away of pension benefits. It is possible that continued employment would ultimately result in a decline in the present value of lifetime benefits, yet another form of wear away in existing plans.

The shift to cash balance plans has sometimes been characterized as plan sponsors reneging on their employment and pension contract. If the company simply provides workers their vested benefit as required by law, the workers will suffer the same pension loss as if they had voluntarily left their employer or if they had been laid off. It is important to recognize that the effect on the present value of pension benefits is the same whether the plan is terminated, converted to a cash balance or defined contribution plan, the worker quits to take a new job, the company lays off the worker, or there is a plant closing. In most conversions to cash balance plans, plan sponsors have used a combination of grandfathering and other transition provisions to eliminate or reduce the extent to which workers are adversely affected by plan changes.

Virtually all traditional defined benefit plans have subsidized early retirement provisions. These plan characteristics have been an integral component of company retirement policies since the 1960s or 1970s and have been used to encourage workers to retire at specified ages. The economic expansion of the 1990s was accompanied by a slowing in the growth the labor force. The twin forces of rapid economic growth accompanied by very low unemployment rates and a relatively slow growth in the labor force meant that many firms were having difficulty attracting the desired number of young, quality workers. These same companies observed that they had in place policies that encouraged skilled older workers to retire. In response, many large companies converted their traditional defined benefit plans to cash balance plans that do not have these early retirement incentives (Clark and Schieber, 2002).

Eliminating the early retirement subsidy is an important part of human resources policies for many firms in the twenty-first century as firm adapt to an aging labor force. Extending worklife is also part of our national retirement policy and increasing labor force participation among older persons would help ease the funding problems of Social Security. Ending these subsidies is also consistent with Congressional action that does not provide subsidized Social Security benefit taken prior to the normal retirement age. One should also note that companies could eliminate the early retirement subsidies in the current plans without converting to cash balance plans.

PENSION VALUES AFTER PLAN CONVERSIONS

The level and composition of labor compensation are the products of worker preferences and the desire of firms to attract and retain quality workers. Changes in the labor market and other economic conditions can alter the equilibrium level of compensation and the characteristics of employee benefits. In recent years, there has been a dramatic shift away from traditional defined benefit plans as many companies have terminated their existing plans and established new defined contribution plans or transform the old defined benefit plans into cash balance plans. We now turn to the impact of plan conversions on real and expected pension benefits and identify the winners and losers in the plan conversion process.

There are two major questions associated with the conversion of pension plans:

1. How is the opening balance in the new accounts for current employees determined?
2. Are current workers, especially senior employees, given an option to continue in the old plan until they retire?

When all workers are given a choice of remaining in the old plan or shifting to the new plan, there typically is little opposition or objection to plan conversions. However, this option implies that the company may have to continue to manage the old plan for as much as 40 years into the future. In actuality, most young workers with relatively few years of experience are likely to opt for the new cash balance plan or a new defined contribution plan because the expected value of participation in these plans will be greater than continued coverage by the traditional defined benefit plan. While relatively few employers have given all workers a choice, many companies have given this option to senior workers who are close to the normal retirement age in the plan. Depending on the age and service requirements associated with this option, companies can avoid most objections to the plan conversion; however, this does require the continued management of the plan for 10 to 20 additional years.

The closeout value from the old defined benefit plan and/or the starting balance in the new pension plan is a crucial component of any plan conversion. Companies can decide if they want to roll the closeout account balance from the old plan into the new plan or start the new account balance at zero. The closeout value from the old pension is the legally accrued benefit as specified in the plan's benefit formula. This is the benefit that would be paid when the worker reaches the normal retirement if she were to quit the company. In the case of a plan termination, this is the

benefit that the firm is legally required to pay the worker at the normal retirement age. Having determined the value of participation in the old defined benefit plan, firms could pay the workers this value or transfer it to individual accounts under the new cash balance or defined contribution plan. The closeout value and the start up amounts are at the heart of workers" views on whether they have been treated fairly.

Some critics of cash balance plans have argued that this form of evaluation imposes significant losses on senior workers and thus, should not be allowed. In effect, the argument is that once a firm establishes a traditional defined benefit pension plan it must guaranty all workers enrolled in this plan the right to remain in that plan until they retire as long as the company retains a defined benefit plan. Interestingly, few analysts question the right of firms to eliminate an existing defined benefit plan without instituting any new plan. Also, there have been few questions raised when companies have terminated a traditional defined benefit plan and established a new defined contribution plan. Why then has the animosity been aimed at almost exclusively at cash balance plans?

In fact, the conversion of a traditional defined benefit plan to a cash balance does impose "potential" losses on senior workers. These losses would occur if that the firm retained the pension plan and the worker stayed with the company until retirement age. Neither of these conditions is a certainty. First, some individuals may choose to quit their current job and move to another firm. In this case, they would receive only the legally required value of their pension. Second, the company could terminate the worker due to adverse economic conditions or for cause. Once again, the worker would likely receive only the legally required benefit (of course, the company could offer a greater benefit through an early retirement plan). Third, the company could terminate the plan and not start a new plan. Here again, the worker would only be guaranteed the legally required benefit. All of these possibilities are legal and all have occurred throughout the American economy during the past three decades. It is important to remember that no company is required to offer a pension and once established, a company has the legal right to terminate the plan provided it pays all vested workers the benefits that they are legally owned.

If workers receive the amount that they are legally guaranteed, why do they feel that they have been treated unfairly? The answer follows from expectations concerning future employment, earnings growth, and the formula under the old defined benefit plan. Workers expectations are a function of the information provided by employers. Many employers may have provided their employees access to benefit calculators that show workers the retirement benefits that they could expect prior to the plan conversion. After a plan conversion, senior workers making the same type of conditional projections of future benefits would find that they can now expect smaller benefits if they remain with the company until retirement. Thus, some senior workers could easily reach the conclusion that they have been mistreated. The potential response by senior employees highlights the need for full and detailed communication with workers during the termination/conversions process.[2] This assessment should also be a warning to companies that still provide traditional defined benefit plans that they should improve their communications to better illustrate retirement benefits conditional on staying with the firm and if the worker were to leave at various ages. Of course, no worker is guaranteed employment until the specified retirement age and there is no promise of a specific rate of earnings growth. Obviously, employment conditions have been changed by the conversion of the pension plan.

Studies by Clark and Schieber (2000, 2002, 2004 forthcoming) have shown that a large majority of workers under age 40 will ultimately have higher total benefits under a new cash balance plan. The primary reason for this is the mobility risk described earlier and the prospect of a plan termination or layoff in the future. In general, the closer workers are to the early retirement age specified in the plan, the more likely they are to be losers after the plan conversion. This is primary reason that most companies have attempted to provide some additional benefits or choice to their senior workers. However, studies have shown that many senior workers also will gain from a transition to a cash balance because of the uncertainty of future employment with their career firm.

A final issue is that much of the potential loss in pension wealth for senior workers in a conversion to a cash balance plan occurs due to the elimination of early retirement subsidies. It should be noted that a company could eliminate these early retirement subsidy by requiring an actuarial reduction of benefits at early retirement. Thus, the existing defined benefit plan could be retained without a subsidized early retirement benefit. Clark and Schieber (2002) have shown that many cash balance conversion impose less severe reductions in benefits than if companies simply eliminated the early retirement subsidy.

DETERMINING WINNERS AND LOSERS IN PLAN CONVERSIONS

Calculating the impact of plans on the lifetime value of retirement benefits for specific workers requires a series of assumptions including: the probability that a worker will remain with the firm until retirement, the probability that the firm will remain in business, the rate of growth of future earnings, the probability that the current pension plan will be terminated at some future date, and the probability that the parameters of the current and/or the new plan will be changed in the future. In addition, we need to know the cost implications of the conversion process including: whether the firm is attempting to reduce its total pension cost or simply altering the distribution of pension benefits and whether the firm is attempting to reduce its total labor costs or restructuring expenditures away from pension contributions while increasing earnings, stock options, or payments to health plans. Another key to understanding the impact of plan conversions on specific workers is whether the company provides transition benefits to some or all of its current workers to offset potential losses in pension wealth.

Clark and Schieber (2002) examined 77 companies that converted traditional defined benefit plans to cash balance plans or another type of hybrid pension plan between 1985 and 2000. They simulated the impact of plan conversions on workers of different ages of first employment, age at the time of the conversion, and level of pay. Their underlying assumption was to assume that the company will remain in business for the working life of their employees, either the old plan would have remain unchanged until all current workers reached retirement or the new plan would remain unchanged during this period, and that earnings growth would be unaffected by changes in the economic climate or by the change in pension plan. They applied age-specific turnover probabilities that reflected the experience of large clients of Watson Wyatt.

The results of Clark and Schieber's analysis indicate that the vast majority of workers who quit or are laid off before age 55 could expect to receive greater benefits under the new cash balance or hybrid plans compared to their continued participation in the traditional defined benefit plans. Workers who remained on the job past age 55 would expect to receive considerably lower benefits under the new plan. Obviously, older workers at the time of the plan transition are more likely to anticipate that they would still be with the company at age 55. Thus, it is senior workers that are most likely to be adversely affected by the transition and most likely to oppose these changes in the employment contract.

It should be noted that Clark and Schieber's analysis focuses solely on the mobility risk associated with these plans and ignored other risks associated with economic fluctuations such as significant declines in the number of workers needed by the company due to adverse economic conditions, future changes in pension characteristics, and the possible termination of the pension plan at some future date. Explicitly modeling these risks would in most cases reduce any projected losses associated with converting a traditional defined benefit plan to a cash balance plan.[3]

While there have been relatively few studies of plan transitions and their impact on actual workers, the basic designs of the plan types have unmistakable implications for current and future workers. Adjusting for mobility risk, most newly hired workers will be better off working for companies with cash balance and defined contribution plans. Among existing employees, senior workers are more likely to be adversely affected while younger workers are likely to gain from plan conversions. Of course, all comparisons depend on the level of generosity that is provided by either the defined benefit plan or the cash balance plan.

The potential impact of plan conversions to cash balance plans or defined contribution plans is well known to both workers and firms. In recognition of this, many companies provide significantly higher benefits to senior workers. Such transition benefits reduce the potential loss in pension wealth associated with the plan conversion and typically, result in many fewer complaints. High quality human resource planning is a key to the plan conversion process.

In response to the second question I raised earlier, policy makers must remember that the pension system is voluntary and employers have many choices. A key concern is what is the appropriate counterfactual if conversions to cash balance plans are not allowed. If cash balance plans are not an option, firms my terminate their defined benefit plans and have no new plan, they might terminate their defined benefit plans and establish a new defined contribution plan, or them may retain the current plan but change the benefit formulas to reduce or eliminate the early retirement subsidies. Would the opponents of cash balance plans prefer one of these options? With this caveat in mind, regulations that are only aimed at preventing cash balance conversions would seem unwise and unlikely to achieve the desired results..

CONCLUSIONS

Employer-sponsored pension plans are an important component of retirement income for many Americans and a significant part of total compensation for many workers. In the U.S., our pension system is voluntary. No company is required to offer a pension plan and no company is required to retain a plan forever. Pension regulations and the accompanying administrative costs alter the pension choices of workers and firms. A policy to preclude the establishment of cash balance plans would restrict pension choices and adversely affect American workers. A policy that would not allow companies to convert traditional defined benefit plans to cash balance plans would likely result in other forms for changes in retirement plans that would have similar effects on pension benefits of senior workers.

Comprehensive analysis of the impact of plan conversions indicates that most workers will have higher lifetime pension benefits in a world of cash balance plans (and defined contribution plans) compared to traditional defined benefit plans. Turnover and the lack of portability is the primary determinant of this finding. Senior workers who are near retirement do face the potential loss in lifetime pension benefits; however, this loss is only realized if the worker remains with the company until the age of early retirement. It should also be remembered that layoffs, plant closings, voluntary quits, firings, and plan terminations have the same impact on senior workers as conversion to cash balance plans. It is unlikely that all of these options will be restricted.

Finally, the primary reason for the loss in pension wealth with plan conversions is the prevalence of early retirement subsidies in current defined benefit plans. In the coming years, it is highly likely that firms will continue to try to eliminate these subsidies as they compete for workers. The aging population and the projected slow growth of the labor force will increase the value of senior workers to the firm. Why pay highly valuable senior workers to leave at relatively young ages only to have to search for new workers? Ending early retirement subsidies is also consistent with our emerging national retirement policies and the need to promote greater labor force participation among older persons.

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ENDNOTES

[1] Some plans have benefit formulas that specify benefits as a dollar amount per year of service. These formulas are most commonly found in plans that are part of collectively bargained contracts.

[2] Communications with workers concerning the reasons for plan changes and the impact of these changes on worker benefits is essential to plan terminations and conversions. Clark,

Haley, and Schieber (2001) and Clark and Munzenmaier (2001) examine the important role of communications in plan conversions.

[3] Samwick and Skinner (2003) focus on the differences in financial market risks and earnings growth risks between defined benefit plans and 401(k) plans. They could that 401(k) plans are preferred to defined benefit plans by all workers, except those with the highest risk aversion.

Table 1 Features of Alternative Employer-Sponsored Retirement Plans

Plan feature	Defined benefit plan	Defined contribution plan	Hybrid plan	Hybrid plan tendency
Employer contributes	Virtually always	Sometimes	Virtually always	DB
Employee contributes	Very rarely	Virtually always	Very rarely	DB
Participation	Automatic	Employee choice	Automatic	DB
Contribution level	Automatic	Employee choice	Automatic	DB
PBGC Insurance	Yes but capped	Not needed	Yes but capped	DB
Early departure penalty	Yes	No	No	DC
Benefits easily portable	No	Yes	Yes	DC
Annual communication	Benefit at end of career	Current balance	Current balance	DC
Retirement incentives	Occur at specific ages	Neutral	Most are neutral	DC
Accrual of benefits	Loaded to career end	Level over career	Level or back loaded	Mixed
Financial market risks	Employer bears	Employee bears	Shared	Mixed
Longevity insurance	Typically yes	Typically no	Not often taken	Mixed

Source: Robert Clark, John Haley, and Sylvester Schieber, "Adopting Hybrid Pension Plans," *Benefits Quarterly* First Quarter 2001.

Chairman BOEHNER. Mr. Hill.

STATEMENT OF ROBERT F. HILL, ESQ., PARTNER, HILL & ROBBINS, DENVER, COLORADO

Mr. HILL. Good morning, Mr. Chairman and distinguished Members of the Committee. Thank you for the invitation to share my views regarding cash balance plans. I am an attorney in private practice in Denver, Colorado, with the law firm of Hill & Robbins, and we represent employees in cases involving cash balance plans.

The adverse impact that cash balance plans have had on older employees has been well documented. I won't repeat that. But I will say that that only begins to tell the story of the hardship that cash balance plans have imposed on those older workers. All too often the cash balance plan arrives long after these employees have made employment retirement and saving decisions based on the promise of a traditional defined benefit plan, leaving them absolutely no practical ability to make that up in their remaining working years.

Equally egregious, older workers often experience what is referred to as wear-away, which means that even though they continue working for their long established employer, they do not continue to generate additional retirement or pension benefits.

The title of this session today I think is well chosen, separating myth from fact, and I have found that a challenge as I have approached this issue from the outside and tried to become acquainted with it. Cash balance advocates frequently suggest that

employers are motivated by the increased, quote, mobility, closed quote, in the workforce. But the facts indicate otherwise. All available studies indicate that baby boomers have been staying on the job as long as or longer than their parents and grandparents when you look at people in the same age. There is also, I have found, a public and a private face when you try to understand what the pension consultants have been recommending to employers in this arena, and this Committee to properly legislate needs to go behind the public veneer.

Thus, while cash balance advocates publicly contend that cost savings is not a significant factor in the rise of cash balance plans, in private and professional society meetings and other organizational meetings such as this they acknowledge that cash balance plans would hardly exist at all if it weren't for cost savings. While they also publicly cite the need for competitiveness in private they acknowledge that although combativeness sounds important, it is rarely an issue in the decisionmaking process. In private, these same cash balance advocates concede that conversions are often used to camouflage or mask, and those are quotes, a benefit cutback or to remove early retirement subsidies.

Even the most aggressive of these proponents concede that in the early days many benefit consultants panned cash balance plans as a gimmick and contended that they couldn't satisfy the rules. There has been talk about clarification. The law is as Congress has pronounced it, and the law is the same as it has been for a long time. For example, following a meeting of what later became known as the Cash Balance Practitioners Group, attendees, which included representatives from four large pension consulting firms and two major law firms, circulated a memorandum. I remind you this is in 1990. They circulated a memorandum acknowledging that, quote, it is well known that a cash balance plan is at risk under a little reading of the age discrimination laws. For that reason the group focused on the need for a, quote, legislative fix, closed quote, a prospect that the group did not view with optimism.

In 1996 and in 1997 warning signs became dramatically clear regarding the age discrimination issues raised by cash balance plans. These came from the Treasury Department notice. They came from the filing of employee lawsuits. They came from a letter from an Internal Revenue district office indicating that a proposed cash balance plan was age discriminatory because the, quote, benefit accrual rate decreases as a participant attains each additional year of age, closed quote.

Despite those warning signs, the number of employees covered by cash balance plans more than quintupled from 1997 to 2000, and I would suggest that against that background it is impossible to suggest that most employers entered into these conversions ignorant of the risks that cash balance plans violated the age discrimination laws.

While I would suggest that in addition to the well-documented cost savings and the desire of many employers to use the conversions to mask benefit cutbacks, it now appears that many of the cash balance plans were motivated by accounting rules that allow publicly held companies to use cash balance plans to present a

more attractive financial picture to the investing public, something sometimes referred to as accounting gimmicks.

I would comment that William Sweetnam, then a member of the Senate Finance Committee staff and now Treasury Department Tax Benefit Council, acknowledged in 1998 that, quote, the primary reason cash balance plans are financially advantageous is the accounting treatments of all cash balance plans versus final average earnings plans. The reason that cash balance plans are better is that they make the corporation's financial statement look better since pension liabilities are less, closed quote.

To understand and deal with cash pension plans you need to understand both the public and the private face. You need to separate myth from fact. I thank you for giving us an opportunity to share our views on that the subject.

[The prepared statement of Mr. Hill follows:]

Statement of Robert F. Hill, Esq., Partner, Hill & Robbins, Denver, CO

Mr. Chairman and distinguished Members of the Committee:

I am an attorney in private practice in Denver, Colorado with the law firm of Hill & Robbins, P.C. Our law firm has represented employees in several law suits challenging the legality of conversions from traditional defined benefit plans to cash balance plans. These cases include the IBM Pension Litigation in the United States District Court for the Southern District of Illinois in which Chief Judge Murphy entered an order last year finding that IBM's cash balance formula violated ERISA's age discrimination rules.

The adverse impact cash balance plans have on long-term older employees has been well documented. Even cash balance supporters have acknowledged that "it is not unusual in some cash balance conversions for the 40 to 50 year old employee to lose one-third to as much as one-half of his expected pension." [1]

The dramatic reduction in benefits for older workers created by the adoption of a cash balance plan was confirmed by a detailed report submitted to this Committee by the General Accounting Office in September 2002. Under the model of a typical conversion used for the GAO study,

> a 45-year old worker at the time of conversion receives an annual annuity of about $18,500 at retirement from the cash balance plan instead of the $39,800 annuity the worker could have received from the defined benefit plan with a final average pay formula. Likewise, a worker 50 years old at conversion receives an annual annuity of about $17,800 from the cash balance plan rather than the $35,100 annuity the final average pay formula would have provided.[2]

But that only begins to tell the story of the hardship that cash balance plans impose on older workers. These are employees who have labored long and hard for an employer based on the promise of benefits under a traditional defined benefit plan where the value of benefits increase significantly in the later years of their career. Suddenly, after decades on the job, the promise of increasing age 65 benefits based on years of service and final pay is withdrawn and replaced by a benefit formula that benefits younger workers at the expense of older workers. A chart included in the GAO report illustrates this phenomenon:

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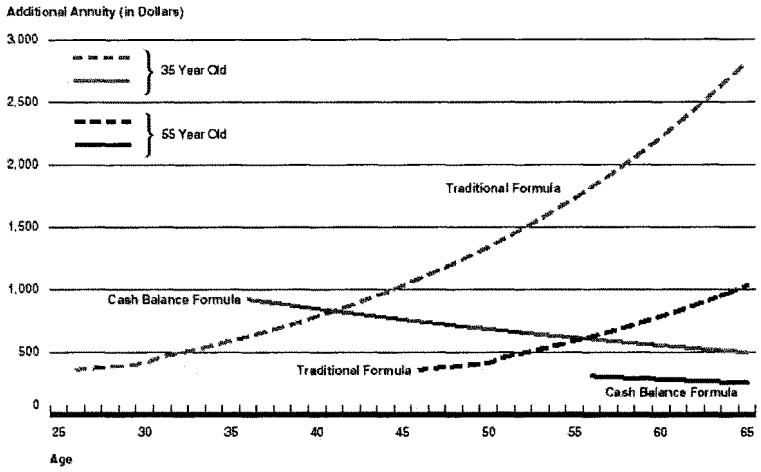
[1] Shapiro & Rachal, Litigation Issues in Cash Balance Plans, Benefits Link, (1999), http://benefitslink.com/articles/cashbalance.html .

[2] U.S. General Accounting Office, PRIVATE PENSIONS—Implications of Conversions to Cash Balance Plans, GAO/HEHS–00–185, at 24–25 (Sept. 2000) (hereinafter "GAO Report") http://www.gao.gov/new.items/he00185.pdf

Figure 5: Incremental Benefit Accruals for Workers of Different Ages Under Different Formulas



Note: Model results are based on the assumption of $40,000 salary and 10-year tenure at conversion for both the 35-year-old and the 55-year-old worker at conversion. See additional assumptions in app. II.

As shown, due to the conversion, older workers, generally those over age 40, end up with the worst of both worlds.

The findings in an ERISA Advisory Group study submitted to the Department of Labor in 1999 aptly describes this problem:

> When a pension plan is converted to a plan design that gives lower benefit accruals to older, longer-service employees, without appropriate transition protections there is a takeaway—a loss of expected future benefits—which is felt much more sharply than if the employer were simply adding a new benefit that tended to offer more to younger employees.
>
> The loss that older employees experience in some cash balance conversions is especially profound in companies that had previously invested the most in promoting their traditional pension plan to employees as a valuable component of the employees" compensation, encouraging employees to build careers in reliance on what they viewed as a retirement income promise.[3]

As that same study recognized, all too often the cash balance plan comes at a time in the employees" lives when they have long ago made employment, retirement and savings decisions based on the promise of a traditional defined benefit plan only to find their reasonable expectations dashed with no practical ability to make up for that loss in their remaining working years.

Some cash balance proponents point to "grandfathering" and other types of transition relief as a means to address this problem. However a study of actual cash balance conversions conducted by the actuarial firm Towers & Perrin determined that in over one-third of the conversions the employers provided no grandfathering or other form of transition benefit.[4] And even when transition relief is provided for some workers, the vast bulk of conversions leave many adversely impacted workers unprotected.

Equally egregious, in many conversions older workers experience what is referred to as "wearaway," which means that even though they continue working they earn no additional pension benefits until the amount in their cash balance plan reaches the amount they had already earned under their traditional defined benefit plan. The GAO found that the amount of wearaway any employee experiences is tied directly to age, with older workers suffering the longest periods of wearaway, some-

[3] U.S. Dept. of Labor, Report of the Working Group Studying the Trend in the Defined Benefit Market to Hybrid Plans, Findings 3(a) and 3(c) (November 10, 1999, http://www.efast.dol.gov/ebsa/publications/cbalinfo.htm). (hereinafter "Working Group Study").

[4] Arcady & Mellors, Cash Balance Conversions, JOURNAL OF ACCOUNTANCY, February 2000, http://www.aicpa.org/pubs/jofa/feb2000/arcady.htm.

time many years. For example, a typical conversion scenario "generated a 2-year lump sum wearaway for a 35-year old worker, a 4-year wearaway for a 45-year old worker, and an 11-year wearaway for a 55-year old worker at conversion."[5] In such an instance, shockingly, the 55-year old would earn no additional pension benefit before reaching normal retirement age.

During the past seven years, a significant number of employers have converted from traditional defined benefit plans to cash balance plans—thereby adversely impacting millions of older workers in the ways described by the GAO Report. We are before the Committee today because employers and employer related groups want Congress to provide exemptions for cash balance plans from the current law that applies to defined benefit plans, including the present prohibition against age discrimination.

Cash balance plans have often been described as "a defined benefit plan masquerading as a defined contribution" plan.[6] While no one disputes that cash balance plans are defined benefit plans, cash balance proponents essentially want the best of both worlds—they want to avoid the income and excise taxes that a change from a defined benefit plan to a defined contribution plan would entail and to retain the funding flexibility of the defined benefit plan, but they also want cash balance plans treated as defined contribution plans for purposes of the ERISA vesting and age discrimination rules.

However Congress has enacted very specific and very different legal frameworks for defined benefit plans and defined contribution plans. These rules were designed with a recognition that taxpayers pay hundreds of millions of dollars to subsidize the private tax-qualified pension system—to assure that employees were treated fairly and to avoid abusive practices that undermine the promises made to employees and the employees" reasonable expectations. The Joint Committee on Taxation has estimated that in 2004 taxpayers will pay about $89 billion in foregone taxes to subsidize the private tax-qualified pension system.[7] It is only right and proper that Congress assure that the taxpayers" monies provide a system that is fair to all workers, including older workers.

Cash balance plans are the very creative invention of a handful of professional consultants who sell their services to employers. While these proponents have publicly advanced a number of lofty motivations for the conversion of traditional plans to cash balance plans, none of their claims justify the harm cash balance plans have imposed on older workers.

Cash balance advocates frequently suggest that employers are motivated to adopt cash balance plans by the increased "mobility" in the workforce. The facts indicate otherwise. Indeed, a prominent cash balance proponent has acknowledged that baby boomers "have been staying on the job longer, actually, than their parents and grandparents."[8] Similarly, a study conducted in 1998 by the Watson Wyatt actuarial firm concluded that this phenomenon applied as well to younger workers, age 25 to 34, who in 1996 spent a considerably longer time, on average, with one employer than did workers in that same age group in the 1950's.[9]

Some employers and actuaries also publicly cite the need for competitiveness as a reason for cash balance plans. However in private they acknowledge that although competitiveness sounds important, it is rarely a real issue in the decision making process.[10]

The more likely reason for many conversions, as many cash balance advocates concede, is that conversions are often used to disguise a cutback in benefits. In 1986, when cash balance plans first began to receive attention, Eric Lofgren, an actuary with Watson Wyatt, outlined for a conference of actuaries that a primary objective of conversion to a cash balance plan was to "to camouflage a benefit cutback, or remove early retirement subsidies."[11] Similarly, an actuary with Towers Perrin told a conference of actuaries that "the way the plan is presented to employees looks so dramatically different than the defined benefit plan that the employees are used

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[5] GAO Report, at 28.

[6] Remarks of Eric Lofgren, Vol 12. No 1 Report of the Society of Actuaries, at 419 (1986)(hereinafter "Lofgren 1986")(copy attached).

[7] Joint Committee on Taxation, Estimates of Federal Tax Expenditures for fiscal years 2000–2004 p. 23, JCS–13–99, December 22, 1999) http://frwebgate.access.gpo.gov/cgi-bin/getdoc.cgi?dbname=1999—joint—committee—on—taxation&docid=f:54622.pdf.

[8] Remarks of Eric Lofgren, New York Annual Meeting of Society of Actuaries, October 18–21, 1998, reported at p.14, Record of Society of Actuaries, Vol. 24, No. 3 (hereinafter "Lofgren 1998") (copy attached).

[9] Workforce Management: The Cultural Shift, Watson Wyatt Insider, Vol. 8, Issue 8, (August 1998).

[10] Lofgren 1998 at 10—11.

[11] Lofgren 1986 at 419.

to that, and the change can be used to mask a benefit cutback."[12] This advantage was still being touted in 1998, when an actuary with PriceWaterhouse–Coopers noted to the annual meeting of the Society of Actuaries that "converting to a cash balance plan does have an advantage of it masks a lot of the changes."[13]

Mr. Lofgren candidly noted that a company converting to a cash balance plan could use two very different definitions to announce the same new cash balance plan. The upbeat version most commonly used to announce a conversion optimistically touts the purported virtues of a cash balance plan, describing it as "an exciting, modern, flexible new plan design with the advantages of both defined benefit and defined contribution." He also proposed what he described as an equally accurate, but more candid, definition:

> "Dear Employee: We've got for you a cash balance pension plan. It's our way to disguise the cutbacks in your benefits. First we're going to change it to career average. We'll express the benefits as lump sum so we can highlight the use of the CPI, a sub-market interest rate. What money is left in the plan will be directed towards employees who leave after just a few years. Just to make sure, we'll reduce early retirement subsidies."[14]

While cash balance advocates publicly contend that cost savings are not a significant factor in the rise of cash balance plans, in private they consistently acknowledge that "cash balance plans would hardly exist at all if it weren't for cost."[15] Most employers with an existing, overfunded, defined benefit plan who want to cut pension costs by moving to a defined contribution model are not willing to pay the cost of terminating the defined benefit plan, which arises primarily from the excise tax payable on the surplus, and then creating a defined contribution plan. A 2002 empirical study of cash balance conversions concluded that:

> If instead the firm converts to a cash balance plan, it can use all of the excess pension assets to fund future benefits. Therefore, among firms that plan to switch from a traditional defined benefit plan to a defined contribution-type plan, the likelihood of choosing a cash balance plan increases with the plan's overfunding.[16]

Employers seek to avoid this tax by creating a cash balance plan instead, which has the advantage of both looking to employees like a defined contribution plan and at the same time allowing the employer to cut their benefit obligations and use the plan surplus to forestall the need to make future plan contributions.[17]

As an additional justification for asking Congress to exempt cash balance plans from defined benefit law, including the prohibition against age discrimination, proponents currently contend that hundreds of employers have adopted such plans, in the good-faith belief that they complied with existing law. According to this argument, "fairness" to the expectations of employers requires special treatment for cash balance plans, regardless of any resulting unfairness to older workers who expected to earn most of their benefits in their later years under the traditional plans in place for decades.

No such unfairness to employers exists. Even the most aggressive cash balance proponents have conceded that in the early days of cash balance plans, many benefits consultants panned cash balance plans as a gimmick and argued that they couldn't satisfy the rules.[18]

For example, following a 1990 meeting of what later became known as the Cash Balance Practitioner's Group, attendees—which included representatives from four large pension consulting firms and two major law firms—circulated a memorandum acknowledging that "it is well known that a [cash balance] plan is at risk under a literal reading of" the age discrimination laws.[19] The Practitioners Group memorandum acknowledged that the practitioners had "heard representatives of the [Internal Revenue] Service express concern that because the benefits under cash balance plans are frontloaded, such plans may violate a literal reading of" the age dis-

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[12] Remarks of Gary Hallenback, 1986 Conference of Consulting Actuaries, quoted in Ward, Eating their Words, Plan Sponsor Magazine (March, 2000). http://www.plansponsor.com/magazine—type1/?RECORD—ID=13766

[13] Remarks of William Torrie, 1998 Society of Actuaries Annual Meeting, quoted in Ward, Eating their Words, Plan Sponsor Magazine (March, 2000)

[14] Lofgren 1986 at 419.

[15] Lofgren 1998 at 10.

[16] Niehaus & Yu, Cash Balance Conversions: Evidence of the Excise Tax Avoidance Hypothesis, (2002) http://www.cba.uri.edu/tong/cash-balance.pdf

[17] Working Group Study.

[18] Comments of Richard Shea, 1999 Enrolled Actuaries Meeting, Session 605: Cash Balance Plans—Current Issues (March 14–17, 1999) (copy attached).

[19] October 23, '1990 Letter from Hugh Forcier regarding Cash Balance Memorandum, at p. 2(copy attached).

crimination laws.[20] In addition, the Report noted that a "number of practitioners believe that there is a very significant risk that the Service will ultimately take the view that it cannot avoid a literal interpretation of the statute."[21] For that reason, the group focused on the need for a "legislative fix a prospect that the group did not view with great optimism. Finally, the practitioners warned that, absent a legislative change, "the potential employer exposure is extremely high—potentially increasing the plan liabilities four or five times."[22]

Despite these legal concerns, and despite the failure of proponents to obtain legislation exempting cash balance plans from the age discrimination laws applicable to all defined benefit plans, a few employers went forward with conversions from traditional plans to cash balance plans in the early 1990's. However, according to a Department of Labor survey, even by 1996–97 only 4% of U. S. workers covered by a defined benefit plan were participants in cash balance plans.[23]

It was only after 1997 that the dramatic increase in the adoption of cash balance plans took place—and the resulting adverse impact on millions of older workers. Employers, eager to exploit the pension fund surpluses created by the booming stock market, rushed to adopt them, despite both the much earlier recognition of their risk and further warning signs that arose in 1996 and 1997. On January 18, 1996, the Treasury Department issued Notice 96–8, which clearly indicated that cash balance plans were subject to the same benefit accrual rules applicable to all defined benefit plans.[24] Also in 1996, the first employee lawsuit challenging age discrimination in cash balance plans was filed: a second was filed in May of 1997. In July of 1997, an Internal Revenue District Office concluded that a proposed cash balance plan violated the age discrimination prohibitions of the Internal Revenue Code because the "benefit accrual rate decreases as a participant attains each additional year of age."[25]

In spite of all of these warning signs, the number of employees covered by cash balance plans more than quintupled between 1997 and 2000, from 4% to 23%.[26] Against this background, it is impossible for the vast bulk of employers to credibly claim that they adopted cash balance plans ignorant of the risks that they violated the age discrimination laws.

Clearly there had to be powerful factors motivating this dramatic increase in the adoption of cash balance plans in the late 1990's. In addition to the well documented cost savings and the desire of many employers to use the conversions to mask benefits cutbacks to older workers, it now appears that many of these conversions were either primarily or incidentally motivated by accounting rules that allow publicly held corporations to use cash balance conversions to further inflate surpluses and generate "pension income," thereby presenting a more attractive financial picture to the investing public. As one consulting actuary puts it: "Pension funds are becoming a major profit center."[27]

Because of the way opening account balances are determined in a conversion from a traditional defined benefit plan to a cash balance plan, the conversion typically reduces the plan's Projected Benefit Obligation. Under the financial accounting standards in FASB Statement No. 87, the effect of this type of "negative amendment" can be spread out over several years, which reduces the plan's annual benefit cost for financial statement purposes in those years. Thus, as Mark Beilke, the current Chairman of the Academy of Actuaries Pension Accounting Committee, recently observed, "gains [from cash balance conversions are] mostly derived from "accounting gimmicks."[28]

Employers and their advisors have long privately acknowledged the powerful motivation these accounting devices have provided to fuel the increased number of conversions. William Sweetnam, then a member of the Senate Finance Committee staff

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[20] Memorandum, Cash Balance Plans: Compliance with the "qualification" requirements of the Internal Revenue Code of 1986, as amended, at 24 (Oct. 23, 1990) (copy attached).

[21] Id.

[22] Id.

[23] U.S. Bureau of Labor Statistics, Employee Benefits in Medium and Large Private Establishments in 1997, p. 103. http://www.bls.gov/ncs/ebs/sp/ebbl0017.pdf

[24] www.irs.ustreas.gov/pub/irs-irbs/irb96–06.pdf

[25] Letter from Andrew J. Fedders, IRS Cincinnati District Office, Government's Position, No. 1 (July 28, 1997) ("The plan does not satisfy the clear and straightforward requirement of section 411(b)(1)(H) of the Code because the plan's benefit accrual rate decreases as a participant attains each additional year of age.") (copy attached).

[26] U.S. Bureau of Labor Statistics, National Compensation Survey: Employee Benefits in Private Industry in the United States, 2000, p. 58. http://www.bls.gov/ncs/ebs/sp/ebbl0019.pdf

[27] Pesek, Hidden Asset: For Many Companies, Pension Plans Are Bolstering Profits, BARRON'S (May 27, 2000)(quoting Adam Reese, Towers Perrin).

[28] Comments posted as "MGB" on Benefits Link Cash Balance Discussion Forum, May 13, 2003. http://benefitslink.com/boards/index.php?act=Print&client=printer&f=22&t=19682

and now Treasury Department Tax Benefits Counsel, acknowledged in 1998 that the

> "primary reason cash balance plans are financially advantageous is the accounting treatment of cash balance plans versus final average earnings plans . . . With final average earnings plan [sic], you must book as a liability on your financial statements the value of pension benefit assuming future earning growth for participant's benefit. With a cash balance plan, you don't have to include future earnings growth you only have to book your current liability for account balances. This reduces the liability in all circumstances—even if the plan grandfathers the old final average earnings benefit for older workers. So the reason that cash balance plans are better is that they make the corporations [sic] financial statement look better since pension liabilities are less." [29]

This accounting treatment of cash balance conversions can create substantial increases in a company's reported income—increases that compound the already misleading impressions that can arise from the inclusion of "phantom" pension income as part of a company's bottom line.[30] In 1999, an accounting expert at Bear Stearns, conducted a study showing that 25% of the companies in the Standard & Poor's 500-stock index reported pension income in 1998, that overall pension income accounted for 3% of 1998 operating income of the companies overall, and that for 15 of those companies pension income represented 10% or more of their total operating income for the year.[31]

While the debate over the motivations of employers to implement cash balance plans in the absence of clear legal authorization will no doubt continue, there is no debate regarding the dramatic and adverse impact of these plans on older workers. It punishes—in some cases brutally and without the ability to recover older workers who have worked for a company for decades based on an unequivocal promise of an increasing age 65 retirement benefit determined by reference to years of service and higher income in their later years.

Equally importantly, cash balance plans often come long after these employees made irreversible decisions regarding employment and savings based on their understandable reliance on their employers" promises only to have them suddenly dashed by the announcement of a change to a newly created pension scheme—the cash balance plan.

That is precisely the kind of abuse of the American work force that our pension laws were intended to prohibit. And it is even more unacceptable when the adverse impacts are due to discrimination based on age.

As the Committee considers any possible legislation addressing the legal issues raised by cash balance plans, I strongly encourage you to keep the need to protect these loyal, long-term older workers in the forefront. At their age and position these abrupt and unfair changes often dramatically and irreversibly adversely impact their remaining years.

These employees are the backbone of our nation's economic engine and they deserve far better and fairer treatment. Congress should continue to assure that if taxpayers are to subsidize the private pension system, employers must treat their workers fairly and without discrimination based on age.

Chairman BOEHNER. Ms. Pfotenhauer.

STATEMENT OF NANCY M. PFOTENHAUER, PRESIDENT, INDEPENDENT WOMEN'S FORUM, WASHINGTON, D.C.

