SUPPLEMENTAL COMMENTS OF
THE ERISA INDUSTRY COMMITTEE

PROPOSED TREASURY DEPARTMENT REGULATIONS
ON
AGE DISCRIMINATION
AND
NONDISCRIMINATION CROSS-TESTING

March 13, 2003

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Introduction. The ERISA Industry Committee ("ERIC")[1] hereby supplements its prior comments, dated January 30, 2003, on the proposed regulations regarding (a) the requirement in Internal Revenue Code §§ 411(b)(1)(H) and 411(b)(2) that retirement plan accruals and allocations not cease or be reduced because of the attainment of any age and (b) the application of the nondiscrimination cross-testing rules under Code § 401(a)(4) to cash balance plans.[2]

The proposed regulations raise profound issues with enormous economic consequences. The issues raised by the proposed regulations involve nothing less than the future of defined benefit retirement plans in the United States, the financial stability of many of the largest defined benefit retirement plans in the nation and their sponsoring employers, and the ability of the U.S. economy to recover from the current downturn. If the proposed regulations are finalized in their current form, they will impose massive unanticipated liabilities on defined benefit plans, subject employers to crushing economic burdens, drive employers away from defined benefit plans, and severely impair the recovery of the U.S. economy. These consequences will be felt not just by the millions of employees and beneficiaries who currently rely on defined benefit plans for retirement security, but by all Americans whose futures depend on the success of the U.S. economy.

The Treasury and the Service should be commended for recognizing that cash balance plans are not inherently age-discriminatory. ERIC appreciates the drafters' recognition that cash balance plans are not inherently age-discriminatory. An employee's benefit under a cash balance plan depends on the employee