AMERICAN BENEFITS COUNCIL

VALIDATING HYBRID PENSION DESIGNS MERELY CONFIRMS LONG-SETTLED READING:

Pension Conference Should Follow Overwhelming Weight of Authority Finding Cash Balance Design Legal and Apply Confirmation to All Plans Regardless of Adoption Date

Since the first cash balance plan arrived on the scene in 1985, the Treasury Department and the Internal Revenue Service (IRS) have repeatedly approved the basic design of cash balance and other hybrid plans, such as pension equity plans. Further, every court save one that has considered the issue has approved these plan designs as lawful. The sole exception is Cooper v. IBM, in which a federal district court held that hybrid plans are inherently age discriminatory because pay credits to younger participants' accounts had more years until age 65 to earn interest. Cooper's indictment of compound interest defies common sense and is clearly an anomaly. Nonetheless, it has exposed hybrid plan sponsors across the country to class action lawsuits seeking hundreds of millions and even billions of dollars. The House and Senate pension reform bills (H.R. 2830, S. 1783) both include provisions confirming the legality of cash balance and other hybrid plan designs, and there is broad bipartisan agreement that the hybrid plan designs are not inherently age discriminatory. However, these bills would have a prospective effect only and would leave the more than 1,800 existing hybrid plans (as of 2003) exposed to litigation based on the aberrant Cooper decision. There is no justification for treating the same plan designs differently based on when the plans were adopted. The pension bills must confirm that the ongoing hybrid plan designs are, and have always been, lawful. In so doing, Congress will not take away the right of any employee to sue his or her employer if the employee believes the employer's hybrid plan <u>conversion</u> violated the law in some way. Given the overwhelming authority supporting the validity of the hybrid pension designs and the broad consensus that hybrid plans serve employee needs, inclusion in the pension conference agreement of a comprehensive confirmation as to the validity of these designs would be a straightforward step.

- **Federal Case Law Confirms Validity of Hybrid Pension Designs.** Four federal courts other than the *Cooper* court have addressed whether the basic hybrid pension design is inherently age discriminatory. In *Eaton v. Onan*,117 F. Supp. 2d 812 (S.D. Ind. 2000), the Court held that the cash balance pension design is not age discriminatory and that the proper benchmark for testing age discrimination is the rate of contributions to employees' cash balance accounts. Similarly in *Campbell v. BankBoston, N.A.*, 206 F. Supp. 2d 70 (D. Mass. 2002), *aff'd* 327 F.3d 1 (1st Cir. 2003), the Court rejected the notion that hybrid plan designs are inherently age discriminatory, stating 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]." In *Tootle v. ARINC, Inc.*, (222 F.R.D. 88 (D. Md. 2004)), the Court rejected the logic of *Cooper* and affirmed the age appropriateness of the cash balance pension design. Most recently, in *Register v. PNC Financial Services Group, Inc.*, Civ. Action No. 04-CV-6097 (E.D. Pa. Nov. 21, 2005), the Court once again affirmed the lawfulness of hybrid plan designs. Federal courts from around the country in decisions rendered both before and after the *Cooper* case have confirmed the validity of the hybrid pension designs and made clear that *Cooper* is an abberation.

- **Treasury and the IRS Have Consistently Approved Hybrid Plan Designs.** Until 1999, the IRS consistently granted favorable determination letters with respect to cash balance plans, approving them as satisfying the tax-qualification requirements, including the prohibition against age discrimination. The moratorium on IRS determination letters that began in September 1999 only applied to conversions to cash balance plans, and was clearly not focused on the inherent design of the plans.[1] Further, in September 1999, IRS Chief Counsel Stuart Brown testified that interest credits under a cash balance plan do not cause the plan to violate the age discrimination statute.[2] Moreover, the Treasury and IRS issued proposed age discrimination regulations that would have squarely recognized the validity of cash balance plans. Those regulations have been withdrawn but that withdrawal was intended only "to provide Congress an opportunity to review and consider a legislative proposal on cash balance plans…."[3]

- **Existing Treasury Guidance Would Be Nonsensical if Hybrid Designs Invalid**. Since 1991, the Treasury Department has repeatedly issued guidance addressing how various rules apply to cash balance plans, which would make little sense if cash balance plans were inherently age discriminatory. Among other questions, this guidance addresses how the nondiscrimination requirements apply to cash balance plans and how minimum lump sum payments from cash balance plans are calculated. In fact, the Treasury Department explicitly rejected the argument that cash balance plans fail to satisfy age discrimination requirements in the preamble to the 1991 nondiscrimination regulations.

- **Many Common Plan Designs Other Than Hybrids Would Be Unlawful if *Cooper* Theory Held.** If *Cooper's* view on age discrimination were correct, then a broad range of pension designs viewed as perfectly appropriate under the pension age discrimination prohibition Congress adopted in 1986 – including contributory defined benefit plans, offset plans, and defined benefit plans with pre-retirement indexation – would be considered age discriminatory. To further highlight the strange consequences of the *Cooper* court's reasoning, the Social Security program would be deemed age discriminatory if the *Cooper* theory were applied to it.

- **Legislative History Makes Clear That Hybrid Plans Are Lawful.** The legislative history of the pension age discrimination statute adopted in 1986 makes clear that the intent of Congress was limited to prohibiting the practice of ceasing pension accruals once participants attained a certain age (e.g., normal retirement age).[4] The erroneous interpretation of the statute in the *Cooper* decision – that it is age discriminatory to make equal contributions on behalf of participants of different ages – is inconsistent with this legislative history. In fact, an example in the 1986 legislative history that clarifies a separate but related pension issue describes approvingly a type of plan (i.e., a "flat dollar" plan) that would be deemed age discriminatory under the *Cooper* decision. 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 had just enacted.

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[1] *See* Carol Gold, IRS Internal Memorandum on Pension Plan Conversions to Cash Balance Plans (Sept. 15, 1999).
[2] Stuart L. Brown, Chief Counsel for the Internal Revenue Service, Testimony before the Senate Committee on Health, Education, Labor and Pensions, 1999 TNT 183-11 (Sept. 21, 1999).
[3] Department of Treasury Press Release, Treasury and IRS Withdraw Proposed Cash Balance Regulations (June 15, 2004); *see also* IRS Announcement 2004-57, 2004-27 I.R.B. 15 (July 6, 2004).
[4] H.R. CONF. REP. NO. 1012, 99th Cong., 2d Sess. at 376-379.