Ms. PFOTENHAUER. Thank you, Mr. Chairman and distinguished Members of the Committee. I am grateful to have the opportunity to appear here today. As the Chairman said, my name is Nancy

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[29] E-mail from "Bill" Sweetnam dated 12–22–98(copy attached); See also, Actuarial Aspects of Cash Balance Plans, Society of Actuaries Conference (July 07, 2000) http://www.soa.org/ccm/cms-service/stream/asset?asset—id=1052150.

[30] Warren Buffet has described the growing practice by some companies of creating "phantom" pension income to inflate reported income as a misrepresentation that "dwarfs the lies of Enron and WorldCom." Buffet, Who Really Cooks the Books?, New York Times, Section A, Page 19 (July 24, 2002).

[31] Singh, Feathering the Nest Egg, CFO Magazine (October 1, 2000) http://www.cfo.com:8080/article/1%2C5309%2C1006/8/A/7/7%2C00.html ; McGough & Schultz, How Pension Surpluses Lift Companies' Profits, Wall Street Journal (September 21, 1999) http://acct.tamu.edu/loudder/private/647—Readings/How%20Pension%20Surpluses.htm ;

Mitchell Pfotenhauer, and I am president of IWF. However, my background is in the field of economics. I have served as Economic Counsel to a former Member of the Senate Republican leadership who sat on the Budget and Banking and Finance Committees. I have also served as Chief Economist as the cabinet level regulatory review body.

As you probably know, the labor force participation rates of women, unlike men, have been increasing across all age groups. This comes as no surprise to us and probably no surprise to the Committee. The Bureau of Census and the Bureau of Labor Statistics simply provide the quantitative evidence of what we have observed in American society. Simply put, more women are working more often while balancing the pressures of home and family, often taking time out of the workforce to care for children and for elderly parents.

Why has IWF got even into this debate over pension policy? Because the national poverty rate for women 65 and older is almost twice that of men. The average age of widowhood in the United States is 56 years old. Fully 80 percent of widows now living in poverty weren't poor when their husbands were alive. The likelihood of poverty increases with age, particularly for minority women.

Right now several specific factors drive the discrepancy between men and women in their later years. First and perhaps most importantly, we live longer. To put it bluntly we may outlive our savings. The average life expectancy at 60 years of age for women is 83 and for men it is 78.

Perhaps most relevant for this discussion, however, is the fact that women change jobs more frequently than men. We average 4.8 years with each employer and, therefore, may not stay on the job long enough to be vested in traditional retirement plans. Because women are more likely to leave the job market to handle family responsibilities, we average 11.5 years out of the workforce compared to 1.3 years for men. With our earning record interrupted we not only lose the opportunity to vest but we have fewer years in which to contribute to retirement plans.

Traditional retirement and pension approaches simply fail to meet the needs of our changing society. Succinctly, they do not reflect the work patterns and demographics of American women. Luckily, pension innovations in the private sector hold promise. Cash balance pension equity and other hybrid pension plans combine attractive features of a traditional defined benefit plan with attractive features of a defined contribution plan. These modernized arrangements have evolved to suit today's more mobile workforce and to respond to employee preferences for transparency, portability and accrual of a more meaningful benefit earlier in one's career.

We believe the emergence of hybrid plans is encouraging news for many, but is a cause for particular hope for women. In fact, one benchmark study done in 1998 by the Society of Actuaries found that an amazing 77 percent of women do better under a cash balance system. They are better off under the system because they move in and out of the workforce in order to balance family needs and because they cannot afford to retire early.

Despite this promise it is clear that controversy exists about how firms should transition to hybrid plans, and many have questioned the fairness of changing pension approaches for employees over 40 years of age. An alternative perspective, and one that we believe has credence, is that any adoption of restrictions that effectively limit the abilities of companies to transition to hybrid plans places the financial well-being of the relatively few employees who have the luxury of staying with one company for a long period of time, usually decades, have the luxury of taking early retirement, and have the luxury of taking their pension benefit in the form of an annuity rather than a lump sum, ahead of all the employees who do not have these options.

So regardless of one's perspective, any discussion about transition is appropriately done within the context of a clear understanding that these plans are voluntarily sponsored by employers. As such, an employer currently could decide to freeze benefit accruals or completely terminate plans altogether if costs become too burdensome, and experience has shown us that many more plans have fallen victim to this fate over the past decade than have transitioned to hybrid plans.

The problem before this Committee is complex and worthy of an objective analysis that is focused on providing a solution that fits the changing nature of America's economy and workforce. The Independent Women's Forum believes that portability is a real and growing need as we look to the future of working women in this country. As such, we strongly urge Congress to act in the manner that recognizes the attributes of new approaches like the cash balance and other hybrid plans and keeps in mind that the one law that cannot be amended is the law of unintended consequences.

Thank you.

[The prepared statement of Ms. Pfotenhauer follows:]

Statement of Nancy M. Pfotenhauer, President, Independent Women's Forum, Washington, DC

Mr. Chairman and distinguished members of the Committee, thank you very much for the opportunity to be here today. My name is Nancy Mitchell Pfotenhauer and I am president of the Independent Women's Forum. IWF is a non-profit, non-partisan public policy organization that focuses on issues of importance to women.

To give you some context, our organization was founded more than a decade ago, and counts among its National Advisory Board women who have served at the highest levels in federal office. In fact, Department of Labor Secretary Elaine Chao, Undersecretary of State Paula Dobriansky, and Assistant Attorney General for Tax Policy Eileen O Connor have all served on our National Advisory Board. Our Board of Directors and Advisors have run divisions of OMB, the Treasury Department, and chaired and served on several independent regulatory agencies.

I personally have served as Economic Counsel to a member of the Senate Leadership who sat on the Budget, Banking and Finance Committees. Subsequent to that, I was the Chief Economist of a Cabinet-level regulatory review body. After serving time as Director of the Washington office of a $48 billion diversified energy company, I transitioned from IWF's Board of Directors into my current position.

Let me begin by explaining what IWF is not. It is not a grassroots organization focused on mobilizing large numbers of our fellow citizens. Rather we are a group whose members are legal scholars, economists, academicians, historians and foreign policy experts who hope to apply our professional experience to impact the formulation of public policy. As such, again let me thank you for the opportunity to appear before this committee and participate in a candid and constructive discussion concerning cash balance pension plans.

As you probably know, the labor force participation rates of women—unlike men—have been increasing across age groups. Women in the 45- to 54- age group saw the

greatest jump in their participation during the 1980–90 timeframe, clocking in with an increase of almost 11 percent. This same cohort again saw the greatest increase in participation in the 1990–2000 (when they were aged 55–64). It is important to note, however, that for the 2000–2010 period, this group will lose their title to a group of younger women aged 25–34.

This comes as no surprise to the Independent Women's Forum—and probably no surprise to this committee. The combined work of the Bureau of Census and the Bureau of Labor Statistics simply provides the quantitative evidence of what we have all observed in American society. Simply put, more women are working more often while still balancing the pressures of home and family.

And, by and large, this is a truly positive indication of the tremendous progress women have made in our country. Presently, women earn the majority of the undergraduate degrees, the majority of master's degrees and—within the next decade—are expected to earn the majority of Ph.Ds. Right now, young women comprise roughly sixty percent of the students attending law school here in the United States.

So, the upside of this story is that women are achieving educational and professional goals only dreamed of in other countries. The challenge from a retirement security standpoint, however, is that we refuse to compromise our roles as mothers and caregivers on the altar of professional accolades. Specifically, women still tend to take time out of the workforce in much greater numbers than men in order to care for young children or elderly members of our family. Having five children between the ages of 10 and 16, this particular point really strikes home with me.

Why has IWF gotten involved in this debate over pension policy? Because the national poverty rate for women 65 and older is almost twice that of men. The average age of widowhood in the United States is 56; fully eighty percent (80%) of widows now living in poverty weren't poor when their husbands were alive. The likelihood of poverty increases with age, particularly for minority women. The gap between Social Security benefits for women and men is slowly narrowing, but the difference between pension benefits is increasing rapidly.

What is driving this phenomenon? We fundamentally reject the notion that our current systems were somehow designed to be biased against women. In fact, historical records reveal that the social security system was, if anything, originally designed to benefit women. Unfortunately, through no ill-intent, the framers of that system failed to accurately predict societal trends and future workforce demographics.

Right now, several specific factors drive the discrepancy between men and women in their later years. First, and perhaps most importantly, women live longer then men. To put it bluntly, we may outlive our savings. The average life expectancy at 60 years of age for women is 83 and for men is78. By 2050, five percent of the baby-boomer population will be more than 100.

Despite our relative longevity, or perhaps because of it, women tend to have more chronic health problems than men, resulting in higher health care costs during retirement. And, if a woman hasn't seen her financial health plummet because her husband died, she's likely to be hit hard through a divorce. Statistics have shown that immediately following divorce, women 50 and older experience a 39 percent decline in income, whereas men's incomes fall only 14 percent. One year after divorce, fully 40 percent of men have regained their pre-divorce incomes; about half that percentage (21) of women have climbed back.

Perhaps most relevant for this discussion, however, is the fact that women change jobs more often then men. We average 4.8 years with each employer and, therefore, may not stay at a job long enough to be vested in traditional retirement plans. Because women are more likely to leave the job market to handle family responsibilities, we average 11.5 years out of the workforce compared to 1.3 years for men. With our earning record interrupted, we not only lose the opportunity to vest, but we have fewer years in which to contribute to retirement plans.

In the opinion of the Independent Women's Forum, traditional retirement and pension approaches simply fail to meet the needs of our changing society. Succinctly, they do not reflect the work patterns and demographics of American women. Whether it's the Wall Street Journal or Family Circle magazine, today's commentators agree that movement in and out of the workforce for American mothers has become the "new normal." In fact, many are noting a current trend of mothers going back home when their children become teenagers. In earlier times, moms simply stayed home when their children were young—now we're worried about the lack of oversight of our teenage children in an increasingly complex culture. Regardless of the reason, this phenomenon, called "sequencing," appears here to stay.

Luckily, pension innovations in the private sector hold promise. Cash balance, pension equity and other hybrid pension plans combine attractive features of a traditional defined benefit plan (employer funding, employer assumption of risk of poor

investment, government insurance and spousal protections) with attractive features of a defined contribution plan (individual accounts, an easily understood benefit formula and portability).

These modernized pension arrangements have evolved to suit today's more mobile workforce and respond to employee preferences for transparency, portability and the accrual of more meaningful benefits earlier in a career.

As you know, unlike traditional defined benefit plans where a significant portion of the benefits go to the relatively few workers with very long service, benefits in so-called hybrid plans grow more evenly over a worker's career and are distributed more equitably across short-, medium-, and long-service workers. For the vast majority of employees who no longer spend a full career with one employer, a hybrid plan will produce higher benefit levels than a traditional benefit plan at equal cost.

We believe the emergence of hybrid plans is encouraging news for many and a cause for particular hope among women. In fact, one benchmark study done in 1998 by the Society of Actuaries found that an amazing 77% of women do better under a cash balance approach. They are better off under a cash balance system because they move in and out of the workforce in order to balance family needs and because they cannot afford to take early retirement [1]. Despite this promise, it is clear that controversy exists about how firms should transition to hybrid plans. Many have questioned the fairness of changing pension approaches for employees over 40 years of age.

An alternative perspective, and one that IWF believes has credence, is that any adoption of restrictions that effectively limit the ability of companies to transition to hybrid plans places the financial well-being of the relatively few employees who have had the luxury of staying with one company for a long period of time (decades), have the luxury of taking early retirement, and have the luxury of taking their pension benefit in the form of an annuity rather than as a lump sum, ahead of all of the employees who do not have these options.

Regardless of one's perspective, any discussion about transition is appropriately done within the context of a clear understanding that these plans are voluntarily sponsored by employers. As such, an employer currently could decide to freeze benefit accruals or completely terminate plans altogether if costs become too burdensome. Experience has shown us that many more plans have fallen victim to this fate over the past decade than have transitioned to hybrid plans.

As such, an overarching concern we have in making these new approaches viable is that Congress avoid the seductive panacea of mandating choice between traditional defined benefit and cash balance plans. Unfortunately, some analysts believe that mandating choice in such a manner could result in employees being faced with a "worst of both worlds" situation. Specifically, employers could make changes to their traditional plans that remove aspects most valued by some of their employees, while ironically being constrained from offering the off-setting attributes of a cash balance plan.

As pointed out by pension experts Olivia Mitchell and Janemarie Mulvey at the University of Pennsylvania's Wharton School, under an approach that mandates choice in circumstances when an employer seeks to convert to a hybrid plan (but not other changes), an employer could eliminate early retirement subsidies without providing choice, but the employer "could not at the same time provide the more portable and more understandable cash balance benefit without offering employees a choice to keep early retirement subsidies." [2]

Obviously the solution does not rest in mandating choice for every plan change. To do so would only facilitate the death of the defined benefit system—a system which offers noted attributes in the form of employer contributions and employer assumption of risk.

The problem before this committee is complex and worthy of objective analysis focused on providing a solution that fits the changing nature of America's economy and workforce. The Independent Women's Forum believes that portability is a real and growing need as we look to the future of working women in this country. As such, we strongly urge Congress to act in a manner that recognizes the attributes of new approaches like the cash balance and other hybrid plans, and keeps in mind that the one law that cannot be amended is the law of unintended consequences.

Thank you again for your time and your attention to this very important matter.

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[1] Kopp and Scher. Society of Actuaries. "A Benefit Value Comparison of a Cash Balance Plan with a Traditional Average Pay Defined Benefit Plan." October, 1998.

[2] Mitchell, Olivia S. and Janemarie Mulvey. Working paper/PRC WP 2003–25. "Possible Implications of Mandating Choice in Corporate Defined Benefit Plans." Pension Research Council, The Wharton School, University of Pennsylvania: 17.

Chairman BOEHNER. Let me thank all of the witnesses for your excellent testimony. It is a very important subject, and having this hearing less than 5 months before a Presidential election and an election for all of the Members of the House and a third of the Members for the Senate probably poses some risk that politics may enter into the debate.

But having said that, this is very important. The retirement security of American workers is at risk. We have seen the number of defined benefit plans, the decline that has occurred over the last 20 years, we know the cost of operating the defined benefit plan is very expensive and we know that especially among younger workers they want more portability with their retirement benefits. While you see this explosive growth in 401(k) plans and, for that matter, the growth that we have seen in cash balance conversions, and for the Members on both sides of the aisle who are serious about our voluntary retirement system, we know that cash balance conversions are an important component to maintaining defined benefit plans, there is just no other way in my view that you can turn the clock back. And given the uncertainty that is out there, given the inability of the regulators to act, we have to open the door for those who want to come in and make some money. And I think we are causing more concern among employers, we are going to see less plans offered, and we are going to see more freezes in the future.

It is pretty clear Congress must act, and I am here to say to all of you today that Congress will act. It is our responsibility as health legislators and public policymakers to make clear what the law is and what it isn't, and too many times we turn over to the agencies the regulatory ability, which in many cases turns into a responsibility for them, to make serious policy decisions as well. But I believe that the Congress has sat back far too long on this cash balance issue and it is time for us to act. And as we look at a comprehensive reform of the defined benefit rules and regulations, the rules and regulations surrounding cash balance plans must be dealt with and will be dealt with.

Having said that, Mr. Delaplane, Ms. Collier, Professor Clark, you heard Mr. Hill's comments about why we have cash balance conversions, what they are intended or not intended to do. What do you think?

Mr. DELAPLANE. Mr. Chairman, I would have to take a different perspective. My guess is that Mr. Hill has not actually been in too many of those employer meetings where the reasons for cash balance conversions have been discussed. If you look at objective studies from folks like the Federal Reserve, they have clearly said hybrid plans have been adopted in industries where labor mobility has increased, and so we are clearly seeing the evidence that tenures are shorter in the companies that have these plans, and these plans, as you highlighted clearly, deliver higher benefits to employees.

So I disagree with that characterization. I also think you folks very appropriately in 2001 enacted some expanded disclosure requirements. The Treasury has issued very detailed regulations there under. It is not even possible if anybody even wanted to hide the ball to do so. Frankly, when Mr. Hill testified in 1999 that was

his focus, that we should do more on the disclosure front. You have done that. The information that employees get is very explicit, very clear as to how they will be affected.

So I think you have addressed the issues that have been out there. I take issue with the characterization.

Chairman BOEHNER. Ms. Collier.

Ms. COLLIER. Thank you, Mr. Chairman. In Eaton's case also we are experiencing mobility, both internally and external to the company. We have some critical skill sets such as engineering that we want to maintain. We go to great lengths to recruit those individuals. We find that the cash balance plan has already begun to help us in that recruiting process and in retention of these employees.

Similarly, we did not convert our plan in order to save money. I think that is another misconception, and I hope we can clear that up a little bit here today.

Lastly, I think that employers go through extensive communication campaigns. As Mr. Delaplane said, you did revise those disclosure requirements in 2001 in order to prevent companies from camouflaging, as the term was used, any benefit changes and decreases in benefits.

Mr. DELAPLANE. If I could also mention the issue of cost reduction. There have been instances where employers have decided they need to spend less resources on their pension plan overall. That is nothing we should run from. If companies decide their programs need to be reduced and that is how to stay competitive and grow their business and add jobs that may be a perfectly appropriate reason to make a pension change. Of course, pension costs can be reduced in many ways. I assume most members would prefer that a company remain in the defined benefit system and have a plan that better delivers benefits to their workforce as opposed to leave the system all together.

So, again, I don't want to act as if cost reduction on a prospective basis is some horrible thing that automatically dams the employer that has gone that route.

Chairman BOEHNER. Professor Clark, how would you react to Mr. Hill's testimony?

Dr. CLARK. Thank you, Mr. Chairman. It is certainly clear that in an economy like ours companies have to respond both to their own interest and to workers' interest in our labor force that has been changing both in terms of age structure and gender and minority status in lots of different ways, and that has encouraged companies to think about how they are going to offer their compensation and in what form.

So companies are in the business of looking at their compensation and trying to determine what is it that their workers want because for every dollar a company spends, they want the worker to get the most value out of that worker wherever that level is.

It is certainly true that companies must use their benefits as well as their cash compensation to help them attract, retain, and motivate workers. As the worker preferences change, as the worker composition changes, companies must change that as well.

I would come back fundamentally to the issue of what is the relevant comparison. As Jamie just said, companies reducing one type of compensation happens all the time. Companies change their poli-

cies, health care policies are changing all the time. You could go back and say are you going to hold constant health care plans over time or are you going to allow companies to restrict them and change them. Certainly the U.S. Congress changes Social Security and changes Medicare. We don't give workers choices about which ones they are going to take in terms of whether they want to stay in the old Social Security system right now, could they still get full benefits at 65. Workers didn't get that choice. Congress made it for them.

So the government and the companies are in the business of trying to appeal to the workforce, trying to set their policies in such a way as to get the maximum value from hiring their workers, and wages go up and they go down.

Chairman BOEHNER. Professor Clark, do you believe that the concept of compounding interest is inherently age discriminatory?

Dr. CLARK. No. How it is specified in the law, I am not a lawyer, I do not come to talk with you about what is age discriminatory or not in terms of the legal approach to it, but certainly it seems to me that a dollar in a person's pocket whether they be 25, 45 or 65 is an equal treatment of that worker. Everybody gets the same dollar, everybody gets the same percentage of their compensation.

Chairman BOEHNER. The Chair recognizes the gentleman from New Jersey, Mr. Andrews.

Mr. ANDREWS. Mr. Kildee was here first.

Chairman BOEHNER. The Chair is happy to recognize Mr. Kildee.

Mr. KILDEE. Thank you, Mr. Chairman. First of all, Mr. Chairman, since we were allowed to have only one witness, the minority had one witness, I would like unanimous consent to submit to the record some documentation to complete the record.

Chairman BOEHNER. Without objection.

Mr. KILDEE. I thank the Chairman. I would like to direct a question first of all to Mr. Hill and then the others may want to comment on that. There is a bill, Sanders-Miller bill, of which I am cosponsor, H.R. 1677, which would first of all give a choice to the employee between the traditional and the cash balance plan and also would ban the wear-away provision.

Could you comment on that?

Mr. HILL. Yes, I will be glad to comment on that.

It is truly clear that some of the most virulent, if you will, or the most emotional reactions to cash balance plans have come in the conversion process, and two of the issues that have caused the most concern among older workers are addressed in that bill. One is, and Dr. Clark has written about it, the nature of the relationship between the employer and the employee. When an employer has essentially entered into what is perceived by them to be a long-term contract, they sacrifice current income in return for later increasing benefits. Having made that choice and having lived with that choice for a decade, two decades, in some cases three decades, only to find that bargain dramatically altered overnight, has been an enormous blow to them, particularly as it comes long after they have made decisions about savings and their future.

That bill would address that very, very serious concern.

Mr. KILDEE. On that point pensions really are an earned deferred income, are they not? They are not just a gift from the employer.

Mr. HILL. I have never met an employee yet who didn't consider it to be a part of their incomes. When you talk to employees who chose to forgo other kinds of plans, chose to forgo higher employment pay on a current basis, chose to forgo stock options during the late 1990's, they certainly thought they made that choice. They lived with that employer and they benefited that employer, and the employer made those promises with that intention.

I mean, those promises are made to attract the kind of workers those employers wish to attract.

The second issue that has hit older workers so severely is also the wear-away which, as the GAO study acknowledged, could impact people to the point where at 55 when their charges occurred, they might go the rest of their professional career without changing their pension benefits, even though they might have been with that employer for 30 years. So that is clearly the case and that bill would address two of the most serious concerns that have arisen.

There are employees—employers, excuse me—and Eaton, I know, only from what I have heard from Ms. Collier—that have taken what I would call a more appropriate response in making a conversion. But I would note that according to the recent study done by Mellon that I being Eaton would fall in a category of 6 percent who have made similar kinds of conversion opportunities available to their employees.

So from the perspective of any one company, any one of these issues may be, I will say, slight or more serious or less serious. However, from the broad breadth of employees, the 7 million or so that have been impacted by this, clearly those two issues are at the forefront of their concerns.

Mr. DELAPLANE. If I might just comment on that, Mr. Kildee.

Mr. KILDEE. Surely.

Mr. DELAPLANE. I want to reiterate something that Chairman Boehner said. We have a provision of law today which ensures and requires that no benefit earned for service today can be taken away. So promises made by employers are promises kept, and that provision of law ensures that. I want to be clear about that.

In addition, let us recognize that when employees experience a significant wear-away, it tends to be because this early retirement benefit under the prior plan was very, very generous. These, again, are some of the richest benefit plans in the country. Many workers would be envious to have such a subsidy in their plan. So that is what really explains this wear-way, the very generosity of the plan prior.

With respect to the legislation you referenced, here is why——

Mr. KILDEE. But their wages may have been generous too. You are not asking them to give some of the wages back through the years, are you?

Mr. DELAPLANE. What I am saying is what Professor Clark has said. In the future for days not yet worked, conditions can change. So I think we go down a very slippery slope with a bill like H.R. 1677 which basically says we are going to guarantee employees future benefit expectations. We are going to turn them into legal rights. Because if I as an employee decide I do not like a pension change, I just choose my way out of it. The problem with that is a very slippery slope. Why are we singling out cash balance con-

versions for these kinds of changes? And employers are very concerned that quickly we are going to say that you can't change your traditional plan without a choice, you can't change your health plan without a choice, you can't change your 401(k) match without a choice. We are not clear where it ends and we worry that that creates very significant problems for employers, minimizes their ability to be flexible. That is our real policy concern with a bill like H.R. 1677.

Mr. KILDEE. My time has expired. Let me say as one who recognizes the fact that you cannot have employees without employers, I want to have a balanced bill. And I think that H.R. 1677 tries to achieve that balance and give some protection to the employee, while recognizing some of the needs of the employers.

We have tried to achieve that balance and I hope if we report a bill out of here, that some of the wisdom from this side of the aisle might be coupled with some of the ideas on your side of the aisle.

Ms. PFOTENHAUER. Congressman Kildee, there is a very interesting working paper that is being authored by Olivia Mitchell and Janemarie Mulvey at the Wharton School, entitled "Possible Implications of Mandating Choice in Corporate Defined Benefit Plans." it is just a working paper and does not speak directly to the legislation that you mentioned. But it heightens my concerns about unintended consequences of doing this type of thing, and I would highly recommend that your staff take a look at this and see whether they think those concerns are relevant.

Mr. KILDEE. We will do that. Thank you very much.

Ms. COLLIER. Mr. Kildee, I believe you asked me to comment on Mr. Hill's testimony as well, and I would like to do that. Although it was, I think he used the word "appropriate," that we had an appropriate conversion and that was appropriate, but it was appropriate for Eaton. I have also worked at a prior employer and been involved in two cash balance conversions at that employer and we also had conversion techniques but they did not involve choice. There are a lot of different techniques out there and a lot of valid techniques out there that should be appropriate for that company.

Secondly, you asked me to speak—oh, and your study also, Mr. Hill, mentioned the 6 percent. I think that is specific just to choice. There are other conversion techniques out there that are either in the Mellon study or in the Watson Wyatt study. I think the number is larger than that when you include all techniques.

And as far as wear-away, we did some have some wear-away in our plan but we took great steps to mitigate that. And also we had 11 percent of our employees over 55 choose the cash balance plan because wear-away is often a temporary condition. And those employees who expect to work longer in their careers were actually better served choosing the cash balance plan.

Mr. KILDEE. Thank you, Mr. Chairman. I thank the witnesses.

Mr. JOHNSON. [Presiding] Thank you. And you know we will take your remarks into consideration in everything we do. Especially Rob down there. Mr. Delaplane, if certain mandates were required in the voluntary employer-sponsored system to mandate employees' expectations of benefits, could these mandates affect employment practices and America's overall competitiveness in the world economy?

Mr. DELAPLANE. Mr. Chairman, I think you raise a very important caution about those sorts of proposals. As I mentioned in my earlier response, it is not clear where the line will be drawn and why all benefit changes would not be subject to this protection of expectations. Part of the reason that we have had robust employment in our country is that employers have had the flexibility, prospectively, to alter their benefit programs, alter their comp structure, and be nimble and move in the economy accordingly.

If you contrast that with more of a European model where it is very, very difficult for employers ever to change the conditions of employment from the day the employee began, you see much less robust employment sort of systemically. And I think the concern is if we layer on these protections of expectations and we prevent employers from being able to make changes, that is the direction we are going to go. Employers are going to be much less willing to add people to the payroll, knowing that it would be virtually impossible to change their pay and benefits going forward. So I think it is a very significant risk to competitiveness.

Mr. JOHNSON. Thank you. You all talk about lump sum payments. That seems to hurt more than helps. Would you all comment on that and can you tell us whether we should even address that issue or not?

Mr. DELAPLANE. It has certainly been one of the attractive features of the hybrid design for most employees. They value the fact that the benefit can be taken as a lump sum.

Mr. JOHNSON. But they do not have retirement for the long term.

Mr. DELAPLANE. By law, luckily the hybrid plans, like the defined benefit plans, are required to offer the benefits also in the form of a joint and survivor annuity. So unlike the defined contribution 401(k) world where that is not a requirement, for hybrid plans it is a requirement to offer an annuity. Part of the reason here——

Mr. JOHNSON. But it is still the employee's choice.

Mr. DELAPLANE. Still the employee's choice. One thing that may address your concern is that employees can take that lump sum from a hybrid, roll it over to an IRA and continue to invest it and have it build more in earnings today, before retirement. And that actually protects from the harms of inflation. In a lot of traditional plans where you can't take a lump sum, your benefit is a fixed dollar amount over time and becomes less valuable over time. The hybrids help respond to that problem. At least the lump sums continue to be invested and rolled over and grow all the way to retirement age.

Mr. JOHNSON. Yes, sir?

Dr. CLARK. Thank you, Mr. Chairman. In comparing what companies might do, certainly many companies might, as has been suggested here, close their defined benefit plans and open a 401(k) plan as many companies have done over the last 30 years. And when you start thinking about are cash balance plans better than that alternative as opposed to are cash balance plans better than retaining the traditional plan, you have to consider, because clearly that is an option that many companies have followed.

And the annuitization issue is certainly one that is very important in that choice, as is the investment risk. One thing about

annuitization and lump sums, though, whether you are looking at the U.S. or Japan or anywhere around the world where lump sum options are offered, people take them.

Mr. JOHNSON. Generally speaking, though, they spend it. It is not there for their long-term retirement.

Mr. DELAPLANE. And one issue that you folks have addressed, recently the 30-year Treasury bonds, which you very helpfully provided a replacement rate for 2 years. A piece of that issue we have not yet confronted is the use of the 30-year Treasury rate in valuing lump sums from defined benefit plans. The fact that we still have to use this low 30-year Treasury rate means that the lump sums are artificially inflated and we are tipping the playing field toward employees taking the lump sums today. They are more valuable than the equivalent annuity. And obviously that is one of the issues you are hoping to address long term, but that contributes to the problem that you are raising.

Mr. JOHNSON. That is a great point. Thank you.

Mr. HILL. Could I respond to your question earlier about international competitiveness? I think employees and employers are mutually concerned about international competitiveness. And as with so many of the issues that you have addressed congressionally in terms of public policy, the question is striking the proper balance.

We are, after all, sitting here talking about Congress having mandated a prohibition against age discrimination in context of certain tax-incentivized private pension plans. I think this year it is going to cost about $90 billion for the taxpayers to have this, quote, private retirement system we are talking about. We are all concerned about that and we are concerned about modifying a prohibition against age discrimination.

If we were talking about modifying a prohibition against sexual discrimination or racial discrimination, I think we would not be talking about the cost of that in terms of international competitiveness. Each of those bears some cost arguably. But I think we as a country have decided those things are sufficiently important to us that we are going to value the prohibitions against sexual discrimination or racial discrimination or any other kind of discrimination that you have chosen as a public policy.

So what we are really talking about is whether there is a modification of the current prohibition in the tax-incentivized private system for pensions. And that is all we are talking about here at the core.

Mr. DELAPLANE. Mr. Chairman, if I might real quickly. As Mr. Hill knows, the legislative history of that pension age prohibition in 1986 was very clear that the practice Congress was focused on was employers who were ceasing continuing accruals when somebody hit normal retirement age at 65. That is in the title of the provision in the statute and in the legislative history. I do not think—I sort of challenge the idea that you are walking away from some commitment that you made. It was very clear that was the fact pattern that Congress was focused on, which wouldn't even reach to the issue of what is happening to pre–65 employees.

Mr. JOHNSON. Thank you. You know, this is an interesting discussion. I appreciate all of you participating. Did you want to make a comment?

Ms. PFOTENHAUER. If I might. Since the Society of Actuaries has done the analysis in 1998 that showed that 77 percent of women are better off under cash balance plans, I don't think it is outrageous to contemplate a scenario where people like me might feel that any action of Congress that made it less likely that a cash benefit plan was going to be available was actually gender discriminatory.

Mr. JOHNSON. Thank you. Mr. Andrews, you are recognized for 5 minutes.

Mr. ANDREWS. Thank you, Mr. Chairman. I want to thank the witnesses for their very substantive additions to helping us solve this difficult problem. Thank you. I have enjoyed reading what you had to say and listening. Solving difficult problems almost always requires us to compromise and to find middle ground between two very defensible positions. The first is the fairness to employees who reasonably rely upon a set of expectations in their lives and in their family budgets, and the second is to make sure that employers who are voluntarily providing pensions can do so in a way that is consistent with the competitiveness and success of their business. I don't think that those are mutually exclusive goals and we are trying to find the common ground between the two of them.

Mr. Delaplane, I wanted to ask you on this question of choice prospectively. That is to say, where an employer is considering make conversion from a defined benefit plan to a cash balance plan. I think I heard you say that you oppose the idea that employees would be permitted to choose whether to go into the cash balance plan or keep the traditional plan. Is that your position?

Mr. DELAPLANE. We would oppose that as a mandate; correct.

Mr. ANDREWS. Under what circumstances would the employer be disadvantaged if an employee chose to stay in the traditional defined benefit plan? What is wrong with that from the employer's point of view?

Mr. DELAPLANE. There may be nothing wrong with that. It depends, obviously, on the demographics of your workforce. I think part of the problem is if that is a worker who will not be with the firm for an entire career, you are likely to see disappointing benefits under the traditional formula because it is so backloaded to the end of a career. If you are as an employer trying to say how can I most equitably use my benefits budget to deliver meaningful benefits to the people who work for me, the traditional plan for many employees is not the way to do that.

Mr. ANDREWS. If I may, that is a disappointment for the employee and he or she has made that choice. People are sometimes a little irrational, but if you have chosen to stay in the defined benefit plan, you do not have a lot of grounds to complain that it is not as good for anything else you might have opted for.

Mr. DELAPLANE. I understand. But employers are trying to do right by their folks. The traditional plan may have these very, very rich early retirement subsidies, and again a lot of employers have job shortages in certain categories.

Mr. ANDREWS. But if I understand correctly, the legislation Mr. Kildee referred to would not prohibit the employer from modifying those retirement subsidies. If you kept your DB plan and chose to modify your early retirement subsidies, there is nothing in that legislation to preclude that. That is a separate question from choosing not to go into the cash balance.

Mr. DELAPLANE. The bill has another provision on wear-away, which Mr. Kildee mentioned, which makes more complicated the effort to strip out the subsidies. So there is a piece to that issue. But I think the primary concern is that you are not—it is really the precedent. Why are we elevating this particular kind of benefit change above all others for this brand-new kind of——

Mr. ANDREWS. I think the answer would be because it is the only kind of benefit change I could think of where the employee might wind up poorer than he or she would otherwise be. I cannot think of any other conversion where that would be the case.

Mr. DELAPLANE. What about the incidents that happened Mr. Andrews where employers have concluded they have to suspend their matching contributions to their 401(k) plan. And employers have had to do that. So that the only money going into the 401(k) at that time is the employee money. The employer contributions which would normally be triggered are not occurring.

Mr. ANDREWS. But that is not a plan conversion. That presumably flows off of economic difficulties that the employer is having generally.

Mr. DELAPLANE. I guess what I would say is that we do not see a principal distinction why, if Congress believes that protecting the expectations is right for the traditional plan, it is also right for the——

Mr. ANDREWS. Here is how I see the difference. I certainly do not support something where we require someone to keep a promise that they did not make. If we passed a law that said we have to keep the employer match under the 401(k) no matter what is happening to your business, that is a promise that the employer did not make.

On the other hand, when an employer enrolls someone in a defined benefit plan and says if you work a certain number of years and make a certain amount of money and retire at a certain age, this is what you are going to get, I know the legality of that promise is subject to dispute but the morality is not, and it seems to me that it is important.

Can I ask Mr. Hill a quick question? I know that you do not seem to like the cash balance plans at all. At least I derive that from your testimony. I do not agree with you on that. I don't think there is anything inherently wrong with these plans. I would ask you to submit for the record your thoughts on what a fair conversion might look like. It is clear what you think an unfair conversion looks like. I would be interested in your thoughts as to what you think a fair conversion looks like.

Mr. HILL. Would submit that. It is unfair to ask a lawyer to do that. We all the time take directions from you and then we argue about what you meant.

Mr. ANDREWS. I know it is unfair. I am a lawyer; that is why I asked you the question.

Mr. HILL. I respect that. I was going to suggest you were getting it back in kind. We normally can dump off and impose on you——

Mr. ANDREWS. It is a professional discourtesy, I guess.

Chairman BOEHNER. [Presiding] Thank goodness I am not a lawyer. The gentleman's time has expired. The Chair recognizes Mr. Burns.

Mr. BURNS. Thank you, Mr. Chairman. I too share your challenge, not being a lawyer. So I will join this discussion a bit and seek to get more input.

As an individual who worked for an organization for 20 years and enjoyed a defined benefit plan, and having a choice late in that career to change, chose not to because, as you suggest, maybe that would be to my personal best interest.

The first question is if you look at defined contribution plans versus defined benefit plans, do we agree on which theoretically is better? Do we agree theoretically, Ms. Collier?

Ms. COLLIER. I actually think they serve different purposes. Someone earlier stated that savings plans, the 401(k) plans were never intended to be one's sole source of retirement. So in our case we use them to encourage employees to save and we do that by matching at one of the safe harbor generous employer match.

Mr. BURNS. If you look at any growth curve—if I started at 25 and stayed to 65, is a defined contribution plan a superior plan?

Ms. COLLIER. No, not necessarily. The defined benefit plan offers security. It offers a guaranteed interest rate. The cash balance plan I am speaking of in this case.

Mr. BURNS. Are we really arguing about conversion issues and about the early retirement boost that many—not many, but some plans offer?

Ms. COLLIER. I think that is one aspect. But I think we are also concerned about the general legality of the age discrimination.

Mr. BURNS. Age discrimination has come into the discussion and it has clouded and muddied the water fairly substantially.

Dr. CLARK. Mr. Burns, if you look at the three types of plans and you line them up and you offer them to different workers, some workers would clearly prefer the traditional defined benefit plans, others would clearly prefer the cash balance plans, and others would clearly prefer the defined contribution plans. In my view, they are all relevant retirement plans that can provide an adequate retirement income, provided that the person follows through or the company follows through on particular decisions.

The characteristics of those plans appeal to different people based on their risk aversion, their career paths, and all of these others, which is why I would say that it is important to have all types of plans out there. And the other thing we have to keep in mind is that the employer and the employee are both interested in the value that they get out of the plan for every dollar that is put into the plan. And that includes all of the costs of managing the plan and operating the plan as well as the net rate of return, then.

And when there are events that happen that increase the costs to any one particular plan, workers and firms are likely to move from one plan to another. And that is basically what has happened with the defined benefit world, is that Congress raised the price of that plan relative to the other types of plans and companies and

workers were choosing increasingly defined contribution plans. It does not make it inherently better; it just means that at the current prices, more people are choosing this plan versus the other.

Mr. BURNS. I have an inherent problem with mandating volunteer participation. And one of the questions I have, if Congress was to mandate early retirement subsidies in a conversion program, what impact would that have on businesses? And really providing benefits to employees that maybe they were not entitled to?

Dr. CLARK. I think that early retirement subsidies were put into the traditional defined benefit plans in an era when companies wanted to encourage older workers to leave. That was in the period of rapid labor force growth and a period of more homogeneous worker force. Lots of reasons why companies chose that as an optimal human resource policy.

In today's climate that is not happening. Instead, more and more companies are going to be looking at a slowly growing labor force. Valuable workers with good experience, these are productive senior workers. There is no reason to encourage them to leave. I believe that companies around the country will ultimately be moving more and more in the direction of looking at their entire human resource policies and trying to figure out how to keep older workers on rather than trying to push them out. And certainly the elimination of early retirement subsidies is consistent with that public policy and consistent with the objectives of Congress as we look at Social Security and other areas of fiscal certain.

Mr. BURNS. Ms. Collier would you address that point?

Ms. COLLIER. Yes. You mentioned specifically the mandate issue and that is what concerns me the most. While we were undergoing our conversion process, a lot of people would call me from around the country, different companies, and ask how we were doing and what the appropriate—how we were converting and what our communication strategy was, et cetera.

Since 2003, even with the threat of mandates and the introduction of proposed legislation, those calls have changed dramatically in content. The employers are calling but they are not changing from one defined benefit plan to another. Rather, they are either freezing or terminating or converting their defined benefit plan and having a defined contribution plan only for the future. It is already starting to take effect in my personal experience.

Chairman BOEHNER. The Chair recognizes the gentlewoman from California, Ms. Woolsey.

Ms. WOOLSEY. Thank you, Mr. Chairman. And thank you to this panel.

We were talking about conversions and that we can take care of the current older workers, and that is possible by letting them grandfather/grandmother and stay in their plans. But you know our responsibility up here is to all workers and all employers and looking at the longterm for retirement. And somebody, one of you, and it may have been you, Mr. Delaplane, said that employers are constantly changing their benefit plans because they are fluid. I am a human resources specialist professional for 20 years before getting here. And that is true. They are, and they have that right.

But sitting up here, the Federal Government, I mean, what we do, if we change Medicare, if we change Social Security and dras-

tically pull the carpet out from what people know that they can count on, we get fired. The CEO does not get fired by the employees when they decide that the company wants to cut costs. We will get fired.

And what we are counting on when we have Social Security is—the minimum base of what a worker gets is that they are building on top of that. So when we talk about—and I have a question for you, Ms. Pfotenhauer, Nancy, I want to call you Nancy. When we talk about unintended consequences it is not just on the employer. We are looking at this long-term woman that worked. You said that she was lucky enough to be working longterm for the same employer. Wrong. The employer is lucky enough to have had an experienced, long-term, loyal employee.

The unintended consequence is to even think about removing her benefits and pulling the rug out from under her. We need to protect those workers. We need to encourage long-term loyalty. So I want to ask you how you think that can happen. And at the same time, I want all of you, if you will, to answer me about more portability, mobility, with these cash balance plans 5 years to vest. How is that more mobile and more portable?

So I will start with unintended consequences.

Ms. PFOTENHAUER. Let me start with why someone is lucky if they are able to maintain employment for two decades. We are struggling right now. It takes two working parents to support a family. Many women are finding themselves in a position of being single parents where they are providing most of the financial support for themselves and their children.

And frankly I think women, as well as the employers who employ them, are lucky if they find a job situation that works out for two decades. It is clearly not happening for the majority of women who stay on a job less than 5 years. And they do that for different reasons and the data does not allow us to imply why. But it seems to strongly support the contention that women tend to take more time out of the workforce as they try to do that balancing act to take care of children and elderly parents.

So basically I think someone is very, very lucky, male or female, if they are able to find a workable employment situation.

Ms. WOOLSEY. Absolutely. So I am going to take back my time a little bit and have a discussion with you. Therefore, we should be using that as the way we want to go, not to make it harder for them. Five years, if they are in and out of the workforce and 5 years vesting?

Ms. PFOTENHAUER. They are averaging 4.8 years. And what you find and what the data clearly shows is that this trend of women going in and out of the workforce is not going away. And I am not sure it is the job of this Committee to try to make it go away. Because what is happening is something called sequencing in labor patterns where women are not just taking time out when their children are first born, but are actually taking time out again when they are in high school, because there has been a resurgence of concerns.

Ms. WOOLSEY. Actually, you are a great straight person for me, because I have legislation called The Balancing Act to Bridge Work and Family. Ms. Collier, did you want to respond to this?

Ms. COLLIER. Yes, I want, thank you. In regards to mobility, I think I mentioned mobility is also an issue for us internally to the company with over 100 locations in 40 States. We have a lot of people that were transferring from one location to another. And in doing so, they were often turning us down perhaps because of the difference in pension plans. So we solved that problem internally as well by doing our choice program.

In addition, as far as vesting, we voluntarily vest our 401(k) match immediately. And then we want to continue to have an incentive for some of these highly recruited employees, be it in engineering, HR—we have an H.R. developmental program—supply resource management, IT, what have you, we would like to have an incentive to keep them for 5 years. There is a considerable amount of training, as you know, that goes into building someone's career skills in the first 5 years, and by doing so we hope to continue to entice them to remain with us by having a plan that is very visible and attractive to these employees.

Ms. WOOLSEY. Just a minute Mr. Delaplane. I want to thank you. I really think we ought to use Eaton as one of our model companies unless there is something I am missing here. But you do know that not all employers are as responsible as you are. Mr. Delaplane.

Mr. DELAPLANE. Just a couple of quick points about vesting when an employee stays with a company for 5 years or 6 years. Under a hybrid plan they will depart with a much higher benefit than they would have departed with under a traditional plan. So you have to make it to that vesting threshold, obviously. But the way the benefits accrue in a cash balance plan, you leave with a much more significant benefit. So that is the advantage.

Ms. WOOLSEY. If you stay 5 years.

Mr. DELAPLANE. If you stay 5 years. And Ms. Woolsey, as an employer organization, we want to emphasize a lot of common ground with you. We do want to see as many employees as possible enjoy those defined benefit plan benefits. They are employer funded, they are backed by Federal guarantees, they have spousal protections. And I think our perspective is that we do want employees to be able to remain in that system. A traditional plan or a hybrid.

And to your point about conversions, I think Eaton has become close to the norm. If you look at the data we cite in our written statement, 9 out of 10 employers provide very significant conversion assistance of one sort or another to their older workers, whether that is choice, whether that is grandfathering. It is the unusual employer in financial distress who may not do those additional conversion benefits. Frankly, I think many of the key concerns many have had about conversion has been addressed in the marketplace.

Ms. WOOLSEY. Dr. Clark?

Dr. CLARK. I think the fundamental principle of a lot of the discussion that we are having today is the difference between the exit pension, or what has legally been earned, and the expectation of workers from their pension. And as Mr. Delaplane just said, if you are leaving from 5 years out to 20 years, you are typically going to leave with a much bigger benefit under a cash balance plan or a defined contribution plan than you would with a defined benefit plan.

If you stay all the way to early retirement, if you stay all the way to early retirement, if the company keeps the pension plan, if the company does not convert to a defined benefit plan, if they do not do away with the early retirement subsidy, then you would get a bigger benefit. One of the problems that companies have with workers is trying to explain what the benefit that they do have under the defined benefit plan is. And the benefit calculators that were mentioned by Mr. Miller earlier is one way that they try to show that, but that is really based on all of these expectations that you might get there, and it certainly leads to the impression that it is a guaranteed benefit even when it is not.

And so how do you explain this? Communication is a very important key for an ongoing plan, but it is essential when you are making a conversion. And those companies that have converted pension plans, that have had good communication strategy, have had the transitional benefits, have made these transitions with essentially no adverse reactions, no need for lots of lawyers involved, and the plan has gone forward.

Those companies that had bad communication plans or did not have transitional benefits, or smaller ones, had more problems. That is the issue. What is the benefit that people have earned? What do they think they have earned? And what is the legal benefit that they actually have earned?

Ms. WOOLSEY. In the long run, the more healthy our benefit plans are, the better the retirement benefits, the healthier this Nation is. Because somebody is going to be supporting older Americans.

Chairman BOEHNER. The gentlewoman's time has expired. The Chair recognizes the gentleman from Georgia, Mr. Isakson.

Mr. ISAKSON. Thank you, Mr. Chairman. I want to congratulate Ms. Pfotenhauer on what I think may be the hearing quote of the decade when she admonished us that the only thing we cannot amend is the law of unintended consequences. I thought that was a great line and I would like to follow up on that line by asking you a question.

It appears to me if the Cooper versus IBM decision stands unaddressed by Congress statutorily, that the unintended consequence vis-a-vis the age discrimination interpretation in that case would be that there are not going to be many defined benefit or cash balance plans and everything is going to be defined contribution. Would you comment on that?

Ms. PFOTENHAUER. That is really why I am here today. That is our greatest concern. As I said, this is not a Republican or Democratic cut on the issue. It is just clearly there in the numbers, and that is that women benefit much more under a cash balance approach than they do under the traditional approaches. And it is not just because of their traffic in and out of the workforce. It is that other point. It is that we rarely can afford to take the option for early retirement.

So we think that we are a relatively small organization. We choose our issues carefully. We think this is dramatically important to our constituency in term of what we work on for retirement security.

Mr. ISAKSON. Mr. Hill, would you agree with my reasoning that if Cooper stands and Congress does not address the issue of age discrimination and the time value of money, that in the future for workers coming into the workplace there is a likelihood the only thing you are going to see is the defined contribution plan?

Mr. HILL. I do not agree with it but I recognize it is speculation as we are all speculating about something that other people would do in the future. The point I would make, though, is that with far less expense than converting to a cash balance plan, if employers wish to address the women's issues——

Mr. ISAKSON. I am letting you handle the men's side. She is to address the women's side. I want you to address the men's side. We do not live as long and all of that stuff. But the absence or the unintended consequence of reducing the availability of defined benefit or cash option or hybrid plans seems to be inevitable if Cooper is not addressed by this Congress. My question to you is, does that not seem pretty apparent to you too?

Mr. HILL. No, it does not. What Congress has done is define two different worlds, a defined benefit plan and a defined contribution plan at this time, and that is what you have done. And you have imposed uniform obligation in each of those categories that differ because of the different structure, the risk analysis, who is taking and making investment decisions, and all of those kinds of things.

It seems to me that if we were properly presented with this issue, it would have been those who wish to see changes made that would be more receptive, for example, to some of the issues that are raised—and I do not disagree that those are valid policy issues for this Congress to address—would have come before Congress and asked for the creation of a third category where these kinds of public issues would have been debated, where the balancing that you are talking about—and I agree it is a proper balancing—would take place.

That is not what happened. Rather, without that kind of consent in the face, I would say, of mandatory age discrimination language in the statute, they chose on their own to go off and come up with plans that have some of the aspects of both the defined benefit plan but also want to have some of the essentially legal defenses and legal authorizations of a defined contribution plan. And that is not the current law.

But the way to come back with that would be for Congress to address this in the first instance with a policy balance that if you agreed, for example, with Dr. Clark that there should be a third type of plan in the marketplace, you would then do that and you would address it in that fashion.

I would suggest also employers can address those same issues regarding women and deal with it in a far less expensive plan than cash plans if that is truly their motivation.

Mr. ISAKSON. Your case, well stated, presumes your obvious agreement in Cooper in regards to age discrimination and the compounding of interest. My comment to you would be the following: Yesterday by happenstance, not by plan, I spoke to 80 employees of a major company in my district, but it is a national company whose company last year, 2003, adopted—gave them choice on defined benefit or to a hybrid cash balance plan. And the con-

cerns expressed to me in that meeting about the uncertainty based in that case on failure of Congress to deal, puts in jeopardy those types of choices in the future and ends up having the unintended consequence—if you look at business and the environment we are in today—of employees really getting less options in the future than they have today.

And I am making a statement here. I am really not asking a question, I apologize Mr. Chairman. But it seems—the argument to me on the comparison of the 25-year-old worker and the 55-year-old worker and the compounding of interest and that being age discrimination is to me ludicrous. But it is more ludicrous that we would sit here as a Congress do nothing and create an environment where the opportunity for benefits for employees, valuable employees working, just diminished because of the consequence of our inaction. Thanks for letting me make a statement.

Chairman BOEHNER. The Chair recognizes the gentleman from Oregon, Mr. Wu.

Mr. WU. Thank you very much Mr. Chairman.

This is a truly challenging issue, and one of the challenges of this job is trying to drill down deeply while covering the breadth that we need to do. My reading on this was done one or more years ago. My recollection from the CRS, the Congressional Research Service materials that I read at that time, is that if you look at graphs, if you change jobs a certain number of times, at some point based on job change and number of job changes or period between job changes, there is a crossover point between the traditional defined benefit plans and the cash balance plans. Do I recall that properly?

Mr. DELAPLANE. Mr. Wu, we actually cite in our written statement an analysis that looks at a person who changed jobs three times in a career as opposed to a person whose changed none, no times. And for the person who changes over three times, which is less than a lot of people do, the hybrid plan would produce 17 percent higher benefits than the traditional plan. And for many employees just a single job change can yield the hybrid plan producing a higher benefit.

Mr. WU. Conservatively speaking, if there are three to five job changes in a career in a working lifetime, your assertion would be that cash balance plans would better serve the financial needs of that particular employee.

Mr. DELAPLANE. Absolutely.

Mr. WU. OK. Having established that, it was my Republican law partner when we were looking at our benefits plans and I thought that we would have a vesting period of 1, 2, or 3 years, and it was my Republican law partner who said having an employee stick around just to vest is probably the worst idea there is and we ought to just vest people on Day One.

If we do assume that people move around from job to job and if hanging on purely to vest is a bad idea, then what is the matter with pushing the vesting envelope so that instead of vesting at 5 years—we had a discussion in this Committee of whether the vesting period should be 1 year or 3 years under different legislation. What would be any meaningful problem or any significant problem with vesting—with pushing that vesting envelope so that instead

of 5 years it was 3 or 1, or even vesting as Eaton does with its defined contribution plan?

Chairman BOEHNER. If the gentleman would yield, as you know under the defined contribution plans, the limit, the maximum limit is 3 years. It could be zero. For defined benefit plans, the maximum vesting period is 5 years. Could be far shorter than that at the election of the employer.

Mr. WU. I understand, Mr. Chairman. And we have had discussions on this topic which I have enjoyed, and the question is whether that upper limit should be legitimately pushed down from 5 to 3 to 1, perhaps approaching zero. Are there any problems with that?

Ms. COLLIER. Well, someone mentioned earlier there are only so many benefit dollars a corporation has to spend. My fear is there is obviously a cost increase there. There is also employee retention. We do vest our defined contribution participants immediately, but we do have an interest in getting the most out of these new recruits. And 3 years does not even give enough return on our investment, if you will, for the new employees. It is both the cost of the benefits and the ability to retain people for those first 5 years, and hopefully then they will see that their career path is with Eaton and not another company. We do not want to train employees who then go on to other companies after a few years.

Mr. DELAPLANE. Mr. Wu, as I think you know, many of the—as a matter of fact, the vast majority of employers who have adopted hybrid plans also offer a defined contribution plan, like Eaton does. So we have got a variety of techniques to use. And you are seeing, not just as a legislative matter but as a voluntary matter, that the vesting schedules in those defined contribution plans have been coming down.

It is a balancing act. You do want to get benefits to people quickly, recognizing the patterns in the workplace today. But as Ms. Collier referenced, you want to have some incentive—not necessarily to be there for 30 years, but to stay to 5, to stay to 7, to stay to 10. And it is a balancing act and Congress has obviously tried to set that balancing act appropriately, as employers do.

Ms. COLLIER. And it is also something that I don't hear about from my employees. They are not expressing an urgent need for it. Congresswoman Woolsey, you were an H.R. professional. You hear about aspects of a benefit plan that are not popular and we are not hearing it.

Mr. WU. Mr. Chairman, since I yielded a part of my time, if I could finish this part of the analysis. It seems to me that most of the surveys show that pay is an important factor, but not the top factor, and probably benefits is behind pay in terms of retention and people's decisions about where they choose to work.

And that being the case, this being such an important policy arena to provide for secure retirement, you are probably not getting that good a leverage from the vesting efforts. At least the competitive philosophy that I have always used, that I picked up from our high-tech clientele that we used to serve before I came here, and the competitive philosophy that we still use on the congressional staff is that we want to provide the absolute most conducive working environment to give satisfaction to our employees in terms of

what they want to do with their lives. And as long as they are adding value to the team and the team is adding value to them, then it makes sense for us to stick together. And that some of these other considerations get in the way of a secure retirement, but they may not be very effective in terms of retention policy.

And I just want to submit that for your consideration and your written comment. And, Professor, if you have something to add, I am sure that the Chairman will indulge you.

Dr. CLARK. Well, the only thing I would add out of that is I think that if you calculated the present value of a defined benefit plan from working 1 year, it would be infinitesimally small; so the value to the worker in a traditional defined benefit plan of working less than 5 years, like, say, 1 year or immediate, would not be that great. You are calculating the value way out and discounting it back.

That is why you don't hear about it from the younger workers. They look at it and say, even if I had this it wouldn't be worth anything to me today.

Mr. WU. I may change my mind as I get older also.

Dr. CLARK. Value to you would be greater if you were older and closer to retirement and had more years of service.

Mr. WU. Thank you, Mr. Chairman. Thank you to the panelists.

Chairman BOEHNER. Mr. Payne. The Chair recognizes the gentleman from New Jersey.

Mr. PAYNE. I am sorry that I missed—this is an area that I have had a lot of interest in over the years. Being older, I am more familiar with the defined benefit because many, many years ago, as all of you know, that was the type of thing that most workers had. You knew you were going to work 40 years at one place, retire, you were going to get X-amount of dollars and that was it. Of course the advent of the 401(k) and the change in the way that employers decided to provide for retirement security changed a bit. And of course this cash balance plan is something that I am less familiar with.

But I might ask Mr. Hill, I know you are strongly opposed to it. And I wonder if you could—I am sure you did in your testimony, but in maybe a minute or two, tick off the two or three reasons why you feel that this would not be wise to advocate this type of plan. I know the discrimination between older workers and younger, but if you could just give me a thumbnail sketch.

Mr. HILL. Certainly. One of the concerns at the forefront that I have, and it goes to the question of myth or fact: why these plans have become popular when they were popular, given the warning signs that were out there about the age discrimination issues. And I would respectfully submit that a significant motivating factor would be what I would call the financial accounting issues, the ability to present the company in a more attractive financial way as a result of these changes.

If that is the case, then a lot of the things that we are talking about here today really become far less significant because they are not really what is motivating these changes in terms of the employer-employee relationship.

A second concern I had—and there was a reference back to 5 years ago when I testified regarding disclosure—even with the cur-

rent disclosure requirements, what has happened is that the implementation or the conversion to a cash balance plan, which is the most controversial portion of them, has come in an environment where they are often masking other changes.

For example, there has been suggestion that one of the impacts has been the elimination of early retirement subsidies and a suggestion that perhaps in the future companies will simply come out and announce: We are going to eliminate early retirement subsidies because we want to keep our older workers.

I would be more comfortable from an employee's perspective if the employer wishing to do that simply did that and said, to the extent you have protected rights in these early retirement subsidies, I am going to keep them, and to the extent that you do not have protected rights in them, I am abolishing them. The employees would understand that and understand what is being done to them and why it is being done and they could act accordingly and make their decisions. They may be disappointed, I do not disagree. But at least they would knowledgeably know and they can make decisions going forward.

The same way with regard to more overall benefits levels. The fact that you can implement it through a cash balance plan and have this, I will say, very positive announcement of this wonderful new gadget that has been developed, as opposed to coming along and saying—and I have an example where one actuary talked about how you could announce these two different ways, one in very glowing terms and one in negative terms. Obviously the negative term is not used, even under the new disclosure requirements. It is still the optimistic terms.

If we are going to have employers and employees working in a free market society making decisions based upon the information made available to them, the employees should be candidly told what is happening. And I would respectfully submit if you take away some of these other motivational factors, we wouldn't be seeing the kind of movement to cash balance plans that we have seen in the past. And we will not see it in the future, no matter what, as the Financial Accounting Standards Boards and other entities move to require more appropriate accounting for these.

I always figure I am in good stead when I have got Warren Buffet on my side, and it so happens on this issue he has sounded the early alarm about pension reporting of income. And that is a major issue and I would suggest that is a major factor in this issue. So to that extent, I do not disagree. That is, there are some employees who have chosen, either because of life's necessities or chosen because of lifestyles, it might be preferable to have a cash balance plan. And I could imagine that Congress should fashion, just as you have fashioned to date a defined benefit plan and a defined contribution plan, there could be a fashioning of something similar to a hybrid or cash balance plan that would be appropriate to employees and to which I would not object to on a policy assistant point. I don't know if that gives you a background from my perspective.

Mr. DELAPLANE. In terms of the disclosure requirements that Mr. Hill would like to see with regard to early retirement subsidies, he is actually describing current law. When Congress in 2001 changed the disclosure requirements to require more specific and detailed

disclosure, they added to the series of things that needed to be disclosed by employers any reductions in early retirement subsidies.

So I think you folks have anticipated that concern and the current requirement and the current regulations actually require employers in that special notice in ERISA to discuss the early retirement subsidy issue and the wear-away issue. I think we have that issue behind it.

Mr. HILL. I should add, that was implemented by Congress, I believe against Mr. Delaplane and his client's objections. I recall testifying the last time on that issue.

Mr. DELAPLANE. We certainly support disclosure. We had some specific challenges in the hearing that Mr. Hill is referencing with the particular bill. That was the not the bill that ultimately was enacted into law. We think the disclosure is an appropriate response to concerns that employees have been raising.

Ms. COLLIER. I would like to comment on a couple of things Mr. Hill has brought on, that the employers went on despite warnings, and they went off on their own and designed these plans. Eaton had had some cash balance programs prior to this conversion and both of those plans did not receive IRS determination letters, as did our cash balance plan that we put in in 2002, and we received that prior to finalizing our choice process for our employees. Employers do not do this willy nilly. We have been seeking the best expert legal advice in this area that we could as we embarked on these plans.

Mr. PAYNE. Let me thank you all for your—he is going to cut me off anyway. I would just like to say before he does cut me off that I have noticed that employers have, over the years, when you would think that benefits would be improved and that companies would become more—I do not want to say liberal, but more supportive of their employees, especially long-time employees, that we have seen sort of a lessening of employee benefits, it seems to me, whether it be protection in the workplace in some of our OSHA laws, we have seen a reduction in protection. We have certainly seen the stagnation of wages in a lot of instances.

And so as I mentioned in my first remarks is that the defined benefit, when 75 years ago a person worked for Westinghouse or RCA or a refrigerator company, when the time came they knew that there was a defined benefit that they would get. And I think that we have actually seen an erosion in employers' responsibility to employees over the years. And that is, I guess, because the world has become global—it has always been global, but business is global, and as we see jobs going offshore for companies to remain competitive here, I think this is a part of the whole almost ratcheting in the wrong direction the employees' benefits.

But thank you all. Thank you, Mr. Chairman, for allowing me the extra time.

Chairman BOEHNER. I want to thank our witnesses for your excellent discipline, your willingness to shed some light on cash balance plans and what they do and do not do, and what they mean for workers today and tomorrow. And I can assure all of you that the Committee is going to continue to proceed with a comprehensive overhaul of our defined benefit rules and will act to make clear

what the rules are for the cash balance plans and the conversions to cash balance plans.

With that, this hearing is adjourned.

[Whereupon, at 12:25 p.m., the Committee was adjourned.]

[Additional material submitted for the record follows:]

Committee on Education and the Workforce

House Education & the Workforce Committee

John Boehner, Chairman
2181 Rayburn HOB · (202) 225-4527

FACT SHEET

Myth vs. FACT: *Cash Balance Pension Plans*

July 7, 2004

Cash balance defined benefit pension plans are often preferred by workers because they provide more portable, equitable, and generous retirement benefits than traditional defined benefit plans. They are portable, may be rolled over to an IRA, are funded solely by employer contributions, and are federally insured by the Pension Benefit Guaranty Corporation. Employees are able to view their benefits in a hypothetical account, just like a savings account based on a given interest rate. Unlike defined contribution 401(k) plans, cash balance plans provide protection for participants from market volatility. Furthermore, participants can choose to receive benefits in annuity form or take lump sum distributions.

Traditional defined benefit plans are economically back-loaded, and workers earn the bulk of their pension benefit only after 20 to 30 years with the same employer. The value of this benefit spikes after employees qualify for subsidized early retirement benefits (if offered by the employer), typically in their mid-50s, but then declines if they fail to retire at a certain age and keep working. As a result, traditional plans are advantageous only for the small proportion of employees who work for the same employer for 20 to 30 years and retire in their mid-50s. Conversely, traditional plans are disadvantageous for younger employees, for workers who change jobs or interrupt their careers (especially women), and for older workers who continue working after early and normal retirement age.

A few conversions to cash balance plans have raised policy issues about whether conversions are age discriminatory. Notably, a large majority of these conversions have been handled properly, within the rule of the law, and to the benefit of workers. Under the Employee Retirement Income Security Act (ERISA), benefits earned under a traditional plan cannot be reduced when they are converted to a cash balance plan. In a typical cash balance plan, a participant's account is credited each year with a pay credit (such as five percent of an employee's compensation) and an interest credit (either a fixed rate or a variable rate that is linked to an index). Cash balance conversion opponents have argued that pay credits for younger workers provide higher benefits than the same pay credits for older workers because the credits for younger workers accrue interest over a longer period of time. However, proponents of cash balance plans argue that no age discrimination occurs with these plans if the pay and interest credits attributed to older employee accounts are equal to or greater than those of younger workers. The following facts debunk certain myths circulated by opponents of cash balance plans:

Myth: *Conversions to cash balance plans allow employers to reduce benefits for older workers.*

FACT: Current law prohibits pension benefit cutbacks. ERISA prohibits employers from cutting back or reducing any pension benefits that have been earned by

employees once they vest in their pension plan. It is important to note, however, that under the voluntary pension system all defined benefit plan sponsors may change benefit formulas prospectively to either enhance or reduce future benefits that have not yet been earned by an employee. Employers need this flexibility to determine what is appropriate for the needs of their workers and their unique business needs. If this flexibility is taken away or if Congress were to unilaterally mandate certain pension benefits, employers would leave the voluntary pension system altogether and worker retirement security would all but vanish.

Myth: *Most courts have ruled that cash balance plan conversions are age discriminatory.*

FACT: The majority of courts have ruled that cash balance and other hybrid pension plans are NOT age discriminatory, including the most recent ruling on June 10, 2004 , in the *Tootle v. ARINC., Inc.* case. In this case, ARINC Inc. was sued by an employee who claimed that the company's conversion from a traditional plan to a cash balance plan constituted unlawful age discrimination under ERISA because contributions to younger employees would be worth more than the same amount of money contributed to older employees simply because the contributions to younger employees would have more years to accrue interest before retirement. The court found the plaintiff's argument illogical and held that the plan formula did not violate the ERISA age discrimination prohibition because the concept of compounding interest is not inherently age discriminatory.

Myth: *Workers receive less benefits overall in a cash balance plan.*

FACT: More workers receive higher benefits from their cash balance plan than benefits earned under a traditional defined benefit plan: Benefits are earned more evenly over a career span, not just at the end of a worker's career. This can result in greater retirement savings for employees who do not remain with the same employer for their entire working careers. Therefore, a broader group of employees – including lower-income workers and women – earn greater benefits with shorter service under a cash balance plan than under a traditional plan.

According to a study published by Watson Wyatt in 2000, more than 80 percent of participants do better under the hybrid plan formula. The earlier accrual and portability of benefits will better facilitate the accumulation of wealth for a more mobile labor force. Moreover, a Kopp & Sher study for the Society of Actuaries in 1998 reported that 77 percent of women employees are better off under a cash balance plan.

Myth: *Employers convert to cash balance plans to save money.*

FACT: Most conversions to cash balance plan have NOT saved the employer any money. The typical company incurs a 2.2 percent cost increase when converting from a traditional defined benefit plan to a cash balance plan, according to a 2004 *Watson Wyatt* study. Moreover, a 2002 study by Copeland & Coronado for the Pension Research Council found projected benefit obligations actually increased after 78 percent of conversions.

Far from saving money, most companies that convert to a cash balance plan actually spend as much or more on retirement benefits after the conversion as before. Instead, companies are switching to cash balance plans to meet competitive pressures imposed by employees' actual career patterns. In a world where the vast majority of employees will not spend 20 to 30 years working for the same employer, the steady accrual of benefits under a cash balance plan provides greater retirement security than the distant accrual of back-loaded benefits under a traditional plan. In a world where women, skilled mobile workers, and older experienced employees form a critical supply of labor for employers, companies find it difficult to continue traditional plans that can disadvantage or penalize these workers and switch to

cash balance plans that provide more equitable rewards and greater retirement security for all employees.

Myth: *Employers convert to cash balance plans to avoid paying excise taxes on any asset surplus.*

FACT: Employers who convert to a hybrid plan do not pay excise taxes on any excess benefits because all of the assets are rolled over to the new plan for the benefit of a larger number of employees.

Myth: *Traditional defined benefit plans are better for older workers.*

FACT: Traditional plans favor a very small group of employees, but actually harm the retirement security of both younger and older workers, according to the Urban Institute. "[P] ension accruals in traditional DB plans are minimal at young ages, grow rapidly in the late 40s and 50s as workers approach retirement age, and then become negative as workers lose pension wealth when they remain at work past the plan's retirement age," said the Institute's study. "For workers in their early 60s who have participated in the DB plan since age 25, for example, pension wealth declines on average by about 14 percent of annual salary each year. These sharp drops in pension wealth provide strong incentives to retire. By contrast, the prototypical hybrid plans we modeled reward work at older ages."

The Committee for Economic Development found in another independent study that continued work after early retirement eligibility (generally around age 50-55) typically reduced the lifetime value of pension benefits by the equivalent of a 30 percent pay cut. Most Americans cannot afford to retire early; therefore, remaining in a typical defined benefit plan will have a negative effect on overall retirement wealth and security for older workers, which would not occur in a cash balance plan. A 2001 study by the Urban Institute of individuals age 51-61 found the median pension wealth is higher under a cash balance plan than under traditional defined benefit plans.

Myth: *Only younger workers change jobs.*

FACT: Only a fraction of employees remain with one employer for their entire careers; most employees change jobs or interrupt their career. Very few employees retire in their mid 50s after spending 20 or 30 years with the same employer. In fact, the median tenure for workers age 45-54 is only 7.6 years, according to a 2002 Pension Research Council study. Overall, only seven percent of workers are likely to stay with one employer for their entire career. Moreover, a 2003 AARP survey of workers between ages 50 and 70 found that 85 percent have never retired and, of those who have not yet retired, 70 percent plan to work in their retirement years or never retire.

This data shows the vast majority of workers do not spend 20 to 30 years with the same employer, are likely to change jobs at least once or twice in their careers, and do not retire in their mid-50s. As a result, because employees with cash balance plans earn benefits steadily over their careers without the deferred spikes and subsequent declines in value typical of traditional defined benefit plans, a large majority of workers both young and old alike would end up with greater retirement benefits under cash balance pension plans.

Committee on Education and the Workforce

House Education & the Workforce Committee

John Boehner, Chairman
2181 Rayburn HOB · (202) 225-4527

FACT SHEET

Independent Research Findings Confirm Benefits of Cash Balance Pension Plans

July 7, 2004

Despite press accounts that have misstated basic facts, cash balance pension plans actually provide more generous benefits for the majority of workers than do traditional plans. As a result, cash balance conversions over the past two decades have actually benefited employees. These conclusions emerge from a growing body of independent research by economists and academics at some of the nation's most respected institutions, including the Federal Reserve Board, the Urban Institute, the Brooking Institution, and the Wharton School . This independent research confirms the following facts:

- Traditional defined benefit plans deliver the bulk of their benefits only to a small group of employees who retire in their mid-50s after spending 20 to 30 years with the same employer.
- Few workers actually retire in their mid-50s after spending 20 to 30 years with the same employer, even at large companies.
- Cash balance plans are better suited to Americans' work patterns because they offer portable benefits that allow workers to earn benefits steadily throughout their careers.
- The motivation for switching to cash balance plans is not cost savings but the need to remain competitive and to better adapt pensions to employees' career patterns.
- Although hybrid plans share accrual patterns with defined contribution plans, hybrid plans have distinct advantages over defined contribution plans.

TRADITIONAL DEFINED BENEFIT PLANS DELIVER BULK OF BENEFITS TO WORKERS WHO RETIRE IN THEIR MID-50s AFTER SPENDING 20 TO 30 YEARS WITH THE SAME EMPLOYER

Traditional plans are economically back-loaded, and workers earn the bulk of their pension benefit only after 20 to 30 years with the same employer. The value of this benefit spikes after workers qualify for subsidized early retirement benefits (if offered by the employer), typically in their mid-50s, but then declines if they fail to retire at a specific age and keep working. As a result, traditional plans are advantageous only for the small proportion of employees who work for the same employer for 20 to 30 years and retire in their mid-50s. Conversely, traditional plans are disadvantageous for younger employees, for workers who change jobs or interrupt their careers (especially women), and for older workers who continue working after early and normal retirement age.

- "The annual increment to pension wealth often turns negative after workers reach the

plan's normal retirement age, because the modest increase in the size of the annuity from an additional year of work does not offset the loss of a year's worth of benefits." Johnson & Uccello, Urban Institute, *Can Cash Balance Pension Plans Improve Retirement Security for Today's Workers?* (2002).

- "A survey of 1,000 [traditional] pension plans showed that continued work after early retirement eligibility typically reduced the lifetime value of a pension by the equivalent of a 30 percent pay cut." Committee for Economic Development, *New Opportunities for Older Workers* (1999).

- "[P]ension accruals in traditional DB plans are minimal at young ages, grow rapidly in the late 40s and 50s as workers approach retirement age, and then become negative as workers lose pension wealth when they remain at work past the plan's retirement age. For workers in their early 60s who have participated in the DB plan since age 25, for example, pension wealth declines on average by about 14 percent of annual salary each year." Johnson & Steuerle, Urban Institute, *Promoting Work at Older Ages: The Role of Hybrid Pension Plans in an Aging Population* (2003).

- "In effect, [traditional] DB plans favor a select group of longer-term employees, often in late middle-age, but disfavor both younger and older workers." Johnson & Steuerle, Urban Institute, *Promoting Work at Older Ages: The Role of Hybrid Pension Plans in an Aging Population* (2003).

VERY FEW WORKERS RETIRE IN THEIR MID-50s AFTER SPENDING 20 TO 30 YEARS WITH THE SAME EMPLOYER, EVEN AT LARGE COMPANIES

Only a very small percentage of employees work for the same employer throughout their career. Most employees change jobs or interrupt their career. Very few workers retire in their mid-50s after spending 20 to 30 years with the same employer. Most Americans work beyond early retirement age because they cannot afford to retire, and an increasing percentage of employees work past normal retirement age for the same reason.

- "[U]sing data from personnel files from 65 large companies we found that only seven percent of workers were likely to stay with one employer for their entire career." Mitchell & Mulvey, Pension Research Council, Wharton School, University of Pennsylvania, *Possible Implications of Mandating Choice in Corporate Defined Benefit Plans* (2003).

- The median years of tenure with an employee's current employer in 2002 for employees age 25 and older was 4.7 years. The median tenure varied by age, for example: 7.6 years for employees age 45 to 54; 9.9 years for employees age 55 to 64, and 8.7 years for employees age 65 and older. Bureau of Labor Statistics, *Median Years of Tenure with Current Employer for Employed Wage and Salary Workers by Age and Sex, Selected Years, 1983-2002.*

- "Over the past 20 years, the median tenure of workers has been declining, particularly for the older age groups. . . . [M]edian tenures for workers age 45-54 has fallen from 9.5 years in 1983, to 7.6 years in 2002, for a 20 percent decline drop over 20 years." Mitchell & Mulvey, Pension Research Council, Wharton School, University of Pennsylvania, *Possible Implications of Mandating Choice in Corporate Defined Benefit Plans* (2003).

- "[A] significant percentage of the workforce has been in their current job for a very short period of time (two years or less) consistently over the years . . . Over the period 1983-1996, the fraction of all wage and salary workers with two years or less of tenure with

current employer hovered in the 36-39 percent range." Yakoboski, Employee Benefit Research Institute, *Debunking the Retirement Policy Myth: Lifetime Jobs Never Existed for Most Workers* (1998).

CASH BALANCE PLANS ARE BETTER SUITED TO AMERICANS' WORK PATTERNS BECAUSE THEY ALLOW WORKERS TO EARN BENEFITS STEADILY THROUGHOUT THEIR CAREERS

Under cash balance plans, workers earn portable benefits steadily throughout their careers without the deferred spikes and subsequent declines in value typical of traditional plans. Because the vast majority of workers do not spend 20 to 30 years with the same employer, are likely to change jobs at least once or twice in their careers, and do not retire in their mid-50s, cash balance plans provide more generous and more secure retirement benefits for workers. In fact, cash balance plan conversions have benefited most employees affected by them. These plans are especially advantageous for women, lower-paid workers, older employees who continue working after early and normal retirement age, younger workers, and employees who change jobs during their careers.

- "Compared with traditional pensions, cash balance plans generate retirement wealth more evenly over time for a couple of reasons: Contributions made early on earn interest for many years, and lifetime earnings rather than final earnings determine benefits. Consequently, a worker changing jobs incurs only a small penalty. For women, who tend to have higher turnover rates than men, the ability to change jobs without jeopardizing pension wealth may be particularly important." Johnson & Uccello, Urban Institute, *Can Cash Balance Pension Plans Improve Retirement Security for Today's Workers?* (2002).

- "[P]ension accruals in traditional DB plans are minimal at young ages, grow rapidly in the late 40s and 50s as workers approach retirement age, and then become negative as workers lose pension wealth when they remain at work past the plan's retirement age. For workers in their early 60s who have participated in the DB plan since age 25, for example, pension wealth declines on average by about 14 percent of annual salary each year. These sharp drops in pension wealth provide strong incentives to retire. By contrast, the prototypical hybrid plans we modeled reward work at older ages." Johnson & Steuerle, Urban Institute, *Promoting Work at Older Ages: The Role of Hybrid Pension Plans in an Aging Population* (2003).

- A study of a traditional plan and a cash balance plan that provided equal pension wealth in the aggregate found that 68 percent of employees receive greater benefits under the cash balance plan. The same study found that 77 percent of women employees would be better off under the cash balance plan. Kopp & Sher, Society of Actuaries, *A Benefit Value Comparison of a Cash-Balance Plan with a Traditional Final Average Pay Defined-Benefit Plan*, The Pension Forum (Oct. 1998).

- "Cash balance plans generally are structured such that workers accrue benefits earlier in their careers than they would under most traditional defined benefit plans. This feature, combined with the lump sum payouts also common to such plans, provides opportunity for more mobile workers to secure and retain higher benefits, even when they change jobs, than they would under most traditional defined benefit plans." General Accounting Office, *Cash Balance Plans: Implications for Retirement Income* (2000).

- "A recent Watson Wyatt report concluded that most workers would do better in cash balance plans than DB plans (Brown, et al. undated). It examined three actual plan conversions by large employers. Pension costs decreased by 32 percent in one

conversion, increased by 23 percent in the second conversion and remained approximately constant in the third. Under the cost-neutral conversion, pension wealth increased for 80 percent of participants." Johnson & Uccello, Urban Institute, *The Potential Effects of Cash Balance Plans on the Distribution of Pension Wealth at Midlife* (2001).

- "The proportion of females who would have received more valuable cash balance benefits is higher –about three-quarters – due to their relatively higher turnover particularly at younger ages where the cash balance plan provides more valuable benefits than the final average pay plan." Kopp & Sher, Society of Actuaries, *A Benefit Value Comparison of a Cash-Balance Plan with a Traditional Final Average Pay Defined-Benefit Plan*, The Pension Forum (Oct. 1998).

THE MOTIVATION FOR SWITCHING TO CASH BALANCE PLANS IS NOT COST SAVINGS BUT THE NEED TO ADAPT PENSIONS TO EMPLOYEES' CAREER PATTERNS

Cost savings are not driving the switch to cash balance plans, but the need to adapt pension plans to the reality of the American workplace – a reality in which full-career employment capped by early retirement in one's mid-50s is a rarity experienced by few employees. Under current law, employers could choose to freeze or terminate their traditional plan without the complexity and expense of converting to a cash balance plan. Far from cutting costs, most companies that convert to cash balance plans actually spend as much or more on retirement benefits after the conversion as before.

Instead, companies have switched to cash balance plans to meet pressures imposed by an increasingly mobile workforce as well as fierce business competition both at home and abroad. In a world where the vast majority of employees will not spend 20 to 30 years working for the same employer, the steady accrual of benefits under a cash balance plan provides greater retirement security than the distant accrual of back-loaded benefits under a traditional plan. In a world where women, skilled mobile workers, and older experienced employees form a critical supply of labor, employers find it difficult to continue traditional plans that can disadvantage or penalize these workers. As a result, some employers have switched to cash balance plans that provide more equitable and generous rewards for all workers.

- "[C]ash balance conversions have been undertaken in competitive industries with tight labor markets and can be viewed largely as a response to better compensate a more mobile labor force. Indeed, many firms appear to increase their pension liabilities through such conversions." Coronado & Copeland, Federal Reserve Board, *Cash Balance Pension Plan Conversions and the New Economy*, Abstract (2003).

- "[T]raditional DB plans provide retirement income security quite effectively for only a fraction of the population, since lifetime jobs were never widespread. Traditional DB plans were never going to be an effective means of ensuring retirement income security for *most* workers. . . . Hybrid plans have emerged combining features of DB and DC plans, including the portability features of DC plans. It can be argued that retirement plans today match the reality of the work experience for most Americans better than at any time in history." Yakoboski, Employee Benefit Research Institute, *Debunking the Retirement Policy Myth: Lifetime Jobs Never Existed for Most Workers* (1998).

- "As a consequence of the new plan elements, hybrid plans are in fact *less* age discriminatory than many traditional DB plans." Mitchell & Mulvey, Pension Research Council, Wharton School, University of Pennsylvania, *Possible Implications of Mandating Choice in Corporate Defined Benefit Plans* (2003).

CASH BALANCE PLANS ARE SIMILAR TO DEFINED CONTRIBUTION 401(K) PLANS,

BUT SHARE THE DISTINCT ADVANTAGES OF DEFINED BENEFIT PLANS

Cash balance plan benefits are portable and may be rolled over to an IRA just like defined contribution 401(k) plans. Employees are able to view their cash balance benefits in a hypothetical account, much like a 401(k) savings account. However, cash balance plans can pay employees benefits in the form of annuities, which defined contribution plans cannot. Under these plans, the employer bears the investment risk; by contrast, workers bear the investment risk under 401(k) plans. As defined benefit plans, cash balance plans can provide subsidized benefits upon death, disability, plant shutdown, and other circumstances, while 401 (k) plans cannot. Finally, as defined benefit plans, cash balance plans are insured by the Pension Benefit Guaranty Corporation, while defined contribution plans are not.

- "Cash balance plans also have an advantage over defined contribution plans—they protect workers from downturns in the stock market." Johnson & Uccello, Urban Institute, *Can Cash Balance Pension Plans Improve Retirement Security for Today's Workers?* (2002).

- "However, unlike DC plans, the balances in [hybrid plan] accounts do not depend on uncertain investment returns. Instead, retirement benefits paid to participants are set by formulas which specify the interest rate at which the account balances grow. Cash balance plans are similar to DB plans, in that employers bear all investment risks." Johnson & Uccello, Urban Institute, *The Potential Effects of Cash Balance Plans on the Distribution of Pension Wealth at Midlife* (2001).

- "For example, if an employer wanted to offer employees a more portable retirement benefit through a cash balance formula that provides annual credits of five percent of pay, mandatory choice might lead the employer to instead freeze its defined benefit plan and adopt a 401(k) plan that provides contributions of five percent of pay. Under the 401 (k) plan, employees would bear the entire risk of stock market declines." Mitchell & Mulvey, Pension Research Council, Wharton School, University of Pennsylvania, *Possible Implications of Mandating Choice in Corporate Defined Benefit Plans* (2003).

Committee on Education and the Workforce

House Education & the Workforce Committee

John Boehner, Chairman
2181 Rayburn HOB · (202) 225-4527

FACT SHEET

Why the IBM Pension Ruling Is Flawed

July 7, 2004

On July 31, 2003 , the U.S. District Court for the Southern District of Illinois issued the *Cooper v. IBM* decision stating that IBM's hybrid plans violate the age discrimination rules under ERISA. The reasoning behind the decision, however, is economically unsound, flawed, and contrary to a large body of other federal court rulings. The judge in this case found the plan design to be inherently age discriminatory because equal pay credits for younger workers have a longer period of time to earn interest and accrue benefits before retirement than the same pay credits for older workers. In other words, the judge ruled the concept of compounding interest to employee accounts, taking into consideration the time-value of money, is discriminatory.

- If a typical cash balance plan accrual pattern is considered age discriminatory, then a typical savings account opened and maintained by two people of different ages would be considered discriminatory as well because interest compounded over longer periods of time would inherently provide a larger account balance to the younger person.
- This logic is inconsistent with every other pension plan design and would even make 401(k) plans and Social Security benefits automatically age discriminatory.
- Simply because an employee age 55 receives his benefit before an employee age 25 does, and therefore, has a shorter period of time to accrue interest should not make a pension plan discriminatory. The time-value of money should always be taken into account.

The Cooper decision is contrary to the legislative history of the 1986 amendments to the federal age discrimination statute. The legislative history is clear the intent of Congress was limited to ensuring employers are prohibited from cutting back or reducing any pension benefits that have been earned by employees once they vest in their pension plan.

- The Cooper decision's interpretation of the statute essentially means that it is age discriminatory to make equal contributions on behalf of participants of different ages. This is inconsistent with every other pension plan design and would even make other plan designs such as 401(k)s automatically age discriminatory.

The Cooper decision is inconsistent with a large body of other federal court rulings. The following three are examples of other federal court decisions addressing this issue that reached a different conclusion.

- *Campbell v. BankBoston (1993)*: The court held the fact that an older worker would have less time to accrue interest is not permitted under the age discrimination laws.

- *Eaton v. Onan (2000)*: The court held the cash balance plan design is not age discriminatory. Instead, the court ruled the proper method for testing age discrimination is whether the rate of contributions to employees' cash balance accounts is at least the same if not greater for older workers as younger employees.
- *Tootle v. Arinc, Inc. (2004)*: The court held the plan did not violate the ERISA age discrimination prohibition because the concept of compounding interest is not inherently age discriminatory.

Letter from U.S. Chamber of Commerce, Submitted for the Record

CHAMBER OF COMMERCE
OF THE
UNITED STATES OF AMERICA

RANDEL K. JOHNSON
VICE PRESIDENT
LABOR, IMMIGRATION & EMPLOYEE BENEFITS

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July 7, 2004

The Honorable John A. Boehner
Chairman
Committee on Education and the Workforce
United States House of Representatives
2181 Rayburn House Office Building
Washington, DC 20515

Dear Chairman Boehner:

On behalf of the U.S. Chamber of Commerce, we would like to thank you for holding a hearing on cash balance pension plans. This letter offers the Chamber's views on the current situation facing sponsors of cash balance and hybrid pension plans and the issues that our members feel must be addressed. Please include this letter as part of the hearing record.

The U.S. Chamber of Commerce is the world's largest business federation, representing more than 3 million businesses of every size and in every sector of the economy. Chamber members with interest in cash balance and hybrid plan issues include companies and organizations in the energy and technology industries, manufacturing companies and businesses in the service industries.

In the absence of statutory guidance, plan sponsors have received unclear and even contradictory messages from regulatory agencies and judicial decisions. These circumstances have unduly increased the risk of sponsoring such plans. To eliminate the escalating liabilities associated with these plans, plan sponsors need legislation that provides certainty and clarity. In addition to outlining the current situation, we have attached to this letter a position statement that has been approved by the Employee Benefits Committee of the U.S. Chamber of Commerce that outlines legislative issues that should, in our view, be addressed by Congress.

Reasons for Cash Balance and Hybrid Plan Implementation

Employers have implemented cash balance plans to respond to the changing demographics of the workforce. In a traditional defined benefit pension plan, most of the benefit accrues close to retirement and tends to favor long-term employees by rewarding longevity and increasing compensation. In a cash balance plan, however, benefits accrue

evenly over a worker's career. For an increasingly mobile workforce, steady accruals under a cash balance plan provide greater benefits than under a traditional pension plan.

Moreover, employers are responding to workers' desires for retirement plans that are less complex than the traditional defined benefit plan. Workers are more easily able to determine their benefit and understand the amount of their benefit at any point during their career in cash balance and hybrid plans. These benefits are more portable than benefits under a traditional pension plan and allow for an even accrual of benefits over the course of a worker's career. For these reasons, workers desire cash balance and hybrid plans because of the similarities to 401(k) plans.

The Importance of Cash Balance and Hybrid Plans

Cash balance and hybrid plans are an important part of the defined benefit plan system. The number of workers covered by a cash balance plan has been steadily increasing even though the number of workers covered by defined benefit plans generally has been decreasing. The percentage of full-time workers covered by a defined benefit plan has dropped from 32 percent in 1996 to 22 percent in 2000. But of those covered by a defined benefit plan, the incidence of cash account plans has risen from 4 percent in 1996 to 23 percent in 2000. These numbers confirm that cash balance plans are becoming an increasingly larger part of the defined benefit system. To discourage the continuation of cash balance and hybrid plans would destroy the most vital aspect of the defined benefit plan system.

Benefits of Cash Balance and Hybrid Plans

Although cash balance and hybrid plans embody many of the advantages of 401(k) plans, they provide an important feature that 401(k) plans do not—a guaranteed benefit. In these plans, the employer must make sure that the plan has enough to pay out the workers accrued compensation and interest credits, even if the plan investments do not perform well. This is an added protection for workers over 401(k) plans because workers do not have to worry about investment risks or fluctuations in the economy.

Moreover, cash balance and hybrid plans increase benefits for most participants. In a Watson Wyatt report from 2000, research indicated that 78 percent of participants enjoy bigger benefits under cash balance and hybrid plans than under their employer's previous plan. The report also shows that cash balance and other hybrid plan conversions reduce costs to the plan sponsor by less than 1.5 percent. In addition, benefits are shared more evenly by all workers and not just those with longevity.

Continued Uncertainty Surrounding Cash Balance and Hybrid Plans

In the past several years, plan sponsors have received conflicting messages concerning the status of cash balance and hybrid plans. The IRS initially gave determination letters approving cash balance plans and has issued guidance on correctly designing cash balance plans. And, yet, in 1999, it issued a moratorium against any

further determination letters. In December of 2002, the IRS, with input from the Equal Employment Opportunity Commission and the Department of Labor, issued proposed regulations (67 FR 76123) specifically addressing the issue of age discrimination in cash balance plans. The proposed regulations discussed how cash balance plans can be designed so as not to be age discriminatory and provide important protections for older workers in a number of ways. By providing a blueprint for cash balance plans to fit within the framework of the age discrimination rules, the IRS rejected the contention that these plans are inherently age discriminatory. However, in June of 2004, the IRS decided to withdraw the proposed regulations in order to clear a path for Congress to act.

The uncertainty surrounding cash balance and hybrid plans has been even more considerable in the area of litigation. In 2000, the Southern District of Indiana ruled that cash balance plans are NOT inherently age discriminatory.[1] However, another case decided in 2003—in the same circuit—refused to accept this precedent. Rather, the Southern District of Illinois, with very little analysis or reference to relevant authority, ruled that cash balance plans are inherently age discriminatory even while recognizing that any disparity in benefits was based upon the time value of money.[2] It is likely that this ruling will be appealed. Most recently, in June of 2004, a Maryland district court ruled that cash balance plans are not age discriminatory.[3] Obviously, this judicial conflict creates uncertainty for sponsors of cash balance and hybrid plans. Left unresolved, this situation will cause plan sponsors to freeze or terminate their plans—thus leaving millions of workers without a guaranteed private pension.

Conclusion

At this time it is urgent for Congress to provide legislative guidance for the thousands of plan sponsors that voluntarily provided these retirement benefits. Again, we ask that you refer to the attached policy and position statement for an explanation of the Chamber's legislative goals. We appreciate the opportunity to provide these comments on cash balance and hybrid plans and the U.S. Chamber of Commerce looks forward to continuing our relationship with the Committee to address these issues.

Sincerely,

Randel K. Johnson
Vice President
Labor, Immigration & Employee Benefits

Aliya S. Wong
Director
Pension Policy

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[1] Eaton v. Onan Corp., 117 F. Supp. 2d 812 (S.D. Ill. 2000).
[2] Cooper v. IBM Pers. Pension Plan, No. 99-829-GPM , 2003 U.S. Dist. LEXIS 13223 (S.D. Ill. July 31, 2003). This case was decided under age discrimination provisions in the Employee Retirement Income Security Act ("ERISA") without reference to the Age Discrimination in Employment Act ("ADEA"). However, the ERISA age discrimination provisions are very similar to the relevant age discrimination provisions in the ADEA.
[3] Tootle v. ARINC, Inc., No., CCB-03-1086, 2004 U.S. Dist. LEXIS 10629 (D. Md. June 10, 2004).

Cash Balance and Hybrid Plan
Policy Statement and Position Paper

- **Congress must state that the hybrid plan design is a legitimate and legal plan design**. The uncertainty surrounding cash balance and hybrid plans stems from conflicting judicial precedents and the lack of regulatory and statutory guidance. In response to this uncertainty and the increasing risks associated with it, plan sponsors have been freezing and terminating their plans. To avoid further deterioration of the defined benefit system, we urge Congress to affirm the continued validity of the hybrid plan design.
    - Formulaic tests may not adequately determine age discrimination in hybrid plans; therefore, a broader test should be used.
    - Calculating benefits in terms of an age-65 annuity is not required under ERISA and is not an accurate method for determining age discrimination in cash balance and hybrid plans. Rather, age discrimination in such plans should be tested by looking at the pay and interest credits received on an annual basis or by looking at the change in an individual's account balance from year to year.

- **Plan sponsors that have made cash balance and hybrid plan conversions need assurance about the validity of those conversions**. Without any legal guidance, lawsuits against plan sponsors continue to put many hybrid plans at risk. Moreover, the continued litigation only serves to confuse the issue even further as seen in recent court decisions. Therefore, Congress must provide assurance to plan sponsors in the conversion aspect of hybrid plans.
    - Past plan conversions are legal unless there is evidence of intentional age discrimination.
    - Future conversions may have some limit on wear away of benefits.
    - Mandatory choice or any other mandatory benefit imposition is inconsistent with the voluntary nature of ERISA.

- **The whipsaw issue must be resolved to allow plan sponsors to continue to provide generous benefits**. The whipsaw effect prevents plan sponsors from providing a more generous benefit because it may result in an unintended windfall for participants who decide to take their benefit in the form of a lump sum. Rather than penalizing plan sponsors for attempting to increase benefits, the law should support such efforts while also ensuring that participants receive the proper benefit.
    - For cash balance plans, it may be appropriate to state the accrued benefit as the balance of the account and determine the actuarial equivalent of benefits from that amount.

Statement of the ERISA Industry Committee, Submitted for the Record

Introduction

The ERISA Industry Committee ("ERIC") is pleased to submit this statement to the Committee on Education and the Workforce for the Committee's consideration in connection with its hearing on cash balance pension plans.

ERIC commends Chairman Boehner, Ranking Minority Member Miller, and all the members of the Committee for holding this hearing. This hearing is a welcome step toward developing an informed understanding of what cash balance and pension equity plans ("hybrid plans") are, the benefits they provide, and the people who benefit from them. We strongly support the Committee's effort to get at the facts and to distinguish myth from reality.

The issues are vital. The future of the private defined benefit plan system is at stake.

The defined benefit plan system is already in decline. Employers that have converted traditional defined benefit plans to hybrid plans have determined that a traditional defined benefit formula does not work for them or their employees. These employers are not likely to return to a traditional pension formula. If Congress errs in its treatment of hybrid plans, employers will have additional incentives to abandon defined benefit plans in greater numbers and at an accelerated rate, disrupting the lives and financial security of the millions of working Americans and their families who now rely on these plans and placing even greater strains on Social Security and other public programs. The consequences will be tragic and unnecessary—not only for the participants and beneficiaries involved but for the Nation as a whole.

Only by carefully studying the issues can Congress avoid potentially irrevocable and calamitous results. We look forward to working with the Committee and its staff as they study these critical issues

Executive Summary

- When Congress considers legislation regarding hybrid plans, it has a responsibility to understand fully how the legislation will affect employers" willingness and ability to sponsor these plans and the benefits that employees will receive from them. We look forward to working with the Committee to expand the knowledge base regarding hybrid plans.
- Voluntary defined benefit retirement plans meet critical retirement security and economic needs.
- In recent years, federal law has not fostered the formation, continuation, and expansion of voluntary defined benefit retirement plans. Future legislation should insure that the formation, continuation, and expansion of voluntary defined benefit plans are viable options for employers.
- It is imperative that an employer's ability to make prospective changes in benefit plan design be preserved if defined benefit plans are to flourish in the future. If employers lose the ability to change their benefit plans in order to respond to changing business circumstances, they will have an even greater incentive to abandon their benefit plans.
- Hybrid plans respond to the needs of a changing economy. They work well for many employers, employees, and the entire Nation.
- Hybrid plans do not invariably reduce benefits.
- Hybrid plans are not age discriminatory.
- Treasury Department guidance has confirmed the lawfulness of hybrid plans.
- ERIC looks forward to working with the Committee on proposals to ensure that defined benefit plans, including hybrid plans, remain a viable retirement security option for employees and retirees in the future.

ERIC

ERIC is a nonprofit association committed to the advancement of the employee retirement, health, welfare benefit, and incentive plans of America's largest employers. ERIC's members provide comprehensive retirement, health care coverage, incentive, and other economic security benefits directly to some 25 million active and retired workers and their families. ERIC has a strong interest in proposals affecting its members" ability to deliver those benefits, their cost and effectiveness, and the role of those benefits in the American economy.

ERIC has played a leadership role in advocating responsible solutions to the critical retirement and health care coverage issues that face our Nation. ERIC has published policy papers and studies that have received wide acclaim and have been instrumental in the formulation of legislative and regulatory policy. These include, among others—

- The Vital Connection: An Analysis of the Impact of Social Security Reform on Employer–Sponsored Retirement Plans,
- Getting the Job Done: A White Paper on Emerging Pension Issues, and
- Policy Statement on Health Care Quality and Consumer Protection.

ERIC and its members have worked for approximately 30 years to resolve important policy questions and to devise practical solutions to the often vexing problems facing the Committee and the country.

Voluntary Defined Benefit Retirement Plans Meet Critical Retirement Security And Economic Needs.

Before we address the specific subject of this hearing—cash balance and plans and pension equity plans—it is important to emphasize the important role of voluntary defined benefit retirement plans in our Nation's economy.

It is also important to emphasize that the strength of the employer-sponsored benefit plan system depends on the system remaining voluntary. Employers are not required to provide retirement plans for their employees. Employers provide retirement plans voluntarily because it is in both their employees" interest and their own interest to do so.

Defined benefit retirement plans have played a critical role in helping to meet many employees" retirement security needs, a role that differentiates defined benefit plans from defined contribution plans:

- They provide a reliable source of retirement income to plan participants and their beneficiaries.
- They act as a form of automatic savings: benefits accrue automatically under most defined benefit plans.
- Employees are sheltered from investment and other risks that can reduce individual retirement savings.
- Once vested, the employee is virtually guaranteed whatever benefit he or she has earned under the plan.
- The employer is responsible for funding the plan. If the employer becomes bankrupt, the Pension Benefit Guaranty Corporation ("PBGC") guarantees payment of most benefits.
- Defined benefit plans make benefits available as an annuity. If a retiree takes an annuity, the plan, not the retiree, bears the risk that the retiree will outlive his or her life expectancy.

Defined benefit plans also help many employers to attract, retain, and motivate employees. In addition, defined benefit plans are major investors in the economy and make major contributions to national savings, investment, and economic growth.[1]

The Decline in Defined Benefit Plan Coverage.

Although defined benefit plans provide valuable retirement security benefits to the millions of employees who participate in them, the coverage of these plans is declining:

- Between 1979 and 1998, the number of defined benefit plan participants fell by over 22%, from 29.4 million to 22.9 million.[2]
- Between 1985 and 2000, the number of active participants in PBGC-insured defined benefit plans fell by about 15%, from almost 27 million to less than 23 million—notwithstanding the expansion of the total workforce during this period.[3]

Why has this happened? From the early 1980s until 1994, Congress piled law on top of law in an effort to meet Congressional budgetary targets by squeezing as much "tax revenue" out of defined benefit plans as it could. Through these laws, Congress created a regulatory climate that not only micro-managed these plans, but also strangled employers" ability to fund these plans for the future. The result was to subject defined benefit plans to a bewildering array of complex, rigid, and inconsistent legal requirements.

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[1] As of December 31, 2001, private-sector defined benefit plans held assets valued at $1.81 trillion. Staff, Joint Committee on Taxation, Present Law and Background Relating to Employer–Sponsored Defined Benefit Plans, at 33–34 (JCX–71–02) (June 18, 2002).

[2] U.S. Dep't of Labor, Pension & Welfare Benefits Administration, Private Pension Plan Bulletin: Abstract of 1998 Form 5500 Annual Reports No. 11, at Table E8 (Winter 2001–2002).

[3] Pension Benefit Guaranty Corporation, 2002 Annual Report, at 14 ("The number of active workers PBGC insures actually fell from almost 27 million in 1985 to less than 23 million in 2000. Meanwhile, the labor force has grown. Now only about 20 percent of private-sector wage and salaried workers are covered by PBGC-insured defined benefit pension plans, down from 30 percent in 1985. If the trend continues, active participants will constitute less than half of PBGC-insured participants in 2003.").

The resulting legal regime has been excessive, oppressive, and convoluted. Its primary effect has been a decline in retirement security, as employees have found the rules to be bewildering and as employers have found sponsoring a plan to be increasingly burdensome and unwieldy. It has discouraged employers from adopting new plans and encouraged many to terminate their existing plans. For example:

- Restrictive, complex, and frequently amended legal requirements, including compensation and benefit limits and distribution rules have required plans to invest a substantial portion of their resources in legal compliance and plan administration, rather than in providing benefits to participants and beneficiaries.
- New short-sighted funding rules have subjected employers to unrealistic funding assumptions, ignored the long-term nature of pension obligations, and limited employers" ability to fund their defined benefit plans until late in their employees" careers.
- Rigid restrictions on the use of pension assets have converted a defined benefit plan into a "black hole" from which contributions cannot emerge—even if the plan's assets vastly exceed the amount required to fund the plan's benefits.

This regime has weakened retirement security by restricting funding opportunities when employers are most able to fund, by increasing funding requirements when employers are least able to fund, by subjecting employers to highly volatile funding requirements that are difficult, if not impossible, for employers to predict, by subjecting plans to excessive administrative costs, by confusing employees, and, in the aggregate, by making it less attractive for employers to maintain and contribute to defined benefit plans. It is difficult to imagine a regime less likely to encourage the establishment and continuation of defined benefit plans.

The decline in defined benefit plan coverage has substantially weakened the retirement security of our Nation's workforce.

Federal Law Should Ensure That The Formation, Continuation, And Expansion Of Voluntary Defined Benefit Retirement Plans Are Viable Options For Employers.

Federal law must create an environment that is conducive to plan formation, continuation, and expansion. If federal law makes it too costly or impractical to maintain a plan, or subjects plans to irrational or counterproductive rules, employers will refrain from creating new plans and will be encouraged to terminate or curtail the growth of existing plans. If federal law makes it difficult or impossible for an employer to modify an existing plan—if adopting a voluntary plan locks an employer into a permanent commitment to maintain the plan without change—employers will be loathe to adopt these plans. If an employee benefit plan becomes a straight jacket from which there is no escape, employers will respond by not adopting plans. The drafters of ERISA understood this well. As the late Senator Jacob Javits (R–N.Y.) observed:

> "The problem, as perceived by those who were with me on this issue in the Congress, was how to maintain the voluntary growth of private plans while at the same time making needed structural reforms in such areas as vesting, funding, termination, etc., so as to safeguard workers . . . [T]he new law represents an overall effort to strike a balance between the clearly-demonstrated needs of workers for greater protection and the desirability of avoiding the homogenization of pension plans into a federally-dictated structure that would discourage voluntary initiatives for further expansion and improvement." [4]

The Employer's Ability To Change The Design Of Its Retirement Plan Must Be Preserved.

One of the great strengths of our Nation's retirement security system is the flexibility it currently provides to an employer to design and adjust its plans to respond to changing business circumstances and to the changing needs of the employer and its employees.

The rapid emergence of new technologies and the obsolescence of old products and services are reshaping many industries, forcing companies in those industries to adapt quickly or—like buggy whip manufacturers in the age of internal combustion engines—die. Businesses change their ways of doing business, move into new businesses, merge, form joint ventures, acquire other companies or are themselves acquired, and divest old lines of business or are themselves divested as they adjust to challenges and opportunities in today's highly competitive international market-

[4] Address by Senator Jacob K. Javits, Briefing Conference on Pension and Employee Benefits, New York State School of Industrial and Labor Relations, Cornell University and Federal Bar Association, Washington, D.C. (Sept. 19, 1974).

place. New global competition and competition from emerging companies have made it essential for employers to change their employee rewards programs.

If employers lose the right to change their retirement plans to respond to changing business conditions, the consequences will be disastrous for employers, employees, and the U.S. economy.

Employees And The Economy As A Whole Will Be Harmed If Employers Are Prevented From Changing Their Plans To Respond To Changing Business Circumstances.

Under current law, employers may not amend their plans to reduce benefits that have already accrued. But employers have always had the right to change their plans prospectively—to change the terms governing benefits that have not yet been earned.

The employer's right to make prospective changes in benefits is essential to the vitality of the U.S. economy and to new and expanded employment opportunities. It is also essential to our voluntary benefit system. As we have explained, elimination of the right to make prospective benefit changes will deter employers from adopting benefit plans. If the right to make prospective changes is eliminated, the principal victims will be employees and their families—who will no longer receive the critical benefits that these plans provide. The harmful consequences are predictable: less retirement savings, less retirement security, greater poverty among the elderly, greater pressure on older employees to continue working, increased financial catastrophes for workers of all ages, greater demands on public assistance programs, greater demands on Social Security, and less investment capital for the economy.

Moreover, if employers lose the right to change the terms on which benefits will be earned in the future, employers that have benefit plans will have their options severely limited. When subject to financial pressures, employers will not be able to reduce costs by reducing future benefit levels and will be forced to adopt alternative measures such as reductions in pay levels, cutbacks in health benefits, layoffs, and outsourcing. Under these conditions, employers with retirement plans will be at a severe competitive disadvantage vis a vis employers that do not have them. The impact on these employers, their employees and retirees, and the economy as a whole will be devastating. Many employers will decide to terminate their plans rather than allow themselves to be in this position.

Most Traditional Defined Benefit Plans Focus Most Of Their Benefits On A Small Group Of Employees.

Under most traditional defined benefit plans, employees earn most of their benefits only after completing 20 to 30 years of service with the same employer. The value of their benefits spikes after they qualify for subsidized early retirement benefits, typically in their mid–50's or later, but then declines if they choose not to retire and keep working. Although the dollar amount of the plan's monthly retirement benefit typically does not decline, the economic value of the retirement benefit does decline if the employee delays retirement; this is because the value of the plan's early retirement subsidy declines as the employee approaches the plan's normal retirement age.

As a result, traditional defined benefit plans are most advantageous to the relatively small group of employees who work for the same employer for 20 to 30 years and retire at the plan's early retirement age. They are far less beneficial for others—for employees who change jobs or interrupt their careers and for older employees who continue to work after early or normal retirement age.[5] Indeed, this has been a major criticism of defined benefit plans for many years.

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[5] "Overall, defined benefit pension wealth—the present value of the expected future stream of [traditional] pension benefits—grows slowly early on in an individual's career, increases rapidly near the end, and then declines at older ages." Johnson & Uccello, Urban Institute, Can Cash Balance Plans Improve Retirement Security for Today's Workers?, at 2 (2002). "[T]raditional DB pensions have imposed large benefit cuts on employees who left the firm prior to retirement age. This is because most traditional DB formulas usually link retirement payments to final pay at the company . . . ." Mitchell & Mulvey, Pension Research Council, Wharton School, University of Pennsylvania, Possible Implications of Mandating Choice in Corporate Defined Benefit Plans, at 3 (2003). "[P]ension accruals in traditional DB plans are minimal at younger ages, grow rapidly in the later 40s and 50s as workers approach retirement age, and then become negative as workers lose pension wealth when they remain at work past the plan's retirement age. For workers in their early 60s who have participated in the DB plan since age 25, for example, pension wealth declines on average by about 14 percent of annual salary each year." Johnson & Steurle, Pension Research Council, Wharton School, University of Pennsylvania, Promoting Work at Older Ages: The Role of Hybrid Pension Plans in an Aging Population, at 21 & Fig. 12 (2003).

Although traditional defined benefit plans are appropriate for some employers and some work forces, they do not meet the needs of many employers and employees.

Hybrid Plans Respond To A Changing Economy.

Many workers in changing industries no longer look forward to a lifetime career with one employer. They expect to change employers more frequently than their parents and grandparents did. A retirement plan that requires workers to stay with the same company and wait for a big bump-up in the value of their pension benefits in the last few years of employment penalizes workers who, for one reason or another, leave an employer early or in mid-career and offers little incentive to join an employer recruiting for top talent.

Recently, new hybrid plan designs, such as cash balance defined benefit plans and pension equity plans, have been embraced by employers and employees alike who need benefit plans that match the new environment in which they work. In contrast to traditional defined benefit plans, hybrid plan designs have stimulated great interest in retaining and expanding defined benefit plans.[6]

The growth and popularity of these new defined benefit arrangements is supported by the findings of numerous independent analysts, as illustrated by the following conclusions:

> "[G]iven the emergence of vehicles such as 401(k) plans and hybrid plans, retirement plans today match the reality of the work experience for most Americans better than at any time in the past."[7]

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> "[W]orkers employed by more than one employer during their career can receive more retirement income under multiple cash balance plans than under multiple traditional defined benefit plans. . . . [In one example, the] benefit earned by the worker who changed employment under multiple cash balance plans will accrue a retirement benefit that is almost 22 percent larger than the benefit received by the workers under multiple [final average pay] plans."[8]

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> "Median lifetime pension wealth would increase under cash balance plans because these new plans distribute pension wealth more equally across the covered population."[9]

See also Appendix.

Hybrid Plans Meet Employee Needs.

Benefits Are Understandable: Unlike traditional defined benefit plans, cash balance plans provide an easily understood account balance for each participant. Employees—who are accustomed to dealing with bank account balances, § 401(k) account balances, and IRA balances—are comfortable with a retirement plan that provides a benefit in the form of an account balance.

Savings Accrue Automatically: Unlike § 401(k) plans, amounts are added automatically to the accounts of all employees eligible to participate in a hybrid plan. The employee does not have to make an affirmative choice to participate or make often difficult decisions about how much of his or her current income to defer.

The Employer Bears The Risk: Like traditional defined benefit plans, but unlike defined contribution plans (e.g., § 401(k), money purchase plans, or profit sharing plans), investment risks are borne by the employer. Sudden or even prolonged downturns in the equity or bond markets do not affect the defined benefit promised to the participant.

Benefits Are Guaranteed: Like traditional defined benefit plans, but unlike defined contribution plans, benefits are insured by the PBGC, a government agency.

Greater Benefits For Short–Service Employees: An employee typically earns most of his or her benefit under a traditional defined benefit plan in the last few years

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[6] "During the middle and late 1990s, hybrid plans, primarily cash balance plans, became a growing percentage of the plans PBGC insures. . . . In 2000, hybrid plans contained an estimated 20 percent of all PBGC-insured single-employer plan participants." Pension Benefit Guaranty Corporation, 2002 Annual Report, at 14.

[7] Yakoboski, Employee Benefits Research Institute, Debunking the Retirement Policy Myth: Lifetime Jobs Never Existed for Most Workers, at 1 (1998).

[8] General Accounting Office, Cash Balance Plans: Implications for Retirement Income, at 26–27 (2000).

[9] Johnson & Uccello, Urban Institute, Can Cash Balance Pension Plans Improve Retirement Security for Today's Workers?, at 3 (2002).

before retirement. By contrast, a hybrid plan delivers benefits more evenly over the employee's career, and an employee who leaves before retirement can roll over his or her benefit, on a tax-deferred basis, to an IRA or a new employer's plan. Thus, hybrid plans are especially attractive in new industries that tend to attract highly talented, mobile workers as well as in industries that are undergoing significant changes.

Women Benefit: Hybrid plan designs offer significant advantages to women (who are most threatened by impoverishment in old age) and others who tend to move in and out of the workforce. In fact, all mobile workers—not just women—are more likely to accrue a significant and secure retirement benefit under cash balance plans than under many other plan designs.[10]

Older Workers Benefit: The advantages of a hybrid balance plan design are not limited to mobile workers, however. For example, the value of the benefit for an older worker participating in a hybrid plan increases at the same rate both before and after normal retirement age (and , in some plans, increases at a higher rate as the employee accrues additional years of age or service). By contrast, under a traditional defined benefit plan, particularly those that offer subsidized early retirement benefits, the economic value of an employee's benefit actually declines when an employee works past the plan's early or normal retirement age.[11]

Portability: Hybrid plans provide portable benefits that can be rolled over to another employer's plan or an IRA, on a tax-deferred basis, for continued retirement savings. In addition, when companies are merged, acquired, or form joint ventures, the benefits are easily transferred to a new plan, making continuity more attractive to the new employer and making it more likely that affected employees will achieve retirement security.

Employee Control: Since the amounts payable under hybrid plan benefits are more easily understood by employees than are the benefits under many traditional defined benefit plans, employees are more likely to take responsibility for their retirement and their future, resulting in greater personal and national savings.

No Penalties: Unlike many traditional defined benefit plans, hybrid plans do not penalize employees who wish to move on to other jobs before reaching retirement eligibility:

> "Traditional DB plans generally encourage early retirement, by offering early retirement subsidies and delayed retirement penalties. As a result, DB plan sponsors seeking to keep their older workers on the job found that their traditional plans did not serve business objectives. By contrast, hybrid plans eliminate early retirement incentives and do not have a "spike" in accrual rates shortly before normal retirement age. Thus workers who leave early are not penalized as was the case of most DB plans, which provided larger accruals for longer tenured employees close to retirement."[12]

Annuities Are Available: Since annuities must be offered by a hybrid pension plan, participants who want to receive their retirement benefit as a stream of income avoid the increased cost and difficulty of purchasing annuities in the individual market. By contrast, if an employee who participates in a defined contribution plan wishes to receive the balance in his or her defined contribution account as an annuity, the employee must approach one or more insurance companies and

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[10] "Compared with traditional pensions, cash balance plans generate retirement wealth more evenly over time for a couple of reasons: Contributions made early on earn interest for many years, and lifetime earnings rather than final earnings determine benefits. Consequently, a worker changing jobs incurs only a small penalty. For women, who tend to have higher turnover rates than men, the ability to change jobs without jeopardizing pension wealth may be particularly important." Johnson & Uccello, Urban Institute, Can Cash Balance Pension Plans Improve Retirement Security for Today's Workers?, at 2 (2002).

[11] "[P]ension accruals in traditional DB plans are minimal at young ages, grow rapidly in the late 40s and 50s as workers approach retirement age, and then become negative as workers lose pension wealth when they remain at work past the plan's retirement age. For workers in their early 60s who have participated in the DB plan since age 25, for example, pension wealth declines on average about 14 percent of annual salary each year. . . . In effect, DB plans favor a select group of longer-term employees, often in late middle-age, but disfavor both younger and older workers. Unlike traditional DB plans, hybrid pension plans, such as cash balance plans and pension equity plans, often reward work at older ages at least as much as work at younger ages, because workers in hybrid plans do not forgo a year of benefits for every year they remain on the job past the retirement age." Johnson & Steurle, Pension Research Council, Wharton School, University of Pennsylvania, Promoting Work at Older Ages: The Role of Hybrid Pension Plans in an Aging Population, at 21, 24 & Fig. 12 (2003).

[12] Mitchell & Mulvey, Pension Research Council, Wharton School, University of Pennsylvania, Possible Implications of Mandating Choice in Corporate Defined Benefit Pension Plans, at 4 (2003) (citation omitted).

purchase an annuity on whatever terms are then available to an individual purchaser in the annuity market.

Hybrid Plans Meet Employer Needs.

Appropriate Employment And Retirement Incentives: Because hybrid plans deliver benefits evenly throughout an employee's career, they do not provide undue incentives for employees to keep working for the same employer until reaching retirement age or to retire immediately when they do qualify for retirement.

Improved Employee Communication: Because benefits in hybrid designs are more understandable, retirement benefits and the need to save are more easily and effectively communicated to all employees, including those who ordinarily do not pay much attention to retirement issues.

Improved Employee Recruitment and Retention: Hybrid plans are an effective tool for attracting new employees and retaining and rewarding current employees.

Enhanced Benefit Coordination: Hybrid plans are easily coordinated with the employer's savings or profit-sharing plan.

Neutral Impact On Enterprise Decisions: Because cash balance and hybrid plan designs of different companies can be coordinated relatively easily, they offer a stable "platform" to retain employees for companies engaged in mergers and acquisitions.

Hybrid Plans Benefit The Nation.

Capital Accumulation: Defined benefit plans—which include hybrid designs—have for decades been an engine of capital accumulation, making available secure sources of capital for business start-ups and economic expansion that have been responsible for the outstanding success of the American economy.

More Efficient Retirement Savings: Because of the longer investment horizon available under a defined benefit plan, a hybrid plan can invest its assets more aggressively and can better withstand market downturns while still providing a full benefit than can an individual participating in a defined contribution plan, who must bear all of the investment risk under the plan.

Increased Retirement Savings: Under hybrid plans, more workers build larger savings earlier in their careers, increasing their opportunity to accumulate significant retirement savings and reducing the pressure on government programs in their retirement years.

Increased Pension Participation: All eligible employees automatically accrue benefits under hybrid defined benefit plans. Because benefit accrual does not depend on an employee's election to participate, more employees whose employers provide a defined benefit pension plan will actually benefit from the plan.

More Compatible Workplace For Women: The design of a hybrid plan can enable an employer to offer a total compensation package that allocates value more equitably between long-service employees and women and others who tend to move in and out of the workforce. Hybrid plans will help to address the phenomena of the considerable number of elderly poor women with insufficient pension resources and the resulting pressure to increase targeted entitlements.

Less Pressure On Government Programs: By providing a reliable source of retirement income, defined benefit plans, including hybrid plans, reduce pressure on government entitlement programs for the elderly.

Employers Have Always Reserved The Right To Revise Their Benefit Plans.

Employers have always had the right to change the retirement plans they provide to their employees. It is a fundamental principle of ERISA. Although current law protects an employee's accrued benefit (including early retirement rights related to the employee's accrued benefit), the law has always allowed an employer to change the terms on which retirement benefits will be earned in the future. As we have explained, if an employer did not have the right to make such changes, employers would be deterred from voluntarily adopting retirement plans in the first place.

Employers frequently make changes in their retirement plans—both major and minor—to accommodate changing employee preferences, to respond to changing competitive, financial, and other conditions, and to achieve specific business objectives. Employees are well aware of the employer's right to change the plan, and have frequently benefited from those changes.

Employees are adequately protected by current law. The law not only prohibits an employer from amending a plan to reduce the pension benefits that employees have already earned, but also requires the plan, after it has been amended, to continue to give employees credit for their service for purposes of qualifying for any early retirement subsidy that applies to the pension benefits that the employees had earned at the time of the plan amendment. For example, if an employer amends a pension plan to provide that pension benefits earned in the future will not include

an early retirement subsidy, employees are still entitled, after the amendment, to continue to earn service credit for purposes of qualifying for any early retirement subsidy that applies to the pension benefits they have already earned.

Hybrid Plans Do Not Inherently Reduce Benefits.

Some critics of hybrid plans have claimed that employees will earn retirement benefits under these plans that are less than the benefits that those employees would have earned if the prior plan formula had remained in effect without change. However, independent studies debunk this claim:

> ". . . [I]t does not appear that most firms are seeking to reduce benefit generosity. . . . Cash balance conversions appear to be largely driven by labor market conditions. . . . [T]he move toward DC-like pensions is likely the result of increased worker mobility." [13]

Ultimately, any comparison between the benefits provided by a hybrid plan and the benefits provided by a traditional defined benefit plan depends on the terms of the plans. Hybrid plans do not inherently provide benefits that are greater or less than the benefits provided by traditional plans. Also, as explained earlier, current law prevents a plan amendment from causing an employee to lose any part of the accrued benefit that he or she has already earned.

In addition, hybrid plans tend to distribute the benefits accrued by plan participants more evenly among employees than do traditional defined benefit retirement plans:

> "By distributing pension wealth more equally across the population than [traditional defined benefit] plans, cash balance plans would increase median lifetime pension wealth in the total covered population and more people would gain pension wealth than lose." [14]

Hybrid Plans Are Not Age Discriminatory.

Claims have been made that hybrid plans invariably violate the Age Discrimination in Employment Act ("ADEA"). These claims lack merit.

Of the four federal district courts that have considered the issue, three have rejected the claim that hybrid plans are age discriminatory. Although one court reached a contrary conclusion, that court's conclusion was subsequently rejected by another federal district court last month.[15]

On its face, a cash balance plan is not age-discriminatory. Each participant, regardless of age, receives the same percentage-of-compensation pay credit—except for the many plans that provide higher pay credits to older workers. The rate at which interest credits are calculated on the participant's cash balance account is age-neutral.[16] Under a pension equity plan, an employee's rate of benefit accrual commonly increases with additional years of age or service.

Claims that hybrid plans are age-discriminatory are based on the theory that because a younger employee will benefit, when the employee reaches retirement age, from a longer period of interest-compounding on his or her account balance than will an older employee, the plan discriminates in favor of the younger employee. What these claims gloss over is that the younger employee must wait longer in order to receive the benefit of the longer period of interest-compounding. The accumulation of interest credits for a longer period of time merely compensates the employee for having to wait longer to collect a benefit from the plan at retirement age.

Cash balance plans are not age-discriminatory for the same reason that Social Security is not age-discriminatory. Both plans index employees" pension benefits prior to retirement: cash balance plan benefits are indexed with interest, while Social Security benefits are indexed for increases in average national wages and the cost of

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[13] Coronado & Copeland, Pension Research Council, Wharton School, The University of Pennsylvania, Cash Balance Pension Plan Conversions and the New Economy, at 23 (2003).

[14] Johnson & Uccello, Urban Institute, The Potential Effects of Cash Balance Plans on the Distribution of Pension Wealth at Midlife, at 29 (2001).

[15] Compare Tootle v. ARINC, INC., Civ. Act. No. CCB–03–1086 (D.Md. June 10, 2004) (rejecting age discrimination claim), Engers v. AT&T, Civ. Act. No. 98–CV–3660 (NHP) (D.N.J. June 6, 2001) (same), and Eaton v. Onan Corp., 117 F. Supp. 2d 812 (S.D. Ind. 2000) (same), with Cooper v. IBM, 274 F. Supp. 2d 1010 (S.D. Ill. 2003) (accepting age discrimination claim). See also Campbell v. BankBoston, N.A., 327 F.3d 1, 10 (1st Cir. 2003) (recognizing problems with age discrimination theory) (dictum).

[16] "By contrast, many employers today prefer hybrid plans because they smooth compensation differentials by age and soften the incentives for early retirement. As a consequence of the new plan elements, hybrid plans are in fact less age discriminatory than many traditional DB plans." Mitchell & Mulvey, Pension Research Council, Wharton School, University of Pennsylvania, Possible Implications of Mandating Choice in Corporate Defined Benefit Plans, at 18 (2003) (emphasis original).

living. These pre-retirement indexing features protect employees against inflation; they are not age-discriminatory.

Some have claimed that when a traditional defined benefit retirement plan is converted to a hybrid plan design, the "wear-away" feature used to transition from the old formula to the hybrid plan formula discriminates against older workers. Where wear-away occurs, an employee who participates in the plan at the time of conversion typically receives the greater of two benefits: (1) the employee's accrued benefit under the old formula at the time of conversion or (2) a benefit based solely on the plan's new hybrid plan formula plus interest.

Depending on the details of the two formulas, an employee with a very substantial accrued benefit under the plan's old formula might find that he or she has no increase in benefits, especially early retirement benefits, for some period of time, while a more recently-hired employee might begin to accrue additional benefits immediately. However, this is not the result of age discrimination. If neither the plan's old formula nor the plan's new formula is age-discriminatory, there is no basis for claiming that a plan that provides an employee with the greater of the benefits provided by the two formulas is age-discriminatory. Indeed, in the past, Congress and the Treasury Department have both required and permitted plans to provide participants with the greater of their previously accrued benefits under the old plan formula or the benefits they accrued under a new plan formula.[17]

Treasury Department Guidance Has Confirmed The Lawfulness of Cash Balance Plans.

Hybrid plans have been on the scene for nearly 20 years, and the Government has indicated on numerous occasions that hybrid plans are lawful. Employers have reasonably relied on Government guidance in adopting hybrid plans:

Preamble to the Final § 401(a)(4) Regulations: In the preamble to the final regulations creating a safe harbor for cash balance plans from the restrictions on discrimination in favor of highly compensated employees, the Internal Revenue Service stated unequivocally that cash balance plans were not age-discriminatory:

> "The fact that interest adjustments through normal retirement age are accrued in the year of the related hypothetical allocation [i.e., the pay credit] will not cause a cash balance plan to fail to satisfy the requirements of [Code] section 411(b)(1)(H), relating to age-based reductions in the rate at which benefits accrue under a plan."[18]

Regulatory Safe Harbor for Cash Balance Plans: The IRS safe harbor for cash balance plans strongly implied that such plans were lawful. Surely, the IRS would not have created a safe harbor for cash balance plans unless it believed that these plans were lawful.[19] In fact, as the preamble explained, the IRS had concluded that cash balance plans were lawful.

Notice 96–8: The Internal Revenue Service announced its intention to propose regulations regarding lump-sum distributions from cash balance plans.[20] Because it contemplated the issuance of guidance on how lump-sum benefits from cash balance plans should be calculated, Notice 96–8 gave employers every reason to believe that cash balance plans were lawful.

Determination Letters: The Internal Revenue Service has issued favorable determination letters to many hybrid plans, including both cash balance plans and pension equity plans. Indeed, the Service today continues to issue favorable determination letters to cash balance plans that were not the subjects of conversions. Surely, the Service would not have done this in the past or be doing this today if it believed that these plans violate the Internal Revenue Code's age discrimination provisions.

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[17] See, e.g., Tax Reform Act of 1986, Pub. L. No. 99–514, § 1106(i)(3), 100 Stat. 2085, 2425–26 (1986); Tax Equity and Fiscal Responsibility Act of 1982, Pub. L. No. 97–248, § 235(g)(4), 96 Stat. 324, 508–09 (1982); ERISA, Pub. L. No. 93–406, § 2004(d)(2), 88 Stat. 829, 987 (1974); S. Rep. No. 575, 98th Cong., 2d Sess. 29 (1984) (a participant who meets the criteria for an early retirement subsidy that was previously eliminated by a plan amendment is entitled to the greater of the portion of the subsidy attributable to service before the plan amendment or the retirement benefit provided under the plan as amended); Treas. Reg. §§ 1.401(a)(4)–13(c)(4) (listing permissible "fresh-start" formulas), 1.401(a)(17)–1(e) (applying "fresh-start" formulas where Code § 401(a)(17) limits were reduced); Notice 88–131, 1988–2 C.B. 546 (Alternative IID) (providing that certain participants may be entitled to the greater of the benefit accrued under preexisting plan provisions or benefits accrued under amendments adopted to comply with the Tax Reform Act of 1986); Rev. Rul. 81–12, 1981–1 C.B. 228 (addressing changes in actuarial assumptions).

[18] 56 Fed. Reg. 47,528 (Sept. 19, 1991).

[19] See Treas. Reg. § 1.401(a)(4)–8(c)(3).

[20] 1996–1 C.B. 359.

We are currently working on the development of a legislative proposal that will address the issues relating to hybrid plans. We will be pleased to share our proposal with the Committee when our work on the proposal is completed.

We very much appreciate the opportunity to submit this statement, and hope that it will be helpful to the Committee. We look forward to working with the Chairman, the members of the Committee, and the Committee staff on the issues addressed at this hearing.

For more information on cash balance plans and pension equity plans, we invite you to visit ERIC's web site at www.eric.org.

APPENDIX

"To show how DB and cash balance pension wealth would be influenced by job changing, we posit two hypothetical workers, one of whom holds three jobs over his career, and another who remains with an employer for his entire career. . . . [In our hypothetical example, the] DB normal retirement benefit, payable as an annuity from age 65, is worth 1.1 percent of his final five-year average salary, times his years of service at termination (retirement). If the worker were to retire early, the benefit would be reduced by 2 percent per year between ages 62 and 65, 4 percent from 60 to 62, and 5 percent for retirement from age 55 to 60. Since this formula embodies an early retirement reduction rate that is smaller than the actuarially fair rate (which would be around 6–8 percent per year) , the DB plan embodies an early retirement subsidy. By contrast, the cash balance plan [in our hypothetical example] has a much smoother accrual rate, with pay credits of 4 percent per year during the worker's first decade of service, 5 percent for the next ten years, and 5.75 percent for service of 20 years or more. There were no early retirement reductions, and contributions are credited with a 7 percent interest credit per year.

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". . . . . If a young worker knew that he would remain with a single employer his entire career and retire at age 65, his anticipated accumulation in the DB plan would be one-third higher than the cash balance plan. But certainty regarding the mobility prospects is unlikely since the average American holds several jobs over his career. In fact, using data from personnel files from 65 large companies we found that only 7 percent of workers were likely to stay with one employer for their entire career. Thus, when we compute the expected value of the two plans based on the likelihood of a worker actually staying to full retirement and receiving the full defined benefit plan[,] the expected value of the benefit from the hybrid plan is 11 percent higher than the expected value of the defined benefit plan. Beyond the expected value of the benefit, for those employees who changed jobs three times over their work life, their pension wealth from the hybrid plan would be nearly 18 percent higher than what they would have received from three different DB plans."

Mitchell & Mulvey, Pension Research Council, Wharton School, University of Pennsylvania, Possible Implications of Mandating Choice in Corporate Defined Benefit Plans, at 5–6 (2003) (citations omitted & emphasis added).

Statement of Hon. Jon Porter, a Representative in Congress from the State of Nevada

Representative Jon Porter
Statement to the United States House of Representatives
Committee on Education and the Workforce
July 7, 2004
Full Committee Hearing on: *"Examining Cash Balance Pension Plans: Separating Myth from Fact"*

Mr. PORTER: Good Morning, Chairman Boehner. Thank you for calling this hearing on the important issue of Cash Balance Pension Plan conversions and their effect on the workers of today and tomorrow. I welcome our panel of distinguished witnesses and look forward to their testimony. This committee must discern the truth on this important issue so that we can best provide pension security for America's and Nevada's workers.

This issue of cash balance pension plans and how best to allow employers to provide for is one that is surrounded by disagreement on the best possible approach to take with regard to reforming these important benefits. Unfortunately, the technical complexity of the issue further confuses the views that lawmakers and the public hold. I look forward to our guests today helping remove some of this confusion and providing us with a more defined notion of the current situation and how best to resolve the issues we face with hybrid pension plans.

We must ensure that the creation of these new, more versatile plans protects older workers from loosing any benefits that they have currently earned, while allowing younger workers, who will likely not work at the same company throughout their career, the portability to carry these pension benefits from job to job. There are drawbacks for certain groups under all situations. We must take every pain possible to ensure that we find a creative and comprehensive approach to this issue so that the benefits of these hybrid conversions provide all workers with equitable benefits.

While protecting the rights of our older workers must remain paramount, we must look at the benefits that these plans provide so many Americans, especially women, in earning the retirement security to which all attain. Finding a balance between these two important forces represents a difficult, but attainable goal to which we must strive.

Again, I thank the Chairman for his attention to this important issue. I look forward to the continued work of this committee and this Congress in bringing about timely and effective action on and insight into this growing portion of pension plans.

Statement of Hon. Charlie Norwood, a Representative in Congress from the State of Georgia

Statement of the Honorable Charlie Norwood
Committee on Education and the Workforce
Hearing on "Examining Cash Balance Pension Plans: Separating Myth from Fact"
July 7, 2004

Mr. Chairman, I thank you for your continued dedication to exploring the future of the defined benefit pension system, and in particular for holding today's hearing to delve into the complex nature of the cash balance pension plan. I look forward to the testimony of our witnesses, and as always, I appreciate their time and expertise in shedding light on this critical issue facing the American workforce today.

Mr. Chairman, I am pleased that our Committee is continuing to explore solutions to the pension security system for workers, and look forward to working with you and the rest of my colleagues on the Committee in developing comprehensive legislation to improve the long-term viability of private pension

plans. After all, as the American workforce continues to change in the 21st century, the nature of the employer-sponsored defined benefit pension system is changing with it. Each year a growing percentage of American employers are beginning to convert their traditional defined benefit plans to hybrid pension plans (such as cash balance plans) that offer key benefits that traditional plans simply cannot match.

And why wouldn't employers begin to move in this direction? Cash balance pension plans offer American workers all the benefits of a federally insured defined benefit plan that is regulated under the Employee Retirement Income and Security Act (ERISA). In addition, cash balance plans offer workers the benefit of an agile and portable portfolio that accumulates interest credit and pay credit that employers often match up to 5% of employee salary. In effect, a hybrid plan therefore gives workers the benefits that make defined contribution plans so attractive to workers while offering them the security and stability of the defined benefit plan.

Working Americans are increasingly seeking this higher degree of flexibility as the workforce around them continues to evolve, and employers must therefore create an attractive pension option that can accommodate mobility. After all, the average American worker will change careers some 7 times over the course of their career, and will only spend an average of 4.7 years with any one employer. In order to stay competitive in this era of high turnover employers must therefore offer prospective employees a secure pension that promises to build wealth for the future and will adapt to their changing needs.

Mr. Chairman, that is why many employers are increasingly moving to cash balance pension plans; they simply offer employees the promise of wealth creation for real retirement security without the burden of significant long-term accruals that may take 20-30 years for an employee to take advantage of. While the folks of my generation often started and finished a career with the same employer, today's worker does not. And if an employee

will spend less than 5 years with a company, it is crucial that they be able to make a change without penalization.

What's more, Mr. Chairman, studies increasingly show that 80% of employees – including 77% of women – just plain do better under the accrual patterns of the cash balance system as opposed to the traditional defined benefit plan. And since cash balance plans offer employees an *actual* account balance that indicates the value of their accumulated benefits under the plan, employers can give workers a very easy and effective tool to see just how well they are doing.

A traditional defined benefit plan cannot guarantee that ease of use for either party since the employee benefit is expressed in a complicated calculation of employee age, normal retirement age, mortality, future wage growth and assumptions of interest. How many folks can keep up with all that?

Mr. Chairman, I believe that this Committee must consider the undeniable advantages that cash balance plans offer American workers as we continue to develop comprehensive pension policy in the 108th Congress and beyond. While significant questions remain unanswered in my mind as to how the federal government can resolve the controversial issues surrounding cash balance pension plans, including the issue of "Wearaway" and "Whipsaw," which opponents of the cash balance plan appropriately raise in the ongoing debate, I believe the long term advantages of the hybrid plan cannot be ignored.

As we've discussed previously in several hearings you've conducted related to pension security, this Committee is all too aware of the poor financial health of the Pension Benefit Guaranty Corporation (PBGC) and the decline in the number of defined benefit pension plans since the 1970's. If Congress and the Administration can reverse this trend by strengthening our policy in regards to the cash balance plan, we will have done a great

service to both the American worker and the employers that are continuing to drive our 21st century economy.

Mr. Chairman, I look forward to hearing our witness' thoughts on how Congress and the Administration can accomplish these goals to ensure that our workers retire with dignity and security.

Thank you Mr. Chairman, and I yield back.

Statement of the National Association of Manufacturers, Submitted for the Record

Cash Balance Pension Plans
June 2004

Background: Until recently, hybrid pension plans, like cash balance and pension equity plans were a source of vitality in the defined benefit pension plan system. These types of plans were developed in part to correct a mismatch between the traditional pension design and the needs of today's mobile workers. Traditional defined benefit plans are geared to employees who spend most—if not all—of their work years with the same employer. Employees get a big "bump up" in benefits during the last years of their career. Today's workforce is more mobile and cash balance plans are more attractive to workers because they accrue benefits at a more even rate. Hybrid plans generally provide higher benefits to the vast majority of workers.

At the same time, cash balance plans include the features that make traditional defined benefit pension plans popular with employees—an insured, employer-funded benefit with lifetime annuity distribution options. In addition, the employer bears the investment risk. Today, there are more than 1,200 hybrid pension plans in the United States, covering more than 7 million employees.

Issue: While these cash balance and other hybrid plans offer a ray of hope for the future of the defined benefit pension plan system, a number of pressing compliance issues regarding hybrid plans remain unresolved. The current uncertainty about the status of cash balance and other hybrid plans could force employers to abandon these types of plans, leaving fewer Americans with pension coverage.

Regulations currently pending at the Treasury Department would provide much-needed guidance on calculating benefits, conversions and the age discrimination rules. Unfortunately, legislation enacted in late 2003 erected a roadblock that prevents Treasury from issuing this much-needed guidance.

Meanwhile, in February, the Administration proposed a series of legislative proposals that are both good news and bad news to companies with cash balance plans. On one hand, if adopted, the proposals would confirm that cash balance plans generally are not age-discriminatory. On the other hand, the Administration's proposal includes overly broad rules for converting from a traditional plan to a cash balance plan. Unfortunately, the Administrator's proposals are prospective only and could not be relied on by sponsors of existing plans.

NAM Position: Rather than burdening the pension system with new counterproductive rules, the government should encourage employers to maintain defined benefit plans by making clear that cash balance plans, including existing plans, are legal. In addition, the government should clarify that conversions--past, present and future--from a traditional to a hybrid plan are lawful as long as benefits that employees have earned through the date of conversion are protected.

For further information about this issue, please contact Dorothy Coleman, NAM's vice president for tax policy at (202) 637- 3077.

Statement of The Principal Financial Group, Submitted for the Record

The Principal Financial Group® (The Principal®) is a diversified family of financial service companies with total assets under management of $144.9 billion. More employers chose The Principal for their 401(k) plans than any other bank, mutual fund or insurance company in the United States. A member of the Fortune 500, The Principal serves 614,000 individual policyholders, 74,000 group employer clients, and 49,000 pension customers (employers). Princor Financial Services Corporation services approximately 800,000 mutual fund shareholder accounts and Delaware Charter Guarantee Trust Company, conducting business as Trustar® Retirement Services, serves as directed trustee to more than 200,000 retirement and savings accounts. In all, 15 million customers (businesses, individuals and their dependents) worldwide rely on the member companies of the Principal Financial Group for their financial services needs. Principal Financial Group, Inc. is traded on the New York Stock Exchange under the ticker symbol PFG.

The Principal® appreciates the opportunity to provide comments regarding cash balance plans. Plan sponsors of cash balance plans have had to work under a good faith interpretation of the law without proper guidance for nearly ten years. The current uncertain legal environment, pending litigation, lack of Treasury guidance, and the determination letter freeze exacerbate to an environment that is undermining the defined benefit retirement system. We urge Congress and Treasury, therefore, to fashion a solution that will not discourage employers from adopting or converting to a cash balance plan and that avoids complex rules that are difficult and costly to meet.

Importance of Cash Balance Plans in the Retirement System

Defined benefit plans play a vital role in America's private voluntary retirement system. However, the Pension Benefit Guaranty Corporation (PBGC) reports the number of defined benefit plans has decreased from over 100,000 in 1975 to fewer than 36,000 in 2003. The decline in popularity is due primarily to low employee understanding and appreciation, uncertainty about upcoming changes in accounting valuation methods, difficulty in the portability of benefits, and high administration costs.

Cash balance plans, a type of defined benefit plan, are viewed by many as a benefit that is understood and valued by plan participants. As with a traditional defined

benefit plan, the employer provides participants with a guaranteed retirement benefit, funds the plan, and assumes the investment risk. No action or contribution is needed from the employee; the employee simply watches her/his account grow.

No single plan design is right for every employer one size does not fit all. Employers need flexibility to evaluate different types of pension plans and choose the one that best fits their needs and those of their employees. In a traditional defined benefit plan, employees earn most of their benefits after 20 – 30 years of employment, the end of a full career at one employer. The traditional design rewards length of service and often has features that encourage early retirement. Cash balance plans deliver benefits steadily at all career stages and offer portability for mobile workers, those who interrupt their careers while they raise families or pursue career retraining, and for those who work into their retirement years.

Cash Balance Plan Advantages

Cash balance plans include many defined benefit plan features for both employers and employees. Advantages of a cash balance plan include:

- **Competition** – Employers are able to maintain a competitive benefits package by offering a pension plan that retains many of the traditional plan features such as employer funded contributions, PBGC insurance, and employer-based investment risk, and the availability of a cash or annuity payout form.
- **Easy to Understand** – Benefits presented as in an account balance are more tangible and easy for employees to understand.
- **Even Accrual** – Employees earn their benefit at a steady rate throughout their career. For employees who leave and then reenter the workforce, cash balance plans typically produce a higher benefit level than a traditional defined benefit plan formula.
- **Portability** – Cash balance plans provide portable benefits for vested employees that leave the company prior to retirement. Benefits can be easily distributed and rolled to an IRA or subsequent employer's plan, which is not always an option under a traditional defined benefit plan.

Issues to be Addressed

Rules are needed that are fair to all employees, and that are flexible and cost-effective for employers. Issues that must be addressed include:

- **Future Conversions** – Rules for converting a traditional defined benefit plan to a cash balance plan must sufficiently protect the rights of older employees without limiting flexibility. Employers must be allowed options so they can decide the conversion method most suitable for their employee groups and business needs. Options include allowing some or all existing participants to earn a benefit equal to the "greater of" the cash balance or traditional plan benefit, "grandfathering" such existing employees by providing the cash balance accrual either to future employees only or younger employees only, giving age and prior service credits to an opening account balance, or providing additional transition credits for a period of years to older and/or long-service employees.
- **Past Conversions** – Requiring retroactive change for plans that converted in the past could generate undue costs to employers as some conversions date back to the mid-to-late 1980s. Plans that were converted prior to the effective date of finalized regulations should be protected as long the conversion method was nondiscriminatory based on facts and circumstances at the time and the plan has operated in good faith since then with the guidance that has been available to plan sponsors. Inasmuch as there have been no final rules or guidance for a long time, general industry practices and good-faith efforts should carry considerable weight.
- **Government Reporting and Administration** -- Small to medium-sized plan sponsors tell us they struggle with the expense of government reporting and the complex regulations surrounding traditional defined benefit plans. While legislation is needed to restore confidence in the cash balance plans for all size employers, it must also contain new approaches through safe harbors and other plan design options that limit the resources and expense that plan sponsors incur in maintaining a retirement plan for their employees.
- **Nondiscrimination** – With the exception of the safe-harbor design currently defined in the regulations, cash balance plans cannot easily meet either the traditional defined benefit or defined contribution nondiscrimination rules. Plan structures that provide

the greater of a traditional or cash balance formula need to be considered for some form of streamlined nondiscrimination testing. Greater flexibility is required for plans that are converting from traditional defined benefit formula to a cash balance formula and that wish to protect future benefits for their older or longer service employees. Flexibility is also needed to ensure that transition benefits are deemed nondiscriminatory as long as each formula (the traditional defined benefit formula and the cash balance formula) is in and of itself nondiscriminatory at the date of transition. It is also important that benefits that protect a closed group of participants at transition, and pass existing nondiscrimination tests at that time, are deemed to always pass those tests for as long as the closed group plan structure is unchanged.

- **Age Discrimination** - Cash balance plans should not be considered age discriminatory if they follow a few simple rules such as provide a uniform pay credit or use a gradual age or service schedule that is effectively available to all eligible employees.
- **Determination Letters** – The IRS ceased issuing determination letters over five years ago. The lack of IRS plan review and approval creates great anxiety for the employer and inhibits future establishment of cash balance plans.
- **"Whipsaw"** – When a plan's interest crediting rate is higher than the 30-year Treasury rate, the amount resulting from the current IRS-prescribed "project forward/discount back" process to determine lump sum payments is greater than the account balance. This is known as "whipsaw". Defining the accrued benefit as the current account balance would disconnect the lump sum rules and the cash balance interest crediting rate. This would eliminate the whipsaw concern. The current whipsaw rules create a situation where plan sponsors are unable to credit interest rates greater than the 30-year Treasury rate without great risk of an unpredictable increase in their liability to participants.
- **Plan Amendments** – Prohibiting employers from changing benefit levels provided to the current employees eligible for the conversion choice is too restrictive for a voluntary employer plan system. Treasury's "five year hold harmless" approach would have delayed employers' ability to convert to a hybrid plan for five years after their announcement of the change. This provision has the potential to force

employers away from a defined benefit solution to a defined contribution plan design. The outcome is a plan design where the results can be seen immediately, but participants would lose guarantees, both the guarantee that their account balance will not decrease and their right to an annuity benefit at retirement.

- **Early Retirement Subsidy** – Traditional defined benefit plans often provide early retirement subsidies that are more valuable than the actuarial equivalent of the normal retirement benefit. We support preserving the early retirement subsidy from the traditional defined benefit plan for those who survive in the group long enough to earn it. The way to accomplish this that most mirrors current early retirement subsidies is to add the subsidy benefit to the cash balance plan benefit when a participant elects early retirement. One other option that we do not support is having the early retirement subsidy immediately reflected in the account balance of active workers who have not yet earned the benefit.
- **Plan Freeze/Termination** – Treasury has proposed an excise tax for unfair past conversions based on the greater of the plan's surplus assets at the time of conversion or the plan sponsor's taxable income. Prospectively, employers could avoid the excise tax in a number of ways such as a temporary plan freeze, waiting for a drop in plan funding levels, or converting to a cash balance plan in a fiscal year when the business experiences losses. We oppose the excise tax since it would cause undue hardship to employers with prior conversions and would discourage employers in the future from converting to a cash balance plan.

In Summary

Congress frequently seeks incentives that would encourage the establishment of new, private, employer-sponsored retirement plans, particularly among small and medium-size enterprises. The Principal believes that cash balance plans provide valuable benefits to employees. Because no single plan design is right for every employer, plan sponsors need flexibility to evaluate the different types of plan designs available and choose the one that best fits their needs and the needs of their employees. Small to medium-size employers would gain the most from this new defined benefit plan design. Legislation that provides certainty for cash balance plans, hassle-free plan sponsor

involvement, and predictable plan contributions is essential before employers will be willing to make new employee benefit commitments.

We urge Congress to resolve the cash balance issue in a way that provides protection to older workers from the adverse effects of a conversion, while allowing employers flexibility to design a plan that meets the needs of their workforce. This action will be one of the steps needed to update and strengthen the defined benefit retirement system.

Watson Wyatt, Press Releases, Submitted for the Record

News

Press Releases

Most Conversions to Cash Balance Pensions Are Cost-Neutral -- and 80 Percent of Employees Actually Fare Better

Issues likely to be raised during this week's IRS hearing on proposed pension regulations

Eric Lofgren and Sylvester Schieber of Watson Wyatt to testify

WASHINGTON, April 7, 2003 — As the debate over cash balance and pension equity plans heats up following the release of proposed new rules governing these plans, experts at Watson Wyatt warn that common misperceptions still abound.

"Critics try to paint all conversions to cash balance plans as attempts by companies to cut costs at the expense of workers, but the facts simply do not support these assertions," said Sylvester Schieber, vice president of research at Watson Wyatt.

According to a landmark study published by Watson Wyatt in 2000:

- The typical company realizes little, if any, net cost savings when it shifts from a traditional pension to a cash balance or other hybrid plan design.
- When employer costs remain neutral, almost 80 percent of participants do better under the hybrid plan formula

"With traditional pension plans, more than three-quarters of benefits can go to only 10 percent of workers and, naturally enough, that 10 percent would like to keep them," said Eric Lofgren, global director of benefits consulting at Watson Wyatt. "But how is that fairer than newer designs that seek to distribute benefits more democratically among workers?"

It is important to separate the distinct issues of pension plan type and the amount of cost savings, according to Lofgren. "No one type of pension plan is inherently more costly than another, and the oft stated equation that cash balance plans reduce benefits by 20 to 50 percent is proved false by our research," he said "An employer can just as easily design a rich cash balance plan or a stingy traditional pension."

Actually, the Watson Wyatt study found that the majority of employers (55 percent) experienced a minimal effect on costs or saw costs increase during hybrid plan conversions, while less than half (45 percent) realized cost savings. The average employer cost savings was just 1.4 percent -- not 20 percent to 50 percent -- after factoring in enhancements that some employers made simultaneously to their 401(k) plans.

The Watson Wyatt study was based on a detailed analysis and financial modeling of the benefit provisions in 78 hybrid plans, representing approximately one-fifth of such plans in existence at the time. The study also included an opinion survey of 79 employers that had made the shift to a hybrid plan to provide additional perspective on motivations for adopting one of these plans.

The study found that when companies reduced costs in the conversion it was largely due to the prospective elimination of subsidies for early retirement, which typically augment benefits at around age 55. The effect on normal retirement benefits was much more muted.

"Employers generally don't suddenly reduce retirement benefits for those close to normal retirement age," said Schieber. "And most employers that converted to a hybrid design protected early retirement benefits for those nearing early retirement as well."

The vast majority of plan sponsors studied (88 percent) included transition benefits to minimize the effect of the transition for these longer tenured workers. In nearly two-thirds of the cases analyzed, workers age 50 with 25 years of service would have received an equivalent or higher benefit at 55 after the transition than if they retired at age 55 under the prior plan. Nearly another third would have had some benefit reduction but were at least partially protected by a transition benefit.

"Companies need to make trade-offs, and the question comes down to the fair distribution of a limited number of benefit dollars," said Schieber. "Many employers no longer can afford to give almost all the retirement benefits to just 10 percent of their employees."

The IRS has scheduled a public hearing regarding the proposed pension regulations for April 9-10, 2003. Eric Lofgren and Sylvester Schieber of Watson Wyatt will testify on April 9. To obtain copies of the testimony, contact Ed Emerman at 609-452-5967 or eemerman@eaglepr.com.Copies of the research report, *The Unfolding of a Predictable Surprise: A Comprehensive Analysis of the Shift from Traditional Pensions to Hybrid Plans*, can be downloaded by clicking here.

About Watson Wyatt

Watson Wyatt & Company, the primary subsidiary of Watson Wyatt & Company Holdings (NYSE: WW), is an international human capital consulting firm that provides services in the areas of employee benefits, human resources technologies and human capital strategies. The firm is headquartered in Washington, D.C., and has more than 4,200 associates in 62 offices in the Americas and Asia-Pacific. Together with Watson Wyatt LLP, a leading European-based consulting partnership, the firm operates globally as Watson Wyatt Worldwide. Watson Wyatt Worldwide has more than 6,300 associates in 89 offices in 30 countries.

Media Contact

Ed Emerman, 609-452-5967, eemerman@eaglepr.com

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An Issue of Fairness

In the end, it comes back to the question of fairness. After all the newspaper articles, the legal maneuvering and the congressional clamor, the core question remains: Are hybrid pension plans unfair to older workers?

Before looking at the most recent events in this debate, let's start with the fundamental reason why cash balance and other hybrids came to be in the first place.

The rap against traditional pension plans has always been that they benefit too few workers within companies, with higher-paid, long-service employees reaping too many of the rewards. With traditional pension plans, more than three-quarters of benefits can go to only 10 percent of workers. Naturally enough, that 10 percent would like to keep them. But what about the other 90 percent of workers?

Sidestepping the fairness argument, critics charge that conversions to cash balance plans are actually just smokescreens, used by companies to cut costs at the expense of workers. But the facts simply do not bear this out. In the most detailed study of its kind, a Watson Wyatt analysis of 78 hybrid plans found that:

- The typical company realizes little, if any, net cost savings when it shifts from a traditional pension to a cash balance or other hybrid plan design.
- When employer costs remain neutral, almost 80 percent of participants do better under the hybrid plan formula.

Against this backdrop, the U.S. Treasury Department (in proposed regulations) and two district courts have affirmed that hybrid plans are not fundamentally discriminatory in nature.

Now to more recent events. At the heart of the recent IBM ruling (see "Court Rules That Cash Balance Plan and PEP Are Age Discriminatory") was the court's acceptance of an argument that essentially disregards common wisdom about the time value of money.

The argument basically says that, in judging whether a pension plan is discriminatory, we should not look at the actual value of benefits earned by employees in today's dollars. Instead, opponents of cash balance plans want us to look only at what the payout will be as an annuity at normal retirement age (typically 65).

What this means is that, if a younger employee accrues an annuity starting at age 65 of 1 percent of final average pay, the older employee generally must also accrue as much or more. The problem is that the cost of an annuity starting at age 65 can be more than 10 times more for a 65-year-old than for a 25-year-old. This is because of the time value of money (with the 25-year-old, the assets underlying the annuity have an additional 40 years to appreciate before payouts begin). With this logic, hybrid plans in effect need to deliver more than 10 times the added value for a 65-year-old as for a 25-year-old to avoid age discrimination.

In the recent court case, the court ruled that the IBM cash balance formula, which provides a 5 percent account addition for each year of service, was deemed age discriminatory because a 5 percent balance addition for a 25-year-old will be larger at age 65 (with the accrual of 40 years of interest) than a 5 percent contribution for a 60-year-old (which will grow with interest for only five years). The court proclaimed in effect that $5 for a 25-year-old is worth more than $5 for a 60-year-old. The same type of formula that the court deemed discriminatory is common and legal in 401(k) plans but also is required in traditional defined benefit plans that accept employee contributions.

Second, the ruling concluded that the IBM plan's alternative pension equity formula is also age discriminatory because the plan's 7 percent credit for a 25-year-old was viewed as being worth more than a 16 percent credit for a 60-year-old, again because the 7 percent credit could grow larger with 35 years of extra increases from the passage of time. By comparison, a similar credit schedule in a defined contribution plan would mean that the older worker is getting more than twice the amount as the younger worker.

The effect of the verdict is to render any plan that recognizes the time value of money as age discriminatory simply because of longer compounding periods for younger employees. Compounding is so powerful that, in

order to satisfy the age standard set by the court, a defined benefit plan would have to provide a benefit to older participants 10 times the value of the benefit provided to younger participants. Merely providing older participants a benefit worth $9 would not be sufficient if younger participants receive a benefit worth $1.

Another way to think about this issue is to move away from a pension example. Lottery winners almost always opt for a lump-sum payment rather than an annuity. That's because we all know that a $20 million payment spread out over 20 years is not valued at $20 million in current dollars. By taking the lump sum upfront, albeit a lesser amount than $20 million, the winner will have a lifetime to invest the lump sum and perhaps do much better than the interest earned under the annuity. This last fact is an important one that opponents of cash balance plans conveniently ignore -- they count interest earned by participants before payout of the lump sum, but then ignore interest earned after the payout and the intrinsic value of the earlier access to funds. For this reason, a payout promised to a 60-year-old at age 65 is worth far more in current dollars than the same payout promised to a 25-year-old who has to wait 35 more years than the 60-year-old to collect the money.

The time value of money is a widely accepted financial principle. Yet critics argue that it does not apply to pension plans, despite the fact that the principle is commonly accepted in affirming the validity of 401(k) plans. That the principle can be used in assessing 401(k) plans, but not cash balance pensions -- which essentially act like 401(k) plans -- is patently unjust.

In the end, the issues boil down to a question of fairness:

- Is it inherently more fair to direct 75 percent of benefits dollars to just one-tenth of employees?
- Is it fair to ignore the basic concept of the time value of money?
- Is it fair to affirm the soundness of 401(k) plans yet reject hybrids when they are based on the same fundamental principles?

In each case, we think the answer is a resounding no. In the end, the argument is simple. Hybrid plans are inherently fair.

September 2003

Dion, Stacey

From: Ed Emerman [eemerman@eaglepr.com]
Sent: Wednesday, July 21, 2004 1:39 PM
To: Dion, Stacey
Cc: David Popper
Subject: Permission from Watson Wyatt

Stacey:

On behalf of Watson Wyatt, I hereby grant you permission to publish Watson Wyatt press releases in the hearing record for the recent hearing on cash balance pension plans. If you need anything else, just let me know.

Thanks,
Ed Emerman

Ed Emerman
Eagle Public Relations (for Watson Wyatt Worldwide)
609-452-5967
eemerman@eaglepr.com

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Statement of the American Federation of Labor and Congress of Industrial Organizations, Submitted for the Record

American Federation of Labor and Congress of Industrial Organizations

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FOR IMMEDIATE RELEASE **Contact: Suzanne Fflolkes 202-637-5018**

Statement by AFL-CIO President John Sweeney
on Congressional Probe of Cash Balance Pension Plans
July 7, 2004

We welcome today's inquiry by the House Committee on Education and the Workforce into the impact of cash balance plans on workers' retirement security. The effects of cash balance conversions are of long-standing concern; whether and how Congress finally addresses this issue will have important implications for the millions of Americans who depend on our pension system.

The spread of cash balance plans -- particularly the conversion of traditional defined benefit plans to cash balance plans without adequate safeguards or protections for older and long service workers -- raises serious questions about worker retirement security. While union-represented employees can require their employer to negotiate the terms of a cash balance conversion, employees without a union have no voice. Unions can resist conversions or negotiate improvements that make conversions more equitable. Without a union, workers cannot prevent an employer from unilaterally converting to a cash balance plan and cutting benefits.

Some would argue that employers should have maximum latitude in converting to cash balance plans, regardless of the impact on individual workers. That approach not only leads to hardship for working families, but also undermines workers' faith in the pension system. We urge policymakers not to overlook this reality as they proceed in their inquiry about whether, and under what circumstances, cash balance plans may provide retirement security for America's workers.

Job-based pensions are an essential component of a strong national retirement system. The corporate scandals of the past few years have served only to underscore the key role that defined benefit plans play in building and safeguarding retirement income security.

Union members, in particular, have an enormous stake in the future of the pension system. Through their unions, workers have been persistent in their efforts to negotiate good pensions at the bargaining table. Today, seven-in-ten private sector union workers participate in a defined benefit pension plan and millions of union members are counting on negotiated pension benefits when they retire.

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Letter from AARP, Submitted for the Record

July 7, 2004

The Honorable George Miller
House Education and the Workforce Committee
2101 Rayburn House Office Building
Washington, DC 20515

Dear Representative Miller:

AARP commends you for holding today's hearing today on cash balance pension plans. We hope the hearing will serve as a catalyst to bring together the Administration, Congress and other interested parties to forge legislation that will strengthen defined benefit pension plans, protect older workers, and address the legal uncertainty surrounding cash benefit pension plans.

AARP has long been concerned with the legal basis for the hybrid cash balance formula itself, and with the significant age discriminatory issues that arise when employers convert defined benefit pension plans to a cash balance formula. We believe that a careful review of the legal distinction between defined benefit and defined contribution plans makes clear that the most common designs for hybrid cash balance plans do not fit within the current legal framework of the Internal Revenue Code (IRC), the Age Discrimination In Employment Act (ADEA), and the Employee Retirement Income Security Act (ERISA). We urge the Committee to address the legal framework for cash balance plans and provide strong and effective protections for older workers involved in cash balance pension plan conversions.

Millions of older employees have given up wages in exchange for traditional defined benefit pension plans. These plans typically provide only small benefits early in a worker's career under a plan design that provides those who devote all or most of their working lives to a company with larger benefits at the end. It is therefore unfair for employers that have sponsored this type of plan for years to pull the rug out from under older workers by taking away these larger, late-career benefits just when long-serving workers are about to earn them.

Yet that is precisely the damage caused by conversions of traditional pensions to cash balance plans – unless older workers are given appropriate transition relief to address the impact of the "pension pay cut" brought about by these conversions.

Older, longer-service workers are the most vulnerable in a conversion: they generally have less time to accumulate benefits under a new cash balance formula, have a harder time leaving their current job if compensation and benefits are cut because they have fewer prospects of finding a new job, and are less able to adjust to the changes that may dramatically reduce their retirement security (for example, they have less time to adjust by increasing their saving for retirement).
Mr. Miller

A conversion to a cash balance plan from a traditional defined benefit plan can often include a so-called wear-away period – a period of time when no benefits are earned. We believe that any age-based wear-away is an illegal and impermissible reduction or cessation in benefit accruals based on age. We were pleased that the recent legislative proposal from the Treasury recognized the problem with wear-away and the unfair treatment of older workers and recommended a ban on any wear-away of benefits at any time after a cash balance plan conversion.

In recognition of the transition problem faced by workers, the Treasury proposal also included a five – year "hold harmless" period after each cash balance plan conversion. While the proposal is a step in the right direction, it simply does not reflect ongoing trends in the marketplace. In the face of adverse publicity and litigation, more recent conversions have tended to afford more protection to older workers. In most cases, the older and longer-service workers were provided more generous transition relief, including a choice to remain in the old plan or move to the new cash balance plan. This is further confirmation that business can and should do the right thing for their older, longer-term employees. Congress now needs to hold all companies that voluntarily choose to convert to a standard that many have been willing to meet voluntarily.

AARP applauds this Committee's continuing review of defined benefit plans as well as the issues raised by cash balance plans and the conversion to these plans. We look forward to assisting this Committee and others to ensure that cash balance plans fully comply with the requirements of current law, and in particular the prohibitions against benefit reductions based on age.

Sincerely,

Michael W. Naylor
Director of Advocacy

Statement of Larry Cutrone, Submitted for the Record

Statement of Larry Cutrone

January 30, 2003

My name is Larry Cutrone, one of thousands robbed of the full value of their earned pensions due to the "Cash Balance" pension conversion. Before AT&T converted my pension it was valued at $350,000 and after the conversion in July 1997, the value dropped to $138,000. Even with AT&T's "Special Update" enhancement to my account, the value only rose to $150,000. The calculation period for my pension was frozen at 1994-1996 salaries, so no value to my retirement account was added for any years I worked after the conversion.

In September 2001, I was "downsized" out of AT&T and decided to take my pension. I discovered that it translated into an annual income of just $23,444 instead of the $47,303 income under the old plan. This seems meager after 31 loyal years of service to the company. As a result, my wife was forced to waive her rights to the survivor benefits of my pension in the event I predecease her. Invoking these rights would have meant between 8% and 20% less per month. While my pension was reduced by more than half, my monthly contribution for medical benefits was increased five times this year.

As representatives of "AT&T Concerned Employees Council on Retirement Protection" (ACE CORP), we are willing to publicize our personal situation in order to bring to the forefront the negative impact of the forced cash balance pension on the older worker. We urge President Bush to support Congressmen Sanders, Miller, Senator Harkin, and their fellow representatives to revise his proposal to the IRS by including protection for the older worker and preventing them from becoming "Pension Challenged" by "Cash Imbalance"!

In President Bush's radio address this past Sunday he states "In 2003, we must work to strengthen our economy; improve access to affordable, high quality health care for all our seniors..." In his State of the Union Address, he urged Congress to pass his plan "...to strengthen our economy and help more Americans find jobs." (Assuming he makes these comments in his State of the Union Address on Tuesday.) We hope our efforts will convince President Bush that his IRS Proposal and the affect of the cash balance pension on the older worker further reduces consumer spending, and reduces tax revenue while causing our economy to continue suffering. We are unaware of any negative impact to the corporations who convert to cash balance pension plans. Should the loyal worker and subsequently America's economy be penalized?

668 Thru Way Drive, Bridgewater, NJ 08807, 908-685-2174

Statement of Janet Krueger, Submitted for the Record

Statement of Janet Krueger

January 30, 2003

I'm Janet Krueger, a former IBM employee from Rochester, Minnesota. I had worked at IBM for 23 years in 1999 when they announced our pensions had been converted to a cash balance plan. Our new cash balances would be increased each year with a 5% pay credit and some interest. The announcement made it sound like a good deal, but when I recieved my first statement in the mail a week later, I was stunned. My new pension balance was less than one year's salary. In fact, it was less than half of what I held in my 401K account! (My 401K account had been started just 8 years earlier, with a 6% contribution each year...) Something was obviously wrong... It was clearly unfair, and if it wasn't illegal, it should have been.

Over the last decade, many thousands of older employees in this country, from over 300 large corporations, have lost significant portions of both their promised pensions through these cash balance conversions. Several thousand open age discrimination charges have been filed at the EEOC. Several dozen lawsuits have been filed in federal courts -- a lawsuit filed against IBM in 1999 now has 140,000 certified class members.

Against this backdrop of lost pensions and angry older workers, the Treasury has decided to come riding to the rescue on their white horse. But wait! They aren't protecting older workers. They aren't even admitting age discrimination has occurred. Instead, they've decided to wipe the books clean by legalizing all of the corporate thefts that have occurred since January 1, 1988. Not only are they changing ERISA law by removing worker protections in order to legalize cash balance plans, they are attempting to do so RETROACTIVELY.

Don't misunderstand me -- cash balance plans, on the surface, are not a bad idea. In fact, the thought of a much simpler kind of plan that small and medium-sized businesses can easily implement and support without hiring consultants and actuaries is great! But when it takes 80 pages of regulations to back door cash balance plans into existing defined benefit plans, the end result is neither understandable nor affordable. Adding more verbiage to try to hold employees harmless just makes them even more confusing and complex.

We want cash balance plans. But not implemented as defined benefit plans (after all, they don't define a final benefit)! And not created through treasury regulations. They need to be implemented the RIGHT way through a well-thought out act of Congress, with the requisite assortment of hearings to ensure all view points are heard.

Let's do cash balance plans RIGHT. Can the regulations, forget trying to pretend unwilling conversions are fair, and do the RIGHT thing. For any of you who are interested, I've got sheets available with facts about how cash balance plans are defined in the proposed regulations.

IEBAC (IBM Employee Benefits Action Coalition), 507 289 9030, Rochester, MN

Statement of Janice Winston, Submitted for the Record

Statement of Janice Winston

January 30, 2003

My name is Janice Winston. I am a 29-year former employee of Verizon Communications. In 1995, Verizon announced that effective January 1, 1996 my traditional defined benefit pension would be changed to a Cash Balance Plan. It was not until 1999 that I truly understood and realized the devastating effect this change had on my fellow employees and myself.

In September of 1999, I went to Washington DC to attend a Senate Hearing on Cash Balance Plans. It was after these hearings and meeting other Verizon employees, Janet Krueger, a former employee of IBM, the Pension Rights Center and the Coalition for Retirement Security and I found that Verizon was not the only company that had switched to a Cash Balance Plan. Employees at Duke Energy, AT&T, and IBM were only a few of the many companies that had converted employees to Cash Balance Plans.

Immediately, Verizon management employees decided to let our voices be heard. As a result of the concentrated, convincing and enduring grassroots effort of the Verizon management, employees that began in 1999 we were able to convince Executives at Verizon that the Cash Balance Plan was wrong for the retirement security of the older, career employees of Verizon. We persuaded the Executives to revisit the decision made in 1995 and come up with a plan that would preserve the trust, motivation and well being of Verizon's career employees. In 2000, the company announced that it would give employees with 15 or more years of service the greater of a traditional defined benefit plan or the Cash Balance Plan. The reason the company listened was because they recognized that this controversial practice had become an employee morale and public relations problem.

I know first hand in actual dollars how devastating the conversion to a Cash Balance Plan formula could have been for me. In December of 2002, my employment terminated with Verizon as a result of a reduction in force. I received a pension benefit statement that showed my actual pension benefit. My traditional defined pension benefit will be $400,000 as opposed to the $184,000 in my Cash Balance Plan - a 54% difference.

I have shared my personal financial information with you today because it is the only way for the Administration and everyone else to see actual effects in real dollars -- not just an actuarial calculation against an imaginary person. If we stand back and do nothing, corporations can use the proposed Treasury regulations to deny older career employees benefits they worked hard to earn over their entire careers. An article in the Philadelphia Inquirer, dated December 11, 2002 stated that the guidelines proposed by the Treasury Department say that as long as companies use "reasonable actuarial assumptions in converting to a cash balance plan, the fact that older workers end up with lower benefits that they would have otherwise cannot be considered age-discriminatory". What is a reasonable actuarial calculation? Would the ordinary employee know? We cannot have this type of ambiguous language affect the future economic well being of millions of employees.

Stop cash balance conversions, NOW!

Statement of Jimmy Tarlau, Submitted for the Record

Statement by Jimmy Tarlau

National Organizing Coordinator of
Communications Workers of America

January 30, 2002

The Communications Workers of America represents over 700,000 workers: newspaper reporters, nurses, correctional officers, telephone installers and automotive assembly line workers among many other professions. Over the last sixty-plus years, our union has negotiated contracts with thousands of employers, covering wages and benefits, including pensions. We believe that our job in negotiations is to reach agreements that insure the security of our members both now and in the future.

We believe that the laws of our nation ought also to protect American workers and not to allow the security upon which they depend, both now and once they retire, to be put at risk to satisfy the short term profit targets of our nation's largest employers. Therefore, we join here today with these Members of Congress and these representatives of employee and retiree groups nationwide, to call into question IRS regulation 209500-86 which undermines the rights and promises to older employees.

Let me say upfront that CWA is not categorically opposed to all changes in pension plans. But we feel that if such changes are made, they should be done only when the benefit promises made to loyal, mid-career employees remain fully protected – just as corporate executives' pensions promises are fulfilled.

We have negotiated cash balance conversions that were fair for our members and, in particular, protected the benefits of mid-career employees. If the Treasury Department wants to know how to implement conversions, they should look to best practices of unions and companies that have done conversions the "right" way, not propose regulations that will enable employers to switch their traditional defined benefit plans to cash balance plans at the expense of older workers.

Let's look at real world examples. Today, we stand with non-union Verizon and AT&T employees who lost benefits when their pension plans were converted to cash balance plans. In 1998, CWA bargainers at both of these companies were presented with management proposals to convert our members' pensions to a cash balance design. After extensive talks, union bargainers at the Verizon table (at that time called Bell Atlantic) rejected the proposal. It was the committee's belief that the pension change was not in the best interest of our members at that time.

Meanwhile, bargainers at the AT&T table came to a different conclusion. The changes we agreed upon in 1998 included the definition of a transition group – workers with 15 or more years of service at the time of the conversion. With this transition group no older

(more)

worker lost any benefits, there was no period of "wearaway". Ultimately, the worker has the right to decide which pension option is best for him or her when they leave the company. All together, we negotiated an improved benefit package for all of our members, not just a different package of lower quality for those workers.

We have the power to negotiate cash balance pension conversions and to optimize the design to fit the needs of the people we represent. We would never negotiate a conversion if it weren't in the interest of our members. However, we believe that these IRS rules will create downward pressure on pension benefits for all workers and will increase the pressure on our members to accept changes that are not in their interest.

It should also be noted that Congress has never authorized cash balance plans or cash balance conversions. CWA believe that the proposed regulations should be tabled until Congress has had a chance to fully examine these regulations and to be sure that employees' concerns have truly been addressed. We believe that the law of the land should protect older workers from the loss of the benefits that they have been promised and on which they will depend when they retire.

Just two days ago, the Senate held confirmation hearings on the President's choice for Secretary of the Treasury, John Snow. It has been reported that CSX provided Snow with a pension of $2.47 million, based on 44 years of service - though he only worked 25 - with 250,000 shares of stock kicked in as an extra bonus. CWA members and all employees wonder why an executives like Mr. Snow can expect pensions that are **more** than they were promised, when other employees can work a lifetime and get **less** than they were promised when they were hired.

We'd like to echo the president's statement in the area of retirement plans - "What's fair on the top floor should be fair on the shop floor." Lets begin by insuring that we protect workers from the loss of retirement benefits that have already been earned.

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JAN 25 1999

NEWS ANALYSIS

The Down-Aging of Pension Plans

With the official unemployment rate low, and many large corporations in a hiring mood until very recently, the reality of the last round of work force downsizing has become evident. Downsizing was really down-aging. Fifty-five-year-old office workers were pushed aside in favor of generation X members.

So what if a 25-year-old lacks the experience of his older counterpart? Most white-collar job performance criteria are highly subjective, and younger workers are cheaper. In the seniority system that prevails in most large corporations, older workers have to be paid more, and their medical benefits cost more, and they accrue pension benefits at a higher rate. (In the old days, when all workers were male, this was an explicit subsidy for male-supported families.) Put a younger worker in the same job, and those medical and pension costs are greatly reduced. Except that generation X turned out to be better savers than their parents, the notoriously spendthrift baby boomers, were. And generation X members are not happy with the indefinite pension benefits traditionally offered to younger workers. Moreover, they tend not to understand any pension concept that does not look like an individual account plan with an identifiable lump sum that belongs to them.

> ***Converting companies view the change as a way to spread a limited number of dollars more evenly across a population of employees.***

Pension consultants think they have the answer. What is known as a "cash balance" pension plan has the effect of reducing the pension accruals of older workers while increasing the accruals of younger workers. In the conventional back-loaded pension plan, much of the value of a worker's pension accrued in the last five years before retirement. In a front-loaded cash balance plan, compounding interest on accruals means far lower accruals for older workers and higher accruals for younger workers, though the accruals are facially level. So once a cash balance plan is installed, older workers who were staying on to accrue the maximum pension benefit may even leave without being explicitly pushed, while younger workers are happy with what they perceive as an individual account plan. (The individual account analogy is pushing it. See *The Wall Street Journal*, Dec. 31, 1998, p. C1.)

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Hundreds of large companies with conventional pension plans in place — it's too expensive to terminate them — have switched to a cash balance format, according to *The Wall Street Journal*, enabling some to cut their pension costs by so much that they do not have to contribute to their plans for a while. Notable converts to the cash balance format are the Bells (Ma and Babies both), which found themselves having to compete with younger communications companies and saddled with pension plans that subsidized both long service and early retirement. Converting companies view the change as a way to spread a limited number of dollars more evenly across a population of employees. Although the promised pension at retirement in a cash balance plan is lower than that of a conventional defined benefit plan — 20 percent of final pay, say, instead of 30 percent — the likelihood of collecting something is greater because cash balance plans pay lump sums to employees who leave after five to 10 years, while conventional defined benefit plans typically do not. That is, the conventional pension plan functions somewhat like a tontine, rewarding the few who hang on the longest.

Employees are being notified of the change in oblique ways in some cases, so that they may not fully understand the change. (*The Wall Street Journal*, Dec. 4, 1998, p. A1, and Dec. 18, 1998, p. C1.) Most employees, that is. Employees at a Big 5 accounting firm that converted understood the change — they are, after all, being paid for their financial sophistication — and were not happy about it. (Should the firm have fired accountants who couldn't figure it out and did not complain?)

Cash balance plans present two problems for the IRS and the Labor Department, which share administration of ERISA. First, the plans may violate rules designed to prevent age discrimination in benefit accruals and reductions in benefits. Second, the two departments, in allowing hundreds of large companies to convert conventional defined benefit plans to cash balance plans without a thorough study of the matter, may have effectively foreclosed their options for dealing with those plans, even if the ultimate decision is to bless them. The sponsors of the converted plans seem to have taken the view that their plans are too big to fail — that is, too big to have their exemptions challenged by the IRS. The history of the pension rules would justify that view; not only has no big plan ever been disqualified, but much of the nondiscrimination rules were written to accommodate the existing practices of big plans.

What is the IRS doing about cash balance plan conversions? Basically, the IRS has decided to accept the conversions and has tried to accommodate cash balance plan sponsors within the letter of the law. Regulation section 1.401(a)(4)-8(c) provided a little-used safe harbor so that cash balance plans could satisfy the rules prohibiting too much discrimination in favor of highly paid participants. The preamble to the 1991 proposed nondiscrimination rules (EE-22-90) seemingly lets cash balance plans off the hook on the age discrimination question. More recently, Notice 96-8, 1996-1 C.B. 359, accommodates some of the plan sponsors' desires in cash-out calculations. Further guidance on cash balance plans is on the 1998 business plan, but its release is not imminent.

But more than this, the government's policy has been to let the questions raised by cash balance plan conversions slide, while pension consultants lobby to have the rules read in their favor or changed. In the wake of the publication of unflattering articles about these conversions in *The Wall Street Journal*, Senate Finance Committee minority members have expressed interest in addressing the employee communications problem, and implicitly the related age discrimination question. (See *Tax Notes*, Jan. 4, 1999, p. 41.)

The Conversions

Employers have great discretion in what kind of retirement plan they set up, whether to contribute to it, and whether to establish any retirement plan at all. This article is not about whether an employer could set up a cash balance plan *ab initio*. The question is whether, once an employer has a conventional pension plan in place, the plan can be converted to a cash balance plan without running afoul of rules prohibiting age discrimination and benefits reductions.

> ***The question is whether a conventional pension plan can be converted to a cash balance plan without running afoul of rules prohibiting age discrimination and benefits reductions.***

Put more simply, the question is whether there is age discrimination against the older participants who are in place when a back-loaded conventional defined benefit plan is converted to a front-loaded cash balance plan. Some lawyers believe there is an age discrimination problem, and older participants in converted plans are suing on this basis under section 4(j) of the Age Discrimination in Employment Act and section 204(g) of ERISA. Even though converting employers may regard the front-loaded formula of a cash balance plan as a more equitable way to allocate benefits, the law does not look favorably on a change that has a detrimental effect on older employees. Another, related age discrimination

question is whether the design of a cash balance plan itself could be discriminatory, because the rate of benefit accruals declines as any employee gets older.

A defined benefit plan, as its name indicates, defines a pension benefit that an employee earns through years of service. There are no individual accounts in a defined benefit plan, as there are in a defined contribution plan; there is just one big pot of money set aside in trust, from which the defined benefits will be paid. The plan sponsor's annual contributions to the fund vary with the ages and salary histories of its employees, the performance of the fund's investments, and legal requirements that set both floors and caps on the amount of contributions. The conventional defined benefit plan is back-loaded in that benefits are defined by a formula that uses the average of each participant's highest-earning years. So employees nearing retirement, and earning at their peak, could be earning as much as half of their eventual benefit. That means that the employer's required contributions go up. (Indeed, the conventional plan is so back-loaded that there are rules restricting the degree of back-loading.)

The nearly retired, and especially early retirees, can easily be the costliest part of a conventional back-loaded defined benefit plan in terms of required contributions. In some conventional defined benefit plans, early retirement subsidies can account for as much as half of current funding requirements. In 1985, a desperate Bank of America took the advice of the then little-known pension consulting firm Kwasha Lipton to convert its conventional defined benefit plan to a cash balance plan. The badly managed bank, cruelly nicknamed "Bankrupt of America" at the time, had nothing to lose, because it could not afford plan contributions. If the Labor Department and IRS disapproved of the conversion, the bank would have to make up the deficiencies of the plan. And if things got really bad, the PBGC would take over the plan. (Kwasha Lipton, which now belongs to PricewaterhouseCoopers, built its business on cash balance conversions.)

A cash balance plan is still legally described as a defined benefit plan. But unlike a conventional defined benefit plan, a cash balance plan makes hypothetical allocations to a hypothetical individual account (the "cash balance") for each participant. The employer hopes to limit its liability under the plan to the amount in each participant's account when the participant leaves, but Notice 96-8 prevents that. (And ironically, even though a switch to a cash balance plan can cut the employer's required contributions drastically, the design of cash balance plans means that they tend not to be sufficiently funded on a termination basis. Terminations of cash balance plans are, in the words of one actuary, "not pretty.")

It is useful to compare the benefit formulas of conventional defined benefit plans to those of cash balance plans. A conventional defined benefit plan does not include an interest component in the formula that defines the benefit, which makes sense since the participant has no individual account. The usual formula is final average pay (or career average pay) times years of service times a rate, usually in the single digits. That formula will produce a monthly retirement benefit beginning at normal retirement age. Actuaries can project the monthly retirement benefit beginning at normal retirement age to estimate the plan's eventual liabilities.

The sponsors of these plans are trying to have it both ways. They want the limited liability of a defined contribution plan and the flexible funding of a defined benefit plan.

A cash balance plan uses a different formula. For each year, each participant earns a rate of his or her compensation, called a "pay credit," usually a single-digit percentage of compensation. The pay credit can be level for all age groups; or if the sponsor wants to ameliorate the front-loading somewhat, the pay credit can be graduated, lower for younger age groups and higher for older age groups. It does not matter. The front-loading effect of the next element of the formula, the interest credit, will vastly outweigh the back-loading effect of a graduated pay credit schedule. Cash balance plans and their ilk, travelling under names like "pension equity plans," provide for hypothetical interest accruals on a participant's account. The interest factor may be stated, as in cash balance plans, or unstated, as in pension equity plans.

Each year, each participant earns an interest credit on that year's pay credit and all prior years' pay credits and interest credits, as though the participant had an individual account. (Delaying the interest credits, as some cash balance plans do, causes the plan to fail requirements against back-loading.) Most cash balance plans use a variable interest rate for the interest credits, tying it to an index like one-year Treasury bills. A plan may also base its annuity conversion factor on a variable interest rate. Each participant's hypothetical account is the sum of the accumulated pay credits and interest credits. By crediting an interest rate that is lower than

what the plan earns on its investments, the employer can keep the difference, saving money through interest rate arbitrage. (The benefit of arbitrage is why, in some cases, employers have chosen to establish a cash balance plan *ab initio* instead of a defined contribution plan. In a defined contribution plan, all investment gains belong to participants; there are no unallocated amounts.)

The miracle of compound interest is what makes cash balance plans front-loaded, and what makes them more favorable to younger employees than to older employees. Because of interest compounding, the *rate of benefit accrual* in a cash balance plan declines, because each year's pay credit will earn one less year of future interest credit. As this article will demonstrate, this built-in decline in the rate of benefit accrual is the key to the age discrimination question raised by cash balance plans. Notice 96-8 makes the important point that the accrued interest credit in a cash balance plan is nonforfeitable part of each participant's accrued benefit, rather than being some sort of ancillary benefit, as the sponsors would prefer. This means that payment of the interest credits that have been earned is not discretionary on the plan sponsor's part.

A variant on cash balance plans, participant-directed plans, ties the interest credit to the performance of an index selected by the participant, such as the Standard & Poor's 500 or the Fidelity Magellan Fund. Structurally, participant-directed plans operate the same way as cash balance plans do. A so-called "pension equity plan," however, defines the pension benefit not in terms of a hypothetical account balance with interest credits, but rather as a hypothetical lump sum, which, at any age, is defined in terms of the participant's years of service times final pay times a single-digit percentage rate. Though this formula looks similar to that of a conventional defined benefit plan, the point is that the sponsor and the participant are viewing the benefit in terms of a lump sum — which is not the way the law sees it.

Although sponsors of cash balance plans use lump sums for purposes of calculating benefits, the law governing defined benefit plans does not. Lump sum calculations are irrelevant to calculations of rates of benefit accrual. But the promoters of cash balance plans are working to persuade the tax administrator to let them apply the rules as though these defined benefit plans were defined contribution plans. That is, the sponsors of these plans are trying to have it both ways. They want the limited liability of a defined contribution plan and the flexible funding of a defined benefit plan. (If defined benefit plan's demographic profile or investment performance is favorable, no contribution may be required in some years.)

Age Discrimination

Unlike a conventional defined benefit plan, a cash balance plan does not, by its own formula, define a deferred annuity. That is, the formula does not establish what is known as a rate of accrual for a normal retirement benefit. Indeed, the amount of a participant's deferred benefit due under a cash balance plan cannot be known with certainty until the participant reaches age 65, particularly if the plan is using a variable index for its interest credit, as most such plans do.

Nonetheless, the law governing defined benefit plans, and in particular the rules regarding age discrimination, contemplates that rates of accrual can be derived for every kind of defined benefit plan. Indeed, Notice 96-8 states that sponsors of cash balance plans have to derive an accrued benefit, and further that they have to assume worst-case scenarios when they make that estimate.

Section 4(i)(1)(A)of the Age Discrimination in Employment Act (ADEA) states, in pertinent part:

> Except as otherwise provided in this subsection, it shall be unlawful for an employer, an employment agency, a labor organization, or any combination thereof to establish or maintain an employee pension benefit plan which requires or permits . . . in the case of a defined benefit plan, the cessation of an employee's benefit accrual, or the reduction of the rate of an employee's benefit accrual, because of age.

Section 204(b)(1)(H) of ERISA states:

> Notwithstanding the preceding subparagraphs, a defined benefit plan shall be treated as not satisfying the requirements of this paragraph if, under the plan, an employee's benefit accrual is ceased, or the rate of an employee's benefit accrual is reduced, because of the attainment of any age.

Code section 411(b)(1)(H) states in pertinent part:

> (H) Continued accrual beyond normal retirement age. (i) In general. Notwithstanding the preceding subparagraphs, a defined benefit plan shall be treated as not satisfying the requirements of this paragraph if, under the plan, an employee's benefit accrual is ceased, or the rate of an employee's benefit accrual is reduced, because of the attainment of any age. (ii) Certain limitations permitted. A plan shall not be treated as failing to meet

the requirements of this subparagraph solely because the plan imposes (without regard to age) a limitation on the amount of benefits that the plan provides or a limitation on the number of years of service or years of participation which are taken into account for purposes of determining benefit accrual under the plan.

The key words in these three similar statutes are "rate of benefit accrual," a term that is not specifically defined but often invoked in discussions of the section 415 limits on contributions and benefits. The rate of accrual should not be confused with the rate of the pay credit or the multiplier in a conventional defined benefit formula. The rate of accrual measures what is happening each year as a participant earns a retirement benefit. A related concept, "accrued benefit," is a defined benefit expressed as an annual retirement benefit beginning at normal retirement age. This is not a lump sum. It is a projection, based on that age of the participant and his earnings, of what annual benefit will be due at normal retirement age; that is, age 65. "Rate of benefit accrual" and "accrued benefit" get at the same thing — what benefit will a participant have at 65, and how fast is he or she earning that benefit?

Code section 411(a)(7), for purposes of section 411 vesting and accrual rules, defines "accrued benefit" in the case of a defined benefit plan as "the employee's accrued benefit determined under the plan and, except as provided in subsection (c)(3), expressed in the form of an annual benefit commencing at normal retirement age."

Regulation section 1.411(b)-7(a)(1)(ii)defines "accrued benefit" in a defined benefit plan that does not specify a benefit as: "an annual benefit commencing at normal retirement age which is the actuarial equivalent determined under section 411(c)(3) and section 1.411(c)-(5) of the accrued benefit determined under the plan."

Code section 411(c)(3) provides that:

> For purposes of this section, in the case of any defined benefit plan, if an employee's accrued benefit is to be determined as an amount other than an annual benefit commencing at normal retirement age . . . the employee's accrued benefit . . . shall be the actuarial equivalent of such benefit or amount determined under paragraph (1) or (2).

Regulation section 1.411(c)-1(e) reiterates: "In the case of a defined benefit plan . . . if an employee's accrued benefit is to be determined as an amount other than an annual benefit commencing at normal retirement age, such benefit . . . shall be the actuarial equivalent of such benefit, as determined by the Commissioner."

In the simplest possible terms, these statutes and regulations mean that the law does not define the accrued benefit in a cash balance plan the same way the cash balance plan defines it. At a minimum, this means that the sponsors of cash balance plans have to redefine their benefits in accordance with the law, as the actuarial equivalent of an annual benefit commencing at normal retirement age, for purposes of determining whether their plans satisfy the section 411 requirements. The cash balance plan sponsors, however, insist that the conflict in the definitions should not change what they have to pay to participants.

The use of an interest factor means that while younger workers have their accruals continually raised by the effect of compounding, older workers at the time of the conversion see their rate of accrual leveled off or even reduced.

Superficially, a cash balance plan with level pay credits does not discriminate on the basis of age; everyone gets the same percentage of pay set aside and the same interest rate credited to it. But when these pay and interest credits are projected forward to produce an annuity commencing at normal retirement age, the age discrimination becomes plain. As previously explained, a younger worker will have more years of interest credits, and the effect of compounding produces the differences in the eventual benefit. The use of an interest factor in the defined benefit formula of cash balance plans means that while younger workers have their accruals continually raised by the effect of compounding, older workers at the time of the conversion see their rate of accrual leveled off or even reduced. On the conversion of a conventional defined benefit plan, older employees may lose the back-loading of benefit accruals in that design. So older employees stand to lose at both ends on the conversion of a conventional defined benefit plan to a cash balance plan.

There are 1988 proposed regulations designed to implement section 411(b)(1)(H) which do not specifically address the cash balance plan question. But the general approach of proposed regulation section 1.411(b)-2 indicates what the answer might be. In these regulations, the IRS has read section 411(b)(1)(H) narrowly to prohibit

cessations and reductions in benefit accruals that are made on the basis of the attainment of a certain age. Section 411(b)(1)(H) was primarily intended to prevent the practice of ceasing benefit accruals for workers who stayed on past the age of 65. The statute and the proposed regulations permit all sorts of changes that have the effect of discriminating against older workers but that have not been made on the basis of age. So a plan design that limits the years of service taken into account in determining defined benefits, though it deleteriously affects older workers, is legal because age was not the deciding factor in this limitation. (Prop. reg. section 1.411(b)-2(b)(2)(i).)

Proposed regulation section 1.411(b)-2(a) states in pertinent part:

> A defined benefit plan is not considered to discontinue benefit accruals or reduce the rate of benefit accrual on behalf of a participant because of the attainment of any age in violation of section 411(b)(1)(H) . . . solely because of a positive correlation between increased age and a reduction or discontinuance in benefit accruals or account allocations under a plan.

The same proposed regulation does, however, prevent plan sponsors from "indirectly" conditioning cessations or reductions in benefit accruals on the attainment of a certain age. This means that, for example, benefit accruals cannot be cut off because a participant has become eligible for social security benefits. (Prop. reg. section 1.411(b)-2(b)(2)(ii).) But it is permissible to have a lower rate of benefit accrual for the last 15 years of credited service than for the first 15 years of credited service in a defined benefit plan, even though the employee with the reduced accruals is going to be an older employee. (Prop. reg. section 1.411(b)-2(b)(3).) That is, a permissible limitation on benefit accruals should be determinable by reference to something other than age. The proposed rules also permit adjustments to the accruals of employees who work beyond normal retirement age, basically preventing them from enlarging their pensions by doing so. Section 411(b)(1)(H) permits those limitations, as do its ERISA and ADEA counterparts.

These proposed regulations give a very narrow reading to the phrase "because of the attainment of any age" used in section 411(b)(1)(H), precluding a finding of age discrimination when the effect of a facially fair practice is discriminatory. And the IRS interpretation of the age discrimination rules governs the approach of the Labor Department and Equal Employment Opportunity Commission. (ADEA section 4(i)(7); ERISA section 204(b)(1)(H)(vi); section 101 of Reorganization Plan No. 4 of 1978; section 9201 of the Consolidated Omnibus Budget Reconciliation Act of 1986.) The EEOC, for its part, is waiting for the IRS to promulgate final age discrimination regulations before it incorporates the IRS conclusions into its own ADEA regulations. Cash balance plans were not common when proposed regulation section 1.411(b)-2 was drafted, so the government could change its approach in final regulations.

Would a cash balance plan fail the test of proposed regulation section 1.411(b)-2? Facially, cash balance plans look evenhanded; every participant either has the same rate of pay credit or, more often, the pay credits are graduated with larger credits going to older workers. It is the compound interest that makes these plans more valuable for younger workers. Whether a cash balance plan would satisfy the proposed regulation depends on the definition of "rate of accrual." If rate of accrual is defined by projecting the participant's benefit to an annual benefit beginning at normal retirement age, then cash balance plans flunk, because the size of a participant's actuarially determined benefit is purely a function of his or her age. Indeed, it is impossible to estimate a cash balance plan participant's pension benefit without knowing his or her age. If cash balance plans were tested for age discrimination as they are for discrimination in favor of the high-paid, as though they were defined contribution plans under the safe harbor of regulation section 1.401(a)(4)-8(c), then no age discrimination would be found.

IRS Response

The conflict between the cash balance plan sponsor's view of what is due the participant and the law's view is clearly evident in Notice 96-8, which discusses what amount should be paid to a participant in a cash balance plan who is being cashed out because he or she is leaving the company. In an era of diminished loyalty on both sides of the employment equation, cash-outs are no small matter. Cash balance plans appeal to companies that have high employee turnover, like computer software companies and financial intermediaries. Indeed, a significant design feature of cash balance plans is their ability to derive some sort of sum to pay a departing employee, unlike conventional pension plans, which typically pay nothing to employees who leave after only a few years. (Aren't cash-outs bad retirement policy? Of course they are. But good retirement policy is regarded as old-fashioned and paternalistic.)

When an employee leaves, the sponsor of a cash balance plan wants to be able to pay the

employee no more than the amount that has accumulated in his or her hypothetical account. The trouble is, the law does not think in terms of cash balances. The law requires that the departing employee's accrued benefit be projected out to an annuity commencing at normal retirement age and then discounted back to present value to determine the appropriate lump sum to be paid. Section 417(e) prescribes interest rates that must be used in discounting the projected benefit to present value. The section 417(e) blended rate is sometimes lower than the rates used by cash balance plans for calculating interest credits, so that the result arrived at from projecting forward and discounting back can be *larger* than the amount of the employee's hypothetical account. For example, if the plan grants interest credits at 6 percent, and the section 417(e) rate is 4 percent, the lump sum required to be paid on departure will be higher than the employee's cash balance. Employers hate that. They call it "whipsaw."

If no more than the employee's hypothetical account balance is paid on his or her departure in a whipsaw situation, then there will have been an impermissible forfeiture of benefits under section 411(a). Notice 96-8 provides a bit of relief for the sponsors of cash balance plans while maintaining the principle that the law governing cash outs of accrued benefits has to be followed even when it conflicts with the plan's practices. Noting that most cash balance plans index their interest credits to unpredictable Treasury rates, the IRS in the notice specified acceptable indices for projecting future interest credits for purposes of deriving an annuity commencing at normal retirement age. Thus the IRS decided to permit small interest rate spreads at which no impermissible forfeiture will be deemed to occur if the departing employee is only paid his or her hypothetical account balance. Basically, the notice makes life more comfortable for the sponsors of cash balance plans by permitting then to compel some departing employees to make small and otherwise impermissible forfeitures.

The IRS has tried to accommodate cash balance plans in other ways. The nondiscrimination safe harbor testing method for cash balance plans is provided under the cross-testing rules of reg. section 1.401(a)(4)-8(c), permitting cash balance plans to be tested for discrimination in favor of high-paid employees as though they were defined contribution plans. The safe harbor testing method permits a cash balance plan to be tested on the basis of the hypothetical allocation formula used to determine an employee's cash balance, rather than on the actual benefits provided under the plan, if certain conditions are satisfied. Sponsors of these plans still, however, find even this safe harbor overly restrictive, and typically try to fit themselves within a benefit accrual rule meant for career average pay defined benefit plans.

The preamble to the proposed 1991 nondiscrimination rules contains the IRS's only statement thus far about the age discrimination question raised by cash balance plans. The preamble states: "The fact that interest adjustments through normal retirement age are accrued in the year of the related hypothetical allocation will not cause a cash balance plan to fail to satisfy the requirements of section 411(b)(1)(H), relating to age-based reductions in the rate at which benefits accrue under a plan." The rules in question, promulgated under section 401(a)(4), are designed to prevent too much discrimination in favor of the highly paid, making this sentence *obiter dicta*.

As this article has demonstrated, the effect of compound interest is precisely what causes the age discrimination problem. In this preamble, the IRS appears to be saying that the very thing that causes the age discrimination problem does not cause an age discrimination problem. To the extent that it means anything, the sentence only refers to the plan design, not the question of transition from defined benefit plan to cash benefit plan. Yet plan sponsors everywhere rely on this sentence to say that they have no age discrimination problems on the conversion of a conventional defined benefit plan to a cash balance plan — a time at which, as this article has demonstrated, the age discrimination issue is most clearly raised.

This preamble does not have the force of law, and no judge would give it that effect. But the age discrimination sentence, *dicta* though it may be, does have a very profound practical effect. For nearly a decade, it has meant, in practice, that the IRS will not deny a determination letter to a defined benefit plan converting to a cash balance format on the ground of age discrimination. Basically, the IRS ignores the age discrimination question in evaluating a determination request from a converting plan. And a converting plan must request a new determination, because a switch to a cash balance format is an amendment.

The upshot of this reading is that plan sponsors have no reason to care about the age discrimination question, at least insofar as their tax qualification is concerned. The preamble cannot prevent employees from suing for age discrimination under ADEA or ERISA. The fact that the preamble is only a preamble, and *dicta* at that, so that the government could change its mind about the age discrimination question in the future, matters not to plan sponsors who would be

entitled to section 7805(b) relief if the answer changed. Though there have been delays in getting determination letters for cash balance plans, there has been no stoppage in their issuance.

The complacency about this preamble dicta is startling. Everyone seems to regard the age discrimination question as settled, and in need of no further official elaboration.

What were the drafters of the preamble sentence thinking? They had come to a conclusion that there was no age discrimination problem in cash balance plan design, especially compared to the heavy favoritism of long-serving, older employees that is typical of conventional defined benefit plan designs. They had concluded that cash balance plans should be tested for age discrimination the same way they were tested for discrimination in favor of the highly paid — as though the plans were defined contribution plans. Thus the accrued benefit should be evaluated on a present value basis rather than on a projected benefit basis.

The drafters of the preamble just didn't bother to state any of this reasoning in a binding official document, nor have their successors bothered to confirm the conclusion. Indeed, the complacency about this preamble *dicta* on both the government and private sides of the equation is startling. Everyone seems to regard the age discrimination question as settled, and in need of no further official elaboration. "Why should the government say any more?" was the reaction on both sides.

A conversion to a cash balance format could be a horizontal partial termination of a defined benefit plan under section 411. Partial termination would be a question if the plan was in surplus, and if the conversion resulted in a significant decrease in the overall rate of future benefit accruals. The partial termination rules were designed to prevent employers from reducing accruals in the quest to recover a defined benefit plan surplus. The remedy for a partial termination would be faster vesting of previously promised benefits, which, in the face of required five-year vesting, is not a big deal.

Is the IRS afraid to disqualify a cash balance plan? The IRS is, generally speaking, afraid to disqualify any large plan. If the IRS read section 411(b)(1)(H) as broadly as some plaintiff's lawyers would like, every cash balance plan would risk disqualification on age discrimination grounds because, as this article has explained, even a graduated pay credit schedule cannot compensate for the effect of compounding interest.

Given that the sponsors of cash balance plans want the best of both worlds — ownership of the funds of a defined benefit plan and the limitation of liability that comes with a defined contribution plan — is there a point when a cash balance plan crosses over into defined contribution territory? Clearly, under the law, no. A disqualified defined benefit plan is a just disqualified plan. It cannot be a defined contribution plan because the trust funds have not been allocated to the participants. (Though a disqualified defined contribution plan can qualify as a defined benefit plan by default, because any plan that is not an individual account plan is a defined benefit plan.) This is why the IRS approach, as reflected in Notice 96-8, has been to try to hold cash balance plan sponsors to the defined benefit plan rules.

Legislation?

Which rather limited IRS effort the plan sponsors resent, deeply. Until the recent *Wall Street Journal* articles appeared, the only talk of legislation in reference to cash balance plans was the attempts by plan sponsors and consultants seeking legislation to grease the skids for cash balance plans. As indulgent as the IRS has been, the sponsors of cash balance plans have not been satisfied. They want the unfettered privilege to run their cash balance plans as they see fit, as though they were defined contribution plans, only without terminating the existing defined benefit plan and without the funds belonging to the employees. They want to have their cake. And these are very large plans, because the trend has been for the sponsors of conventional defined benefit plans, most of which were large employers, to convert. So these large employers have a lot of political muscle.

The appropriate narrow response, which would require legislation, would be to deem cash balance conversions to be terminations of defined benefit plans followed by establishments of defined contribution plans. Employers who want limited liability should be required to allocate all their funds to participants. The hybrid of limited liability and employer ownership of the funds is contrary to the ERISA design that set individual account plans apart.

Before it attacks cash balance conversions, however, Congress should be mindful of how little the reams of federal pension plan rules have accomplished in the way of actual delivery of retirement security. One cannot be too nostalgic for the old conventional defined benefit plan, which provided huge benefits to a fortunate few.

U.S. Treasury Department, Office of Public Affairs, Submitted for the Record

FROM THE OFFICE OF PUBLIC AFFAIRS

February 2, 2004
JS-1132

Preserving Cash Balance Plans for Workers:
Treasury Proposes Legislation to Protect Defined Benefit Plans and Ensure Fair
Treatment of Older Workers
in Cash Balance Conversions

Today, the Treasury Department proposed legislation to ensure the fair treatment of older workers in cash balance conversions.

"This proposal will make sure that every company converting to a cash balance plan deals fairly with its older workers," said Secretary John Snow. "Cash balance plans play an important role in achieving retirement security for millions of American workers and their families. But we must make sure that companies changing from a traditional pension to a cash balance pension include a fair transition for older workers. Cash balance plans can be a better option, particularly for today's younger, more mobile workforce."

A cash balance plan is a pension plan that combines the benefit formula of a defined contribution plan with the worker investment security of a defined benefit plan. Cash balance plans are better suited to a mobile workforce because employees accrue more substantial benefits earlier in their careers and can take their cash balance benefits with them as they move from job to job. Under a cash balance plan, a hypothetical account is set up for each worker and is credited with hypothetical pay and interest credits. Most cash balance plans have been set up by "converting" traditional defined benefit plans.

Treasury's proposal would ensure fairness for older workers in cash balance conversions. The proposal would impose a 5-year "hold harmless" period after each conversion. During this period, the benefits earned by any worker under the cash balance plan would have to be at least as valuable as the benefits the worker would have earned under the traditional plan if the conversion had not occurred. The proposal would ban any "wear-away" of retirement benefits, so that all workers would earn benefits immediately after the conversion.

These protections would be enforced through a 100 percent excise tax. The tax would not apply if a company gives workers a choice between the traditional plan and the cash balance plan or if the cash balance conversion grandfathers current workers.

The proposal would also clarify that cash balance plans do not violate the age-discrimination rules that apply to pension plans as long as they treat older workers at least as well as younger workers. This would remove uncertainty created by inconsistent federal court decisions and would ensure the future of cash balance plans.

The proposal would also eliminate the "whipsaw" effect, which acts as a cap on the interest credits that cash balance plans can provide to workers. This would permit companies to give higher interest credits, allowing larger retirement accumulations for workers.

All changes would be effective prospectively from enactment of the proposal.

Attachments:
Cash Balance Plan FAQ
Cash Balance Plan Proposal

Frequently Asked Questions on Treasury's Proposal for Cash Balance Plans

What are the goals of the proposed legislation for cash balance plans?

The proposal would accomplish three major objectives. Specifically, the proposal would:

- Protect the defined benefit system by clarifying the status of cash balance plans.
- Ensure fairness for older workers in cash balance conversions.
- Remove the cap on interest credits in cash balance plans.

Together, these objectives will help strengthen the defined benefit system while ensuring that companies treat older and longer-service workers fairly when they convert to cash balance plans.

What is a cash balance plan?

A cash balance plan is a type of tax-qualified retirement plan. It is often described as a "hybrid" plan because it combines features of a defined benefit plan and a defined contribution plan.

A cash balance plan provides for annual "pay credits" to an employee's "hypothetical account" and "interest credits" on the balance in the hypothetical account. For example, a cash balance plan might provide for pay credits each year equal to 5 percent of compensation, with interest at the rate on long-term Treasury bonds.

The plan is a defined benefit plan, so the employer bears all investment risk and benefits are insured through the Pension Benefit Guaranty Corporation. Otherwise, the plan functions much like a defined contribution plan from the perspective of an employee.

The Pension Benefit Guaranty Corporation estimates that there are more than 7 million American workers covered by cash balance and other hybrid plans.

How does a cash balance plan differ from a traditional defined benefit plan?

A cash balance plan states the employee's benefit as an account balance, much like a 401(k) plan. A traditional defined benefit plan typically states the employee's benefit as an annuity payable at normal retirement age. The annuity is often expressed as a combination of a percentage of final average pay and years of service (for example, an annual annuity equal to 1 percent of final average pay times years of service).

A traditional plan delivers most of its value to an employee in the very last years before retirement. By contrast, a cash balance plan provides for more level accruals throughout an employee's working career.

Recent studies have shown that cash balance plans help employers compete in tight labor markets because of the more level accruals of cash balance plans. This is especially true where employers are trying to attract and retain more "mobile" workers. Studies have also suggested that cash balance plans may provide higher benefits for a majority of the next generation of workers than would traditional defined benefit plans.

So cash balance plans have an important role to play in the retirement security of millions of American workers and their families.

What is a cash balance conversion?

When an employer amends a traditional defined benefit plan to become a cash balance plan, that process is known as a conversion. Most cash balance plans have been set up in this way.

Why is this legislative proposal needed?

Cash balance conversions can result in unfair treatment of older and longer-service workers because of the abrupt change from the traditional formula to a cash balance formula.

Many employers have voluntarily provided transition relief for older and longer-service workers. But ensuring the fair treatment of older and longer-service workers in conversions requires strengthening current law.

Current law does not protect the future expectations of older and longer-service employees affected by cash balance conversions, and it does not give Treasury the authority to impose fairness requirements for conversions. This very important issue has to be resolved through a change in the law.

What does the legislative proposal say about cash balance conversions?

The proposal requires that an employer converting to a cash balance plan provide for fair treatment of its older and longer-service workers. The proposal would do this in two ways.

First, the proposal would impose a 5-year "hold harmless" period after each conversion. During this period, the benefits earned by any employee under the cash balance plan would have to be at least as valuable as the benefits the employee would have earned under the traditional plan if there had been no conversion.

Second, the proposal would ban any wear-away of benefits at any time after the conversion. A wear-away occurs when an employee's benefits under the cash balance plan have to "catch up" with the benefits already accrued under the traditional plan. This means that some employees do not earn new benefits for a period after the conversion. By banning wear-away, the proposal would make sure that all employees immediately earn new benefits after the conversion.

Why is the "hold harmless" period 5 years?

The hold harmless period has to protect reasonable expectations of older and longer-service employees. At the same time, it cannot be so burdensome that the company decides to freeze the plan entirely, which harms all employees. A 5-year period strikes this balance.

Along with the complete ban on benefit wear-away, the 5-year period will ensure a fair transition for older and longer-service employees to the cash balance formula. In particular, employees who are within 5 years of normal or early retirement will have full protection under this proposal.

How would the new conversion rules be enforced?

The new conversion rules would be backed up by a 100 percent excise tax on the employer. The tax would apply to any shortfall between the benefits required under the new rules and the benefits actually provided by the cash balance plan. We believe that, faced with such an excise tax, employers will provide the benefits

required under the proposal.

Some employers may convert to cash balance plans because they are experiencing adverse business conditions. For this reason, the amount of the excise tax would not exceed the greater of the plan's surplus assets at the time of the conversion or the plan sponsor's taxable income.

Would the excise tax apply if the employer provided some other kind of protection for its older and longer-service workers?

The excise tax would not apply if employees were given a choice between the traditional plan and the cash balance plan or if the conversion grandfathers current employees under the traditional plan. This would preserve flexibility of plan sponsors to implement other protections for older and longer-service employees.

Does this mean that Treasury thinks cash balance conversions violate the age-discrimination rules?

The legislative proposal released today goes beyond current law to ensure that every cash balance conversion provides for fair treatment of older and longer-service employees. In December 2002, Treasury and the IRS proposed regulations that interpret the current age-discrimination rules in the context of cash balance plans and cash balance conversions. Those regulations say that some, but not all, cash balance conversions could be age-discriminatory.

These new rules would apply even if the conversion satisfies the current age-discrimination rules.

Don't employers convert to cash balance plans mainly to save money on their pension obligations?

The evidence on the motivation for cash balance conversions is mixed. One recent study states that a majority of large companies had higher costs after a conversion while another suggests that costs were slightly reduced on average. Regardless, cost savings is only one of many possible motives for conversion. Even where an employer converts to save money, the conversion is preferable to simply freezing or terminating the plan, as long as older and longer-service workers are treated fairly.

What does the legislative proposal say about cash balance plans?

The proposal would clarify the legal status of cash balance plans under current law.

The federal courts have split on the question whether cash balance plans satisfy the age-discrimination rules. This has created uncertainty about the basic legality of these plans. Removing that uncertainty is critical to preserving the vitality of the defined benefit system, which provides retirement income security for millions of American workers and their families.

The proposal would clarify that a cash balance plan satisfies the age-discrimination rules if the plan provides pay credits for older and longer-service employees that are not less than the pay credits for younger employees and if the interest credits are not discriminatory.

The proposal would also clarify that certain transition strategies used in conversions do not violate the age-discrimination or other applicable rules. This would allow companies that convert to preserve the value of early retirement subsidies, for the benefit of employees, without violating the law.

The proposal would provide similar rules for other types of hybrid plans, such as pension equity plans.

Hasn't a federal court already said that cash balance plans are illegal?

One federal district court in Illinois said that one company's cash balance plan violates the age-discrimination rules (Cooper v. IBM Personal Pension Plan). However, other federal district courts have reached the opposite conclusion on other cash balance plans (Eaton v. Onan Corp.; Campbell v. BankBoston). These inconsistent decisions have left the law in a state of uncertainty.

So does this mean that Treasury thinks cash balance plans are good plans?

Treasury believes that cash balance plans have an important role to play in providing retirement security for millions of American workers and their families. However, Treasury also believes that the transition from a traditional defined benefit plan to a cash balance plan must provide for the fair treatment of older and longer-service workers. That is why the proposal calls for new transition protections in cash balance conversions.

What does the legislative proposal say about "whipsaw"?

The proposal would eliminate whipsaw on a prospective basis.

This means that a cash balance plan could distribute an employee's account balance as a single sum as long as the plan does not credit interest at an above-market level. This would permit plan sponsors to give higher interest credits to employees, allowing larger retirement accumulations.

What exactly is whipsaw?

Whipsaw is an interpretation of current law, set out in IRS Notice 96-8, that says that cash balance plans must increase single sum distributions above employee account balances for future interest credits. This interpretation was never set out in formal IRS regulations. Nevertheless, three federal courts of appeals have followed the Notice 96-8 interpretation.

Whipsaw applies if the plan provides an interest crediting rate above the rate on 30-year Treasury bonds (or an equivalent rate).

So does that mean that the proposal will reduce employee distributions?

Absolutely not. The proposal would be effective on a prospective basis, so no employee would get a dollar less than what they would get without this new legislation.

In the future, the distributions of many employees should increase because the proposal will allow their employers to provide more generous interest credits, resulting in higher account balances and higher distributions.

What is the effective date of the proposal?

The entire proposal would be effective for periods after enactment. That means that the new rules will not apply before the date Congress enacts this proposal.

ENSURE FAIR TREATMENT OF OLDER WORKERS IN CASH BALANCE CONVERSIONS AND PROTECT DEFINED BENEFIT PLANS

Current Law

Qualified retirement plans consist of defined benefit plans, which allocate

investment risk to the plan sponsor, and defined contribution plans, which allocate investment risk to plan participants. In recent years, many plan sponsors have adopted cash balance and other "hybrid" plans that combine features of defined benefit and defined contribution plans. A cash balance plan is a defined benefit plan that provides for annual "pay credits" to a participant's "hypothetical account" and "interest credits" on the balance in the hypothetical account. As with traditional defined benefit plans, the sponsor of a cash balance plan bears investment risk (as well as some mortality risk), and benefits are guaranteed by the Pension Benefit Guaranty Corporation. Otherwise, the cash balance plan functions like a defined contribution plan from the perspective of a participant.

Questions have been raised regarding whether and how cash balance plans satisfy the rules relating to age discrimination and the calculation of lump sum distributions.

Age Discrimination. Code section 411(b)(1)(H) provides that a defined benefit plan fails to satisfy the benefit-accrual rules if, under the plan, a participant's benefit accrual is ceased, or the rate of a participant's benefit accrual is reduced, because of the attainment of any age. Section 204(b)(1)(H) of the Employee Retirement Income Security Act of 1974 (ERISA) and section 4(i)(1)(A) of the Age Discrimination in Employment Act (ADEA) set forth similar rules.

Age-discrimination questions have been raised regarding two aspects of cash balance plans. First, some have argued that pay credits for younger participants provide higher benefits than the same pay credits for older participants because the pay credits for younger participants accrue interest credits over longer periods. Although one federal district court has agreed with this analysis, others have rejected it. Compare Cooper v. IBM Personal Pension Plan, 274 F. Supp. 2d 1010 (S.D. Ill. 2003) (cash balance plan found age-discriminatory) with Campbell v. BankBoston, N.A., 206 F. Supp. 2d 70 (D. Mass. 2002) (cash balance plan found not age-discriminatory), aff'd, 327 F.3d 1 (1st Cir. 2003), and Eaton v. Onan Corp., 117 F. Supp. 2d 812 (S.D. Ind. 2000) (same).

Second, some have argued that "conversions" of traditional defined benefit plans to cash balance plans disadvantage older participants. A conversion occurs when a plan sponsor amends a traditional plan to make it a cash balance plan. A conversion can result in lower future accrual rates for some or all participants. If this occurs, ERISA section 204(h) and Code section 4980F require that participants receive advance notice. The conversion can also result in "wear-away" – a period following the conversion during which a participant's prior accrued benefits under the traditional plan exceed the benefits payable under the cash balance plan. Thus, during wear-away, the benefits under the cash balance formula of some or all participants must "catch up" with benefits accrued under the traditional plan. Wear-away may occur for the normal retirement benefit, the early retirement benefit, or both. However, under Code section 411(d)(6) and ERISA section 204(g), the conversion may not reduce the accrued normal or early retirement benefit of any participant.

Some have argued that the adverse effects of cash balance conversions fall more heavily on older participants than on younger participants because traditional plans usually provide more valuable accruals to older and longer-service participants. Many plan sponsors have adopted strategies to mitigate these effects, including protection of participant expectations through "choice" and "grandfathering" as well as avoidance of wear-away. However, these strategies have been voluntary, as current law generally gives the plan sponsor broad authority to amend a plan for any reason at any time. Hughes Aircraft Co. v. Jacobson, 525 U.S. 432, 443 (1999).

In December of 2002, Treasury and the IRS proposed regulations to address these and other age-discrimination issues. 67 Fed. Reg. 76123 (Dec. 11, 2002). The proposed regulations provide that a cash balance formula is not discriminatory as long as pay credits for older participants are equal to or greater than pay credits for younger participants. The proposed regulations also provide that cash balance conversions are not discriminatory as long as the conversions satisfy one of three permissible methods specified in the regulations. The proposed regulations do not prohibit reductions in future accrual rates or benefit wear-away because, under the

conditions specified in the proposed regulations, those effects are not inherently age-discriminatory.

Calculation of Lump Sum Distributions. Three federal appellate courts have addressed the calculation of lump sum distributions under cash balance plans. Berger v. Xerox Corp. Retirement Income Guarantee Plan, 338 F.3d 755 (7th Cir. 2003); Esden v. Bank of Boston, 229 F.3d 154 (2d Cir. 2000), cert. dismissed, 531 U.S. 1061 (2001); Lyons v. Georgia-Pacific Salaried Employees Retirement Plan, 221 F.3d 1235 (11th Cir. 2000), cert. denied, 532 U.S. 967 (2001). All three courts held that a participant's hypothetical account balance must be projected to normal retirement age using the plan's interest crediting rate, converted to an annuity, and then discounted to a lump sum using the section 417(e) interest rate. If the plan's interest crediting rate is the section 417(e) rate, the present value of the normal retirement age annuity will be the same as the hypothetical account balance. However, if the plan's interest crediting rate is higher than the section 417(e) rate, the present value of the normal retirement age annuity – and the amount of any lump sum distribution – will be greater than the hypothetical account balance. This result is sometimes referred to as "whipsaw."

These federal court decisions have followed an analysis set out in IRS Notice 96-8. Many plan sponsors have responded to whipsaw by limiting the interest crediting rate to the section 417(e) rate (or a deemed equivalent). This response effectively makes the section 417(e) rate a ceiling on plan interest credits.

Reasons for Change

Although cash balance plans and cash balance conversions are not inherently age-discriminatory, current law does not provide adequate protection for older workers in every conversion. For example, the statutory age-discrimination rules do not prevent a plan sponsor from changing future benefit accruals. Also, current law does not prevent a plan sponsor from imposing wear-away of normal or early retirement benefits. (Current law actually restricts certain transition practices, such as preserving the value of early retirement subsidies through additions to participant account balances.) Many plan sponsors have voluntarily tried to mitigate any adverse effects that cash balance conversions may have on older and longer-service participants. However, ensuring the fair treatment of older and longer-service participants in conversions requires strengthening current law to guarantee reasonable transition protections and to prohibit benefit wear-away.

Inconsistent federal court decisions make it necessary to clarify that cash balance plans are not inherently discriminatory as long as older participants are treated at least as well as younger participants. Removing uncertainty about the basic legality of cash balance plans is critical to preserving the vitality of the defined benefit system, which provides retirement income security for millions of American workers and their families.

As applied by the courts, the whipsaw effect under Notice 96-8 has harmed participants by leading plan sponsors to limit interest credits to the section 417(e) rate. This results in lower retirement accumulations for participants. The whipsaw effect should be eliminated so that plan sponsors can give participants higher interest credits.

Proposal

The proposal would accomplish three major objectives:

1. Ensure fairness for older workers in cash balance conversions.

2. Protect the defined benefit system by clarifying the status of cash balance plans.

3. Remove the effective ceiling on interest credits in cash balance plans.

Ensure fairness for older workers in cash balance conversions. The proposal would

provide new protections for participants in cash balance conversions that would ensure fair transitions from traditional plans to cash balance plans. For each of the first five years after a conversion, the benefits earned by any current participant under the cash balance plan would have to be at least as valuable as the benefits the participant would have earned under the traditional plan if the conversion had not occurred. Additionally, there could be no wear-away of normal or early retirement benefits for any current participant at any time.

To prohibit violations of the new transition protections, there would be a 100 percent excise tax, payable by the plan sponsor, on any difference between the benefits required under the proposal and the benefits actually provided by the cash balance plan. In recognition of the fact that some plan sponsors may be experiencing adverse business conditions, the amount of the excise tax could not exceed the greater of the plan's surplus assets at the time of the conversion or the plan sponsor's taxable income. Failure to implement the new transition protections would not result in disqualification of the plan.

The excise tax would not apply if participants were given a choice between the traditional formula and the cash balance formula or if the cash balance conversion grandfathered current participants under the traditional formula. This would preserve flexibility of plan sponsors to implement other provisions that protect older and longer-service participants.

Protect the defined benefit system by clarifying the status of cash balance plans. The proposal would clarify that a cash balance plan satisfies the age-discrimination rules if the plan provides pay credits for older participants that are not less than the pay credits for younger participants, in the same manner as any defined contribution plan. The proposal would also clarify that certain transition strategies used in conversions (such as preserving the value of early retirement subsidies) do not violate the age-discrimination or other qualification rules. The proposal would provide similar rules for other types of hybrid plans and for conversions from traditional plans to other types of hybrid plans.

Remove the effective ceiling on interest credits in cash balance plans. The proposal would eliminate whipsaw, providing that a cash balance plan may distribute a participant's account balance as a lump sum distribution as long as the plan does not credit interest in excess of a market rate of return. The Secretary would be authorized to provide safe harbors for what constitutes a market rate of return and to prescribe appropriate conditions regarding the calculation of plan distributions. This would permit plan sponsors to give higher interest credits to participants, resulting in larger retirement accumulations.

Conforming amendments and effective date. There would be conforming amendments under ERISA and the ADEA for statutory changes to the existing age-discrimination and distribution rules (but not for the new excise tax).

All changes under the proposal would be effective prospectively. The legislative history would state that there would be no inference as to the status of cash balance plans or cash balance conversions under current law.

Companies That Have Converted to Cash Balance Pension Plans, Submitted for the Record

Companies That Have Converted to Cash Balance Pension Plans
Source: Pensions and Investments **(as of 1999)**

1.ABB
2. ADT Security
3. Aetna Life Insurance
4. AG Communications Systems
5. Agway
6. AHERF
7. AK Steel
8. Akzo Nobel
9. All Saints Hospital Systems
10. Allegheny Health Systems
11. Alliant Health Systems
12. Alliant Techsystems
13. AlliedSignal
14. Allina Health Systems
15. Allmerica Financial
16. American Express Co.
17. American Trading & Prod.
18. Ameritech
19. Andritz
20. Angus Chemicals
21. Arch Coal
22. Armco
23. Asea Brown Boveri
24. Ashland
25. Associated Banc Corp.
26. AT&T
27. Atlantic Healthcare
28. Atlantic Mutual
29. Atlas Copco
30. AutoAlliance Int'l
31. Automatic Data Processing
32. Avnet
33. Avon Products
34. B. Braun Medical
35. B.E.& K. Alabama Cons.
36. Badger Meter
37. Banc One Corp.
38. Bank of Oklahoma
39. Bank Of Tokyo
40. Bank South
41. Bank America
42. Bank Boston
43. Bankers Trust
44. Bashas
45. Belk Stores
46. Bell Atlantic
47. BellSouth
48. Beth Israel Hospital
49. Blue Cross/Shield NJ
50. BOC Group
51. Borden
52. Boston University
53. BP America
54. Brown Bros. Harriman
55. Browning-Ferris
56. Burns & Roe Enterprises
57. Cabot Corp.
58. Cadbury Schweppes
59. Caldor Corp.
60. Calif. State Teachers (part-time)
61. Caltex Petroleum
62. Capital One
63. Carborundum Co.
64. Care Group
65. Carlisle Cos.
66. Case Western Res. Univ.
67. Casual Corner Group
68. Catholic Health Initiatives
69. CBS
70. Ceco Corp.
71. Cenex Harvest States
72. Central & Southwest
73. Central Hudson G & E
74. Central Suffolk Health
75. Centura Healthcare
76. Chase Manhattan Corp.
77. ChemRex
78.CIGNA
79. Cincinnati Bell
80. Citigroup
81. City Banc
82. Clarkson Hospital
83. Cleveland Clinic
84. Clorox Co.
85. Cognizant
86. Colgate-Palmolive
87. Collins & Aikman
88. Columbus Regional Heathcare
89. Commerce Bancshares
90. Commonwealth Industries
91. Conectiv
92. Congr. Sisters of St. Joseph
93. Congressional Info. Services
94. Continental Can
95. Contraves
96. Cooper Cameron
97. Cooper Industries
98. Corn Products Int'l
99. Corning
100. Countrymark Cooperative
101. Crown Cork & Seal
102. Cummins Engine
103. Dade Behring A22
104. Dana
105. Daughters of Charity
106. Daughters of Charity Nat'l
107. DB Riley Consolidated
108. Del Monte Fruit
109. Deloitte & Touche
110. Desert Hospital
111. Detroit Diesel
112. Dev. Corp. for Israel
113. Digital Equipment
114. Diocese of Colorado Springs
115. Diocese of Sacramento
116. Domestic Cheese
117. Donaldson
118. Duke Energy
119. Dun & Bradstreet
120. Dundee
121. Durable Manufacturing
122. Duracell Int'l
123. Eagle Industries
124. Eastman Kodak
125. Eastman Savings & Loan
126. Easton Mem. Hospital
127. Eaton
128. EDS
129. El Camino Hospital
130. El Paso Electric
131. Elwyn
132. EMC Insurance
133. Emigrant Savings Bank
134. Eni Chem Elastomers
135. Enron

136. Equitable Life
137. Estee Lauder
138. Evangelical Health System
139. Fairchild
140. Falcon Building Materials
141. Federal Home Loan Bank
142. Federal-Mogul
143. Federated Dept. Stores
144. First USA
145.Florida Light & Power
146. Formosa Plastics
147. Freudenberg-NOK
148. Friendly Ice Cream
149.Furr's/Bishop's
150. General Atomics
151. General Signal
152. Genesco Telephone
153. Georgia-Pacific
154. Glaxo Wellcome
155. Great Atlantic & Pacific Tea
156. Great Northern Paper
157. Great Western Financial
158. GreenPoint Savings Bank
159. Hallmark Cards
160. Hannaford Bros.
161. Harbor Beach
162. Harvard University
163. Helix Health
164. Henry Ford Health Systems
165. Hershey Foods
166 Hertz
167. Hoechst-Mario Rousell
168. Home Foods
169. Howmet
170. Huck International
171. Hyster-Yale
172. IBM
173. Imperial Corp. of America
174. Ingram Industries
175. International Home Foods
176. Interpublic Group
177. Intracoastal Health
178. Iroquois Pipeline
179. Jobst Institute
180. Julia Dyckman Andrus Home
181. Kayser-Roth
182. Kendall International
183. KeyCorp.
184. Kwasha Lipton
185. Laboratory Corp. America
186. Lafayette American Bank
187. Lake Region Hospital
188. Laura Askley
189. Leaseway Transportation
190. Leslie Fay Cos.
191. Lexmark International
192. Lifespan
193. LifeStyle Furnishing Intl.
194. Loctite Corp.
195. Loews Corp.
196. Londontown
197. Lucent
198. Lummus
199. Lutheran General Hospital
200. Luxottica
201. Magnetek
202. Manor Care
203. Marion Merrill Dow
204. Marquette Bancshares
205. Maryland Insurance Group
206. Mass. Institute of Tech.
207. Massachusetts General
208. Massey-Ferguson
209. Mazda
210. Medlantic Healthcare
211. Mercantile Bankshares
212. Merck-Medco Managed care
213. Mercy Hosp. Pittsburgh
214. Meredity Corp.
215. Meritcare Health Sys.
216. MidAmerica Mutual Life
217. Monarch Machine Tools
218. Monsanto
219. Nanticoke Memorial Hsop.
220. Nashua Corp.
221. National City
222. National Grange Mutual
223. NCR
224. Nebraska Methodist Health
225. New Century Energies
226. New England Deaconess
227. New York Hospital
228. Niagra Mohawk
229. Nielsen Media Research
230. Northeast Savings
231. Nunmi-Mazda
232. NutraSweet
233. Ogilvy & Mather
234. Onan
235 .Orange Co. Water District
236. Oryx Energy
237. Our Lady of Lourdes Medical
238. Owens Corning
239. Penske Truck Leasing
240. Peter Kiewit Sons'
241. Poe & Brown
242. PolyGram Holding
243. PriceWaterhouseCoopers
244. Providence Health System
245. Prudential Securities
246. Public Service G&E
247. Puget Sound Energy
248. R.H. Donnelley
249. R.L. Polk
250. Reckitt & Coleman
251. reSource Partner
252. Rexnord
253. Riverside Community Hospital
254. RJR Nabisco
255. Robertson-Ceco
256. Rohr
257. SAFECO
258. Safeway
259. Sargent & Lundy
260. SBC Communications
261. Service Corp. int.
262. Service Merchandise
263. Shaw's Supermarkets
264. Showa Denko Carbon
265. Sigma-Aldrich
266.Simplex Time Recorder
267. Sinai Hosp. of Maryland
268. Sisters of Charity
269. Skadden Arps Slate
270. SmithKline Beecham
271. Solutia
272. Southern California Edison
273. Southern New
274. Springs Industries
275. SPS Technologies
276. SPX

277. SSM Health Care
278. St. Joseph's/St. Anthony's
279. State Street Bank
280. Suburban Propane
281. Sun Co.
282. Susquehanna Bancshares
283. Swiss Bank
284. TCF Financial
285. Tektronix
286. Texas Bancshares
287. Texas Commerce Bank
288. Texas District & County
289. Thomson Consumer Elec.
290. Thomson Newspapers
291. Times Mirror
292. Tosco
293. TPI Enterprises
294. Turner Corp.
295. Twin Cicites Pipe Trades
296. U.S. Bancorp
297. U.S. Shoe
298. Union Bank of Switzerland
299. Uniontown Hospital Pittsburgh
300. United Industrial Corp.
301. United Methodist Church
302. United Wisconsin Services
303. University Hospital Denver
304. University of Miami
305. US WEST
306. Via Christi Health System
307. Visiting Nurse Serv. N.Y.
308. W. Pa. Hospital
309. Wake Medical Center
310. Washington County Hosp.
311. Washington State Teachers
312. Wellpoint Health Sys.
313. Wells Fargo
314. Wendy's International
315. Wesley Jessen
316. Wheaton Franciscan Servs.
317. Wickes Cos.
318. Wiremold
319. Wisconsin Electric
320. World Bank
321. World Color Press
322. Xerox
323. YWCA
324. Zeigler Coal
325. Zurich American Ins.

Employers Awaiting IRS Determination Letters Under the Cash Balance Moratorium (September 1999 - January 2003) [redacted]) 1

Name	City	State	EIN#	Plan #	Exp #	Plan Name	Plan Type	Included	Excluded	# of Participants	Year Applied
Atlas Copco North America Inc.	Pine Brook	NJ	22-1669012	001	12/31	Atlas Copco Pension Plan	Cash Balance	Full vesting after 5 years	Under 1 year service or 21 years old and other	not visible in copy	not visible in copy
Red Meyer, Inc / The Kroger Co.	Portland	OR	91-1626443				Cash Balance	1. Collective bargaining 2. Leased employees 3. Non-resident alien who has no US source earned income		148,787	2000
University of California	Oakland CA	CA	94-2587496				Cash Balance		1. Members of other retirement plans 2. Regents Professors and Lecturers 3. Student employees 4. Special Circumstances 5. Per diem 6. Visiting employees	166,180	1998
US West	Denver	CO	84-0921198	005	12/31		Pension Equity	Other		95,986	June-00
Electronic Data Systems Corp.	Plano	TX	75-2648221				Cash Balance	Effective 12/31/99	1. Non-US employees	90,051	January-00
Eastman Kodak Co.	Rochester	NY	16-0417150				Cash Balance		Pension plans are those who elect or are required	80,349	1998
Aetna Inc.	Hartford	CT	23-2229683	001	12/31	Retirement Plan for Employees of Aetna Inc.	Cash Balance	Other: separate attachment	other	61,068	January-00
Aetna Services, Inc.	Hartford	CT	06-0643808	001			Cash Balance	Effective 1/1/99	1. Collective bargaining 2. Under another affiliated plan 3. Contract employees	55,717	March-99
SmithKline Beecham Corporation d/b/a/ GlaxoSmithKline	Philadelphia PA	PA	23-1098060	003	12/31	GlaxoSmithKline Cahs Balance Pension Plan	Cash Balance	Full and Immediate	Under 1 year service	52,770	1998
Compaq Computer Corporation	Houston	TX	76-0011617	002	12/31	Compaq Computer Corporation Cash Account Pe	Cash Balance	Full vesting after 5 years	other: separate attachment	52,064	1998
The Prudential Insurance Co. of America	Newark	NJ	22-1211670	003	12/31	The Prudential Merged Retirement Plan	Cash Balance			52,064	1941
The Prudential Insurance Co. of America	Newark	NJ	22-1211670	003	12/31	The Prudential Merged Retirement Plan	Cash Balance	Full vesting after 5 years	Under 1 year service service	81,029	1941
Bell South Corp.	Atlanta	GA	64-2103578	001	6/30		Cash Balance	1. Salaried employees 2. Non-representable	1. Leased employee 2. No represented employee who is not otherwise an eligible employee and who is temporarily promoted to salaried status for a year or less 3. No employee who is non-resident alien, who has no US income and was not covered by Predecessor plan on 9/30/90 and any 3rd country or local national	45,034	October-99
National City Corporation	Cleveland	OH	34-1111088	002	12/31	National City Corporation Non-Contributory Retirement Plan	Cash Balance	1. All employees 2. Full vesting after 5 years	1. Special project employees 2. Collectively Bargained employees unless specified as allowed within Bargained agreements 3. Non-resident aliens who receive income from source inside US 4. Leased employees 5. Employees hired after 6/95 and is employed by National City Investments, Inc.	44,818	December-99
Wells Fargo	Minneapolis	MN	41-0449260	001	12/31		Cash Balance	Not specified		41,577	February-99
Foot Locker, Inc.	New York	NY	13-3513936	001	12/31	Foot Locker Retirement Plan	Unit Benefits/Cash Balance	Full vesting after 5 years	Under 1 year service or 21 years old and othe	40,410	1946
HouseHold International, Inc.	Prospect Heights	IL	36-3121988	001	12/31	Household Retirement Income Plan	Cash Balance	Full vesting after 3 years	other: separate attachment	40,388	1962
Hallmark Cards, Inc	Kansas City	MO	44-0272180				Cash Balance		19,572 excluded employees	35,730	1998
6363: Celanese Americas Corporation	Summit	NJ	22-1862783	004	12/31	Celanese Americas Retirement Pension Plan	other: separate attachment	Full vesting after 5 years	other: separate attachment	35,142	1947
PNC Bank Corp	Pittsburgh	PA	25-1435979				Cash Balance	1. All employees 2. Full vesting after 5 years	1. Union 2. Leased construction laborer	34,368	1999
Sisters of Providence	Seattle	WA	91-0216586			Providence Health Systems	Cash Balance		1. Collective Bargaining 2. Sisters of Province, Sacred Heart 3. Leased employees 4. Highly Compensated employees 5. Persons who perform services for an entity but who are treated as other than employees	33,586	1999
Nortel Networks	Nashville	TN	04-2458332				Cash Balance/ Unit Benefit		1. Collective bargaining 2. Employees under another plan	31,112	April-01
Pitney Bowes	Stamford	CT	06-0495050				Cash Balance		1. Collective bargaining 2. Non-US, DSR maintenance employees	31,012	December-96
Dun and Bradstreet Corp.	Murray Hill	NJ	13-3998945			Dun and Bradstreet Corp. Retirement Account	Cash Balance	All employees		29,411	September-96
Bank One Corp	Chicago	IL	31-0732696			First Chicago NBD Corp Personal Pension Account Plan	Cash Balance	1. All US based employees 2. Full vesting after 5 years		26,969	1999
Aqual Island Inc.	East Chicago	IN	36-1362600	001	12/31	Aqual Island Inc. Pension Plan Personal Retirem	Cash Balance	Full vesting after 5 years	non-salaried, union or independent contractor	26,484	1999
Ma. St. Carp. Guarant. Annuity Fund	Wilmington	MA	04-2776873	001	12/31	Ma. St. Carpt Guarant. Annuity Fund	Cash Balance	Full and Immediate	other: separate attachment	26,348	1961
Southern California Edison Company	Rosemead CA	CA	95-1240335	001	12/31	Southern California Edison Company Retirement	Cash Balance	Full vesting after 5 years	other: separate attachment	25,198	1958
Reliant Energy, Inc	Houston	TX	74-0694415	001	12/31	Reliant Energy, Inc. Retirement Plan	Cash Balance	Full vesting after 5 years	other: separate attachment	23,699	1953
Danaher Corporation	Washington	DC	59-1995548	003	12/31	Danaher Corporation & Subsidaries Pension Pla	Unit Benefits/Cash Balance	Other: separate attachment	Under 1 year service and other: separate atta	21,728	1957
Georgia-Pacific Corporation	Atlanta	GA	93-0432081	046	12/31	Georgia-Pacific Corporation Salaried Pension Pla	Cash Balance	Other: separate attachment	Under 1 year service and other: separate atta	21,100	1987
Asea Brown Boveri Inc.	Norwalk	CT	13-2871634	301	12/31	Asea brown Boveri Inc. Cash Balance Pension Pl	Cash Balance	Full vesting after 5 years	other: separate attachment	20,757	1992
A.O. Smith Corporation	Milwaukee	WI	39-0619790	001	12/31	A.O. Smith Retirement Plan for Magnet Eng	Unit Benefit	Full vesting after 5 years	other: separate attachment	19,907	1999
Bankers Trust Corp	New York	NY	13-6180473				Cash Balance			19,790	1989
Enron	Houston	TX	47-0255140				Cash Balance	All employees Effective 1/1/97, 1/1/98	1. Collective bargaining 2. Leased employees 3. Non-US	19,646	April-00
BASF Corp.	Mt. Olive	NJ	16-1095809			BASF Corp. Salaried Plan	Cash Balance- Fixed	Salaried employees only Effective 1/1/00		18,962	January-00
Laboratory Corporation of America Holdings	Burlington	NC	13-3757375	002	12/31	Cash Balance Retirement Plan	Cash Balance	Full vesting after 5 years	Under 1 year service or 21 years old and othe	18,327	1999
BB&T Corporation	Wilsnton-Salem	NC	56-0539947	003	12/31	BB&T Corporation 401(k) Savings Plan		Full and Immediate		17,242	1982
Franciscan Healthcare Corp d/b/a Catholic Health Initiatives Eastern Region	Aston	PA	23-2575537	001	12/31	Franciscan Health Systems CB Plan	Cash Balance	1. Not specified because not subject to 0411 rule - church 2. Full vesting after 5 years		16,245	May-99
Louisiana-Pacific Corporation	Portland	OR	93-0609074	032	12/31	Louisiana-Pacific Corporation Retirement Accoun	Cash Balance	Other: separate attachment	temporary employees	16,030	1985
Niagra Mohawk Power Corp.	Syracuse NY	NY	15-0265555				Cash Balance	All employees	1. Collective Bargaining 2. Non-resident alien of the US 3. Leased employees 4. Summer student	15,844	1999
Inova Health System	Falls Church	VA	54-1071867	001	12/31	Inova Health System Retirement Income Plan	Cash Balance	Full vesting after 5 years	non-eligible employees of participating empl	13,481	1984

Sutter Health	Sacramento	CA	94-2789507	333	12/31	Sutter Health Retirement Plan	Cash Balance	none listed	none listed	14,290	1958
CBIS Corp.	New York	NY	25-0877540			Groom Law Group	Cash Balance	All full time and part-time empla	1. Collective bargaining 2. Leased employees 3. A few subs	14,177	December-96
The Standard Register Company	Dayton	OH	31-0455440	001	12/31	The Standard Retirement Plan	Unit Benefit	Full vesting after 5 years		14,176	1946
Polaroid Corporation	Cambridge	MA	04-1734655	002	12/31	Polaroid Pension Plan	Cash Balance	1. All employees 2. Full vesting after 5 years 3. Retirement age 4. Reached 55th birthday before 12/31/97 5. Terminated employee older than 55, providing he/she had 3 years vesting service		13,804	August-00
Ameren Corporation	Saint Louis	MO	43-1723446	004	12/31	Ameren Retirement Plan	Unit Benefit w/ Cash Balance	Full vesting after 5 years	other: separate attachment	13,518	1941
Ameren Corporation	Saint Louis	MO	43-1723446	004	12/31	Ameren Retirement Plan	Unit Benefit w/ Cash Balance	Full vesting after 5 years	other: separate attachment	13,518	1941
Memorial Hermann Healthcare System	Houston	TX	76-0025117				Cash Balance		1. Collective bargaining unless included in agreement	13,030	May-00
Kaleida Health	Buffalo	NY	16-1533232	001	12/31	Kaleida Pension Growth Plan	Cash Balance	Other: separate attachment	Under 1 year service service and other: sepa	12,846	1956
Hannaford Bros. Co.	Scarborough	ME	01-0065930				Cash Balance	Full vesting after 5 years	1. Leased employees 2. Independent contractors 3. Persons employed in the Southeast Division	12,863	1999
Southern California Gas Company c/o Sempra Energy	San Diego CA	CA	95-1240705	001	12/31	The Southern California Gas Company Pension	Unit Benefit w/ Cash Balance	Full vesting after 5 years	Under 1 year service or 21 years old and othe	12,871	1932
Equiva Services LLC	Houston	TX	51-0362328	001	3/31	Alliance Pension Plan	Cash Balance	Full vesting after 5 years	1. Collectively bargained that does not specifically provide coverage under the plan 2. Non-resident aliens 3. Leased employees 4. Employees of Star Staff or Petrowan 5. Program employees	12,359	December-99
President and Fellows of Harvard College	Cambridge	MA	04-2103580	003	6/30	Harvard University Retirement Plan	Cash Balance	All employees prior to 6/1/98	1. Degree candidates 2. Employees with part-time teaching appointments 3. Interns	11,521	May-99
Saks and Company	New York	NY	13-1256625				Cash Balance		1. Collective bargaining 2. Leased employees 3. Contractors	11,168	July-99
Empire Blue Cross and Blue Shield	New York	NY	23-7391136				Cash Balance	All employees	Kept early retirement subs, had transition prof, not clear on all of who got	10,358	October-99
The Penn Traffic Company	Syracuse	NY	25-0716800	010	12/31	The Penn Traffic Company Cash Balance Pensi	Cash Balance	Full vesting after 5 years	Under 1 year service or 21 years old and othe	10,189	1953
Cummins Inc.	Columbus	IN	35-0257090	001	12/31	Cummins Inc. Cash Balance Pension Plan "A"	Unit Benefit	Full vesting after 5 years	Under 1 year service or 21 years old and othe	9,817	1901
Bausch & Lomb Incorporated	Rochester	NY	16-0345235	001	12/31	Bausch & Lomb Retirement Benefits Plan	Cash Balance	Full vesting after 5 years	Under 1 year service or 21 years old and othe	9,627	1942
Bausch & Lomb Incorporated	Rochester	NY	16-0345235	001	12/31	Bausch & Lomb Retirement Benefits Plan	Cash Balance	Full vesting after 5 years	Under 1 year service or 21 years old and othe	9,627	1942
Oakwood Healthcare, Inc.	Dearborn	MI	38-1465141	003	12/31	Oakwood Healthcare, Inc. Cash Balance Plan	Cash Balance	Other	Not Covered by CBA	8,842	1960
Hartford Hospital	Hartford	CT	06-0646668	001	12/31	Retirement Plan for Employees of Hartford Hosp	Cash Balance	Full vesting after 5 years	Under 1 year service or 21 years old and othe	8,685	1847
Grant/Riverside Methodist Hospital Corp.	Columbus	OH	31-4394942			Ohio Health Cash Balance Retirement Plan	Cash Balance			8,368	1998
Baystate Health System	Springfield	MA	04-2105941				Cash Balance	All employees - not clear		8,374	November-98
Herman Miller, Inc.	Zeeland	MI	38-0837640				Cash Balance	All employees	1. Leased employees 2. Represented in collective bargaining and employed outside of US on assignment of 5 or more years	8,238	2000
Cummins Engine Co.	Columbus	IN	35-0257090				Cash Balance	Includes collective bargaining		8,180	1998
Saint Luke's/Shawnee Mission Health System, Inc	Kansas City	MO	43-1747502	001	12/31	Saint Luke's/Shawnee Mission Health System, In	Cash Balance	Full vesting after 5 years	Under 1 year service service or 21 years old	7,821	1973
Beth Israel Deaconess Medical Center	Boston	MA	04-2103881			Care Group Pension Plan	Cash Balance		1. House staff 2. Residents 3. Fellows 4. Leased employees	7,840	November-99
Integris Health, Inc.	Dallas	TX	73-1192764				Cash Balance	All employees		7,704	1999
El Paso Energy Corporation	Houston	TX	76-0568816	001	12/31	El Paso Energy Corporation Pension Plan	Cash Balance	Full vesting after 5 years	1. Non-resident aliens 2. Leased employees 3. Hourly employees 4. Foreign nationals working on temp projects 5. Collectively bargained	7,611	December-98
Pediatric Otolaryngology Head and Neck Surgery Associates, P.A.	Houston	TX	76-0568816	001	12/31	El Paso Energy Corporation Pension Plan	Cash Balance	Full vesting after 5yrs	1. non-resident aliens 2. leased eee 3. Hourly	7,611	December-98
Cooper Cameron Corporation	Houston	TX	76-0451843	014	12/31	Cooper Cameron Corporation Retirement Plan	Unit Benefit/Cash Balance	Other: separate attachment	other: separate attachment	7,483	1995
Accor Economy Lodging, Inc.	Dallas	TX	77-0116487	001	12/31	Accor Economy Lodging Retirement Plan	Cash Balance	Full vesting after 5 years	Under 1 year service or 21 years old and othe	7,479	1978
SC Johnson and Son	Racine	WI	39-0379990				Cash Balance	All employees Effective 6/98		6,942	October-98
Agribank, FCB	St. Paul	MN	41-1717543	001	12/31	Seventh Farm Credit District Retirement Plan	Unit Benefit	Full vesting after 5 years	other: separate attachment	6,713	1974
Genex Harvest States Cooperating	Inver Grove Heights	MN	41-0251095				Cash Balance	All employees	1. Collective bargaining 2. Independent contractors 3. Leased employees 4. Non-resident alien	6,458	1999
Avon Products, Inc.	New York	NY	13-0544597				Cash Balance		1. Collective bargaining unless so stated in agreement 2. Sales Reps	6,317	1999
Midamerican Energy Company	Des Moines	IA	42-1425214	001	12/31	Midamerican Energy Company Retirement Plan	Cash Balance	Full vesting after 5 years	other: separate attachment	6,176	1948
Conectiv	Wilmington	DE	51-0377417			The Conectiv Retirement Plan	Base Plan and 3 sub plans	1. CB plan: non-bargain employees 2. Delmarva Sub Plan: local 1238 3. ACE Sub plan: local 210		6,152	2001
Freudenberg-NOK General Partnership	Plymouth	MI	38-2838208	005	12/31	Freudenberg-NOK General Partnership Cash Ba	Cash Balance	Other: separate attachment	other: separate attachment	6,122	1990
ING America Life	Atlanta	GA	58-0298930	001	12/31	ING Retirement Plan for Employees of Life Insur	other: separate attachment	Full vesting after 5 years	CBA and Leased	5,987	1947
Carolina Power and Light Co.	Raleigh	NC	56-0165465				Cash Balance	All employees		5,953	1986
Friendly Ice Cream Corporation	Wilbraham	MA	04-2953130	001	12/31	Friendly Ice Cream Corporation Cash Balance Pl	Cash Balance	Full vesting after 5 years	Under 1 year service or 21 years old	5,895	1935

North American Coal Corporation	Dallas TX	TX	34-1554846	005	12/31	The Combined Defined Benefits Plan for NACCO	Unit Benefits/Cash Balance	Other: separate attachment	other: separate attachment	5,769	1998
Nine West Group Inc./ Association of Nine West Group Inc	White Plains NY	NY	06-1091855				Cash Balance		1. Leased employees 2. Collectively Bargained	5,722	1999
San Diego Gas & Electric Company d/o Sempra Energy	San Diego CA	CA	95-1184600	002	12/31	San Diego Gas & Electric Company Cash Balanc	Cash Balance	Full vesting after 5 years	Under 1 year service and other: separate atta	5,649	1981
Carefirst of Maryland, Inc.	Owing Mills	MD	52-1365894	001	12/31	Carefirst of Maryland Inc. Retirement Plan	Pension Equity	1. Full vesting after 5 years 2. Plan participants prior to 12/31/98 as amended and effective 1/1/99	1. Leased employees 2. Union 3. Non-resident alien and employees who receive earned income from the ER which constitutes income from sources within the US 4. Independent contractors 5. Consultants 6. Any individual not classified as an employee 7. Employees with employment contracts 8. Interns	5,354	June-00
Clorox Company	Oakland	CA	31-0585760				Cash Balance		1. Collective Bargaining 2. Leased employees 3. Non-resident alien	5,300	1999
Toshiba America, Inc.	New York	NY	13-3503896	001	12/31	The Toshiba America, Inc. Retirement Plan	Cash Balance	Full vesting after 5 years	Under 1 year service or 21 years old and othe	5,299	1981
6318: La Quinta Inns, Inc.	Irving	TX	06-1519294	001	12/31	La Quinta Retirement Plan	Cash Balance		Administrative burden due to new laws	5,067	1969
Reader's Digest Association, Inc	Pleasantville	NY	13-1726769				Cash Balance	Full vesting after 5 years	1. Union 2. Foreign subsidied temps 3. Independent Contractors	5,062	1999
Commerce Bancshares, Inc.	St. Louis	MO	43-0889454	001	12/31	Commerce Bancshares Restated Retirement Pla	Cash Balance	Full vesting after 5 years	Under 1 year service or 21 years old and othe	5,013	1958
Ondeo Nalco Company	Naperville	IL	36-1530480	002	12/31	Ondeo Nalco Company Retirement Income Plan	Cash Balance	other: separate attachment	other: separate attachment	4,918	1944
Lear Corporation	Southfield	MI	13-3386776	004	12/31	Lear Combined Pension Plan	each Exhibits specifics	Full vesting after 5 years	under one year service and groups not specif	4,824	1988
Mattel, Inc.	El Segundo	CA	95-1567322	013	12/31	Mattel Automatic Investment Plan	Cash Balance	Full vesting after 3 years	1. Seasonal, on-call, or temps 2. Employees covered by collective bargaining 3. Regular employed outside of the US but has been transferred to US for less than 12mo 4. Any employee of a division of the company to which the plan has not been extended	4,700	April-99
Trigon Insurance Co.	Chicago	IL	54-0557120				Cash Balance	All employees	1. Collective bargaining 2. Leased employees	4,687	1999
Navy Federal Credit Union	Merrifield	VA	53-0116706	001	12/31	Navy Federal Credit Union Employees' Retirem	Cash Balance	Full vesting after 2 years	other: separate attachment	4,660	1958
Meridian Hospital Corp.	Wall	NJ	22-3471515				Cash Balance	All employees		4,641	1999
Healthwest	St. Paul	MN	41-1560657	001	12/31	Healthwest Pension Plan	Lump Sum Plan	Full vesting after 5 years	Under 1 year service service or 21 years old	4,532	1967
Montana Power Co	Butte	MT	81-0170530				Cash Balance	1. Salaried employees 2. Adopting union members		4,515	1999
Blue Cross and Blue Shield of Michigan	Detroit	MI	38-2069753	001	12/31	Blue Cross and Blue Shield of Michigan Employee's Retirement Account Plan	Cash Balance	1. All employees 2. Full vesting after 5 years	1. Collective Bargaining 2. Leased employees 3. Independent Contractors	4,508	September-99
Portland General Electric Company	Portland	OR	93-0256820	001	12/31	Portland General Electric Company Pension Plan	Cash Balance and defined b	Other: separate attachment	Under 1 year service or 21 years old	4,112	1945
GenAmerica Corporation	St. Louis	MO	43-0289530	004	12/31	GenAmerica Corporation Performance Pension P	Cash Balance	Full vesting after 5 years	Under 1 year service or 21 years old and othe	4,295	1954
Varity Automotive, Inc.	Cleveland	OH	31-0209313	004	12/31	Lucas Retirement Account Plan	Cash Balance	Full vesting after 5 years	Under 1 year service or 21 years old and unio	4,266	1992
Allied Domecq North America Corp.	Detroit	MI	95-2292816	001	12/31	Retirement Plan of Allied Domecq USA	Unit Benefit w/ Cash Balanc	Other: separate attachment	other: separate attachment	4,242	1954
Alliant Energy	Madison	WI	39-1914946				Cash Balance	All employees Effective 1/1/98	1. Collective bargaining 2. Leased employees 3. Affiliate employees	4,121	November-99
B. Braun Medical Inc.	Bethlehem	PA	23-2116774	002	6/31	B. Braun Medical Inc. Pension Plan	Cash Balance	Other: separate attachment	Under 1 year service or 21 years old and othe	4,064	1981
St. Joseph's Hospital Health Center	Syracuse NY	NY	15-0532254				Cash Balance	All employees	1. Contract employees 2. PC nurse or office staff	4,025	2001
MCN Energy Group, Inc.	Detroit	MI	38-2820658				Cash Balance	All (hourly and salaried employe	1. Collective bargaining	3,919	August-99
6318: Springs Industries, Inc.	Fortnoil	SC	57-0252730	013	12/31	Dundee Mills Pension Plan	Unit Benefit	Termination to align with acquiring company		3,844	May-99
Memorial Medical Center	Johnstown	PA	25-0963307	001	12/31	Memorial Medical Center Cash Balance Plan	Cash Balance	Full vesting after 5 years	Under 1 year service and other: separate atta	3,834	1992
Group Hospital and Medical Services	Washington	DC	53-0076070				Pension Equity		1. Leased employees 2. Union 3. Non-resident alien 4. Independent contractors 5. Interns	3,771	2000
Deutsche Bank America's Holding Corp.	New York	NY	13-3645372	001	12/31	Deutsche Bank America's Holding Corp. Cash Account Pension Plan	Cash Balance	1. All employees 2. Full vesting after 5 years	1. Collectively bargained	3,563	December-99
The Great Atlantic & Pacific Tea Company, Inc.	Montvale NJ	NJ	13-1890974	013	12/31	The Great Atlantic & Pacific Tea Company, Inc. B	Unit Benefit	other: separate attachment	Under 1 year service or 21 years old and othe	3,393	1961
Blue Cross and Blue Shield of Minnesota	St. Paul	MN	41-0984460	001	12/12	Blue Cross and Blue Shield of Minnesota Pension	Cash Balance	Full vesting after 5 years	other: separate attachment	3,389	1953
Belden Wire and Cable Co.	St. Louis	MO	76-0405879				Cash Balance	All employees	1. Collective bargaining 2. Hourly employees at certain locations	3,374	1998
The Good Samaritan Hospital of Cincinnati, Ohio	Cincinnati	OH	31-0537486	001	12/31	Good Samaritan Hospital Retirement Plan, a Part	Pension Equity		Under 1 year service and other: separate atta	3,371	1976
Case Western Reserve Univ.	Cleveland	OH	34-1018992	003	6/30	Case Western Reserve University Employee's Retirement Plan B	Basic Pension Theory 7/92	Full vesting after 5 years	1. Already retired 2. Not reaching age limit 3. Not competed 1 year of service	3,347	June-99
CAE- Link Corporation	Binghamton	NY	51-0311065	002	12/31	CAE- Link Corporation Personal Retirement Account Plan	Cash Balance	1. DC and profit sharing with elective referrals subject to 401(K) code	1. Union employees who are not participants of plan (Unions use DB Fixed Pay Plan) 2. Non-resident aliens with no US source income	3,321	June-94
Suburban Propane L.P. and Subsidiaries	Whippany	NJ	22-3410352				Cash Balance/ Unit Benefit		1. Leased employees 2. Collective bargaining 3. Fee for service	3,248	1999
Genesis HealthCare System	Zanesville	OH	31-1480941	001	12/31	Genesis HealthCare System Employee's Retirem	Cash Balance	Full vesting after 5 years	Under 1 year service or 21 years old and othe	3,080	1963
Holy Redeemer Health System	Huntington Valley	PA	23-1534300	001	12/31	Retirement Plan for Employee's of Holy Redeemer Health System	Unit Benefit	1. All employees 2. Full vesting after 5 years		3,080	September-99
Capital Health System	Trenton	NJ	22-3546695	001	12/31	Capital Health System Pension Plan	Cash Balance	Other: separate attachment	Under 1 year service and medical residents,	3,077	1988

Employers Awaiting IRS Determination Letters Under the Cash Balance Moratorium (September 1999 and thereafter) 4

Harrot Health Foundation	Erie	PA	25-1521550	001	8/30	Harrot Health Foundation Cash Account Pension Plan	Cash Balance	3- 7 year graded vesting	1. Employee of the ER who is participating in ER 2. Employee employed as resident physician 3. Temps 4. Leased employees	2,966	Jun-99
Florida Health Services Center, Inc.	Tampa	FL					Cash Balance	All employees	1. Collective bargaining 2. Independent contractors 3. Leased employees 4. Persons who employee status is not recognized by IRS	2,942	1999
Meredith Corporation	Des Moines	IA	42-0410230	005	12/31	Meredith Employees' Retirement Income Plan	Cash Balance	3 to 7 years graded vesting	Under 1 year service and other; separate atta	2,916	1971
American Chemical Society	Washington	DC	53-0196572	001	10/31	American Chemical Society Retirement Plan	Cash Balance/ Unit Benefit	Full vesting after 5 years	other: separate attachment	2,873	1963
Peninsula Regional Medical Center	Salisbury	MD	52-0591626				Cash Balance	1. All employees 2. Full vesting after 5 years	1. Union 2. Temps 3. Fee for service 4. Leased employees 5. Per diem	2,701	1986
Equitable Resources, Inc.	Pittsburg	PA	25-0464690	001	12/31	Equitable Resources, Inc. Retirement Plan for Ex	Cash Balance	Full vesting after 5 years	other: separate attachment	2,550	1936
Trustmark Corporation	Jackson	MS	64-0471500	001	12/31	Trustmark Pension Plan	Unit Benefit	Full vesting after 5 years	Under 1 year service or 21 years old and par	2,549	1951
Donaldson Company Inc.	Minneapolis	MN	41-0222640	001	7/31		Cash Balance	Salaried employees only		2,533	April-99
Hoinam Inc.	Dundee	MI	38-2943735	001	12/31	Hoinam Inc. Pension Plan	Unit Benefit	All US salaried and hourly employees whose employment is not subject to a c		2,482	1991
Anne Arundel Medical Center	Annapolis	MO	52-0591534	001	12/31	Pension Plan of Anne Arundel Medical Center	Cash Balance	Full vesting after 5 years	other: separate attachment	2,413	1970

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Table 1. Median years of tenure with current employer for employed wage and salary workers by age and sex, selected years, 1983-2002

Table 1. Median years of tenure with current employer for employed wage and salary workers by age and sex, selected years, 1983-2002

Age and sex	January 1983	January 1987	January 1991	February 1996	February 1998	February 2000	January 2002
TOTAL							
16 years and over	3.5	3.4	3.6	3.8	3.6	3.5	3.7
16 to 17 years	.7	.6	.7	.7	.6	.6	.7
18 to 19 years	.8	.7	.8	.7	.7	.7	.7
20 to 24 years	1.5	1.3	1.3	1.2	1.1	1.1	1.2
25 years and over	5.0	5.0	4.8	5.0	4.7	4.7	4.7
25 to 34 years	3.0	2.9	2.9	2.8	2.7	2.6	2.7
35 to 44 years	5.2	5.5	5.4	5.3	5.0	4.8	4.6
45 to 54 years	9.5	8.8	8.9	8.3	8.1	8.2	7.6
55 to 64 years	12.2	11.6	11.1	10.2	10.1	10.0	9.9
65 years and over	9.6	9.5	8.1	8.4	7.8	9.5	8.7
Men							
16 years and over	4.1	4.0	4.1	4.0	3.8	3.8	3.9
16 to 17 years	.7	.6	.7	.6	.6	.6	.8
18 to 19 years	.8	.7	.8	.7	.7	.7	.7
20 to 24 years	1.5	1.3	1.4	1.2	1.2	1.2	1.3
25 years and over	5.9	5.7	5.4	5.3	4.9	5.0	4.9
25 to 34 years	3.2	3.1	3.1	3.0	2.8	2.7	2.9
35 to 44 years	7.3	7.0	6.5	6.1	5.5	5.4	5.1
45 to 54 years	12.8	11.8	11.2	10.1	9.4	9.5	9.1
55 to 64 years	15.3	14.5	13.4	10.5	11.2	10.2	10.2
65 years and over	8.3	8.3	7.0	8.3	7.1	9.1	8.1

Women

16 years and over	3.1	3.0	3.2	3.5	3.4	3.3	3.4
16 to 17 years	.7	.6	.7	.7	.7	.6	.7
18 to 19 years	.8	.7	.8	.7	.7	.7	.7
20 to 24 years	1.5	1.3	1.3	1.2	1.1	1.0	1.1
25 years and over	4.2	4.3	4.3	4.7	4.4	4.4	4.4
25 to 34 years	2.8	2.6	2.7	2.7	2.5	2.5	2.5
35 to 44 years	4.1	4.4	4.5	4.8	4.5	4.3	4.3
45 to 54 years	6.3	6.8	6.7	7.0	7.2	7.3	6.5
55 to 64 years	9.8	9.7	9.9	10.0	9.6	9.9	9.6
65 years and over	10.1	9.9	9.5	8.4	8.7	9.7	9.5

NOTE: Data for 1996, 1998, 2000, and 2002 are not strictly comparable with data for 1991 and earlier years because population controls from the 1990 census, adjusted for the estimated undercount, are used beginning in 1996. Figures for the 1983-91 period are based on population controls from the 1980 census. Also, beginning in 1996, the figures incorporate the effects of the redesign of the Current Population Survey introduced in January 1994. Data exclude the incorporated and unincorporated self-employed.

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Statement of the National Committee to Preserve Social Security and Medicare, Submitted for the Record

National Committee to Preserve Social Security and Medicare

Barbara B. Kennelly, President and CEO
Max Richtman, Executive Vice President

STATEMENT FOR THE RECORD
HOUSE COMMITTEE ON EDUCATION AND THE WORKFORCE
"EXAMINING CASH BALANCE PENSION PLANS: SEPARATING MYTH FROM FACT"
JULY 7, 2004
NATIONAL COMMITTEE TO PRESERVE SOCIAL SECURITY AND MEDICARE

I am Barbara Kennelly, President and Chief Executive Officer of the National Committee to Preserve Social Security and Medicare, and I appreciate the opportunity to submit this statement for the record. With millions of members and supporters across America, the National Committee is a grassroots advocacy and education organization devoted to the retirement security of all citizens.

The National Committee is very pleased that the Committee on Education and the Workforce is holding this hearing to examine the important policy issues involving hybrid defined benefit plans, also known as cash balance pension plans. As an organization dedicated to the retirement security of all Americans, we at the National Committee believe that the legal uncertainty currently enveloping cash balance plans is a significant retirement policy issue that Congress must address to prevent further weakening of the defined benefit pension system.

The defined benefit pension system helps millions of Americans achieve retirement security. It does this by providing employer-funded retirement income that is insured and guaranteed to last a lifetime. Employees are not typically required to make any contributions toward their benefits in these plans and investment professionals manage the assets of the plan. Moreover, employers, rather than employees, bear the investment risk of ensuring that plan assets are sufficient to pay promised benefits. Given these facts, the value of defined benefit plans to many American families is undeniable. Yet, we have seen an alarming decline in defined benefit plan sponsorship and today is a particularly precarious time for the defined benefit system.

Cash balance pension plans represent a hybrid pension model that combine features of both defined benefit and defined contribution pension plans. Cash balance plans' universal coverage and guaranteed employer contribution are the greatest strengths they bring from the world of defined benefit plans. Their ability to express benefits in the form of an account balance, and their portability, are features they draw from traditional defined contribution plans. Cash balance plans also can be more relevant to today's mobile workforce, as employees frequently change jobs before they earn significant benefits in traditional defined benefit plans. Properly designed hybrid plans that combine the best features of the defined benefit and defined contribution system can help stem the tide away from defined benefit plans.

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However, conversions from traditional defined benefit plans to cash balance plans have had a negative impact on older and long-tenured employees, a group that is least able to make up for any losses because of their proximity to retirement. Workers who have spent long years earning lower benefits with the expectation that they will make up for lost ground as they near retirement age end up at a significant disadvantage when the rules are changed part-way through the process. In addition, employees at or near early retirement age can face prolonged periods of time during which they accrue no new benefits, the so-called "wear-away" period, if the value of their old plan benefit is much larger than the opening balance in the new cash balance plan. Thus, workers with long years of service who may be nearing retirement have had expected benefits reduced.

No resolution of this contentious issue would leave all parties fully satisfied. Ultimately, there must be a balance between protecting older workers from certain changes in plans and preserving employers' flexibility to make changes in a private pension system where they are not required to adopt or continue plans. It is crucial that any legislative approach combine reasonable protection for employees with reasonable flexibility for the employer.

To facilitate Congressional consideration of an appropriate framework for legislation, I offer the following policy initiatives to minimize confusion and reduce or eliminate the potentially adverse effects of cash balance plan conversions on long-tenured workers:

1) Employers should be required to provide a clear, understandable and timely disclosure of the effects of plan changes on future benefit accruals and employee choices;
2) Employers should be required to protect long-tenured plan participants benefit expectations. Providing a choice between remaining in the old plan and receiving an equivalent pension benefit under the new plan ("grandfathering"), or some comparable mechanism such as providing supplemental pay credits, interest credits or more generous opening account balances for financial losses they would otherwise incur under the new plan would achieve this goal;
3) Employers should be encouraged to retain the financial incentives for early retirement and other retirement-type subsidies that are often included in traditional defined benefit plans; and
4) Employers should be encouraged to use conversion savings to improve other employer-sponsored retirement savings or retiree health benefits programs.
5) Finally, in order to protect all workers affected by a plan conversion, Congress must give careful consideration to the appropriate interest rate companies are permitted to use as the discount rate when calculating the present value of pension benefits in a conversion.

Mr. Chairman, I believe following the above principles will result in a hybrid pension plan design that benefits younger workers without sacrificing the retirement security of older employees. I look forward to working with you on this matter in the days and weeks ahead.

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The National Committee is a nonprofit, nonpartisan organization that acts in the interests of its membership through advocacy, education, services, grassroots efforts and the leadership of the board of directors and professional staff. The work of the National Committee is directed toward developing a secure retirement for all Americans.

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Committee on Education and the Workforce, Democratic Staff, Press Release, Submitted for the Record

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EMPLOYER CASH BALANCE STATEMENTS: FACT AND FICTION

EMPLOYER CLAIM: Employers convert to cash balance plans because they are easier to understand than traditional defined benefit plans.

False. Cash balance promoters are disingenuous when they argue that cash balance plans are easier for employees to understand. To the contrary, cash balance proponents have argued in favor of these plans because they make it more difficult for employees to understand that their benefits are being slashed.

Cash balance promoters have been very open amongst themselves about the ability of these plans to mask benefit cuts. In a July 27, 1989 letter from Kwasha Lipton to Onan Corporation, the consultant notes, "One feature which might come in handy is that it is difficult for employees to compare prior pension benefits formulas to the cash balance approach." Similarly, Joseph Edmunds stated at a 1987 Conference of Consulting Actuaries, "[I]t is easy to install a cash balance plan in place of a traditional defined benefit plan and cover up cutbacks in future benefits."

A significant reason that corporations convert to a cash balance plan is to cut the pension benefits of older workers - workers who comprise a larger and larger percentage of the workforce. Kyle N. Brown, a retirement and pension lawyer with Watson Wyatt Worldwide said at a Society of Actuaries Conference in October of 1998: "What that means is that for your older, longer service workers, their rate of accrual is going to go down. There is going to be a reduction in their rate of accrual."

EMPLOYER CLAIM: Cash balance plans have been adopted in response to a more mobile workforce.

False. Watson Wyatt's Insider dispels one of the other myths advanced by cash balance proponents, namely, that these plans are a response to an increasingly mobile American workforce: "Contrary to popular belief, Americans are not changing jobs faster than ever before. According to an in-depth study of employment records by Watson Wyatt, as baby boomers are driving up the average age of the workforce, job mobility is decreasing."

Worker mobility is not the rationale for converting to a cash balance plan, money is. As 11,000 people a day turn 50, which Watson Wyatt posits will turn us into a "Nation of Floridas," employers need to find ways to retain them. Instead of creating incentives to retain older workers, companies have turned to cash balance plans, which make it much more likely that older workers will have to delay retirement. Employers who convert to a cash balance plan thus see a two-fold benefit. Companies retain older workers who can no longer afford to retire and the benefits the employees do receive at retirement will be significantly lower.

In fact, most cash balance pension plans still retain 5 year vesting requirements, thus ensuring that most workers, who have an average tenure of 3 years, will never earn any benefits under the cash balance plan.

EMPLOYER CLAIM: Employers have provided transition assistance to older workers.

Not true. Some employers have included protections for older workers, but not all. That is why over 800 claims of age discrimination have been filed with the EEOC and dozens of lawsuits are pending in the

courts, including challenges to AT&T and IBM's conversions. The IRS proposed regulations would have legalized conversions without provisions to protect the benefits of older workers. Employer surveys of conversions post-1999, after the IBM controversy, found that up to 15% did not include transition protections.

EMPLOYER CLAIM: Congress addressed concerns about cash balance plans by imposing notice requirements in the 2001 Tax Act.

Congress only passed improved notice requirements as part of the 2001 Tax Act. Comprehensive protections for older workers were not included because agreement had not been reached on minimum standards and protections for older workers under cash balance plans. In 2003, 258 bipartisan members of the House and the Senate unanimously voted to stop the Treasury Department from issuing proposed cash balance conversion regulations and require it to submit legislation to Congress to protect older workers. Numerous legislative proposals to protect workers under cash balance conversions are pending in Congress.

The Following Items Have Been Placed in the Permanent Archive Files:

1. Hewitt, Survey Findings, Current Retirement Plan Challenges: Employer Perspectives, 2003
2. Possible Implications of Mandating Choice in Corporate Defined Benefit Plans, Olivia S. Mitchell and Janemarie Mulvey, Pension Research Council Working Paper, The Wharton School, University of Pennsylvania, PRC WP 2003–25
3. An Empirical Analysis of the Transitions to Hybrid Pension Plans in the United States, Robert L. Clark North Carolina State University, and Sylvester J. Schieber, Watson Wyatt Worldwide, Sponsored by The Brookings Institution, Stanford Institute for Economic Policy Research and TIAA–CREF Institute, Washington, D.C., 9/21/00
4. Dan C. Tootle v. ARINC, Inc. et al., Civil Action No. CCB–03–1086, In The United States District Court For The District of Maryland, 6/10/04
5. Eaton v. Onan Corporation, Cause No. IP97–0814–C–H/G, United States District Court Southern District of Indiana, Indianapolis Division, 9/29/00
6. E-mail from Jane Banfield, 7/6/04, with newspaper clipping from The Reporter
7. E-mail from Brian D. McCarthy, 2/26/04
8. GAO Report, September 2000, GAO/HEHS–00–185, Private Pensions, Implications of Conversions to Cash Balance Plans
9. U.S. Department of Labor, Office of Inspector General, PWBA Needs to Improve Oversight of Cash Balance Plan Lump Sum Distribution, Report No. 09–02–001–12–121, 3/29/02
10. Congressional Research Service, Memorandum to Hon. Bernie Sanders, Estimated Benefit Under A Cash Balance Plan, 2/11/03
11. Testimony of J. Mark Iwry, Subcommittee on Employer–Employee Relations, Committee on Education and the Workforce, 7/1/03
12. H.R. 1677, 108th Congress, lst Session
13. Cooper, Harrington and Hillesheim, et al. v. The IBM Personal Pension Plan and IBM Corporation, Civil No. 99–829–GPM, U.S. District Court for the Southern District of Illinois, 7/31/03
14. The Wall Street Journal, Ellen Schultz with permission, (1) Ins and Outs of Cash–Balance Plan–Employees will need to Know What Effects the New Setup Could Have on their Pensions, 12/4/98, (2) Some Workers Facing Pension Hit–Longtime Employees May Find Themselves on Long "Plateau" As Companies Make Switch, 12/18/98, (3) Older Workers Fight "Cash Balance" Plans, 2/11/99, (4) Your Pension May Be Changing; Go Figure How If You Can, 3/3/99, (5) New Pensions May Hurt Young Professionals, 12/16/99, (6)Pension Paternity: How A Single Sentence By IRS Paved the Way To Cash–Balance Plans–Age Bias Was No Concern, It Said, Offering Comfort To Firms and Consultants–Treasury Official's Key Role, 12/28/99

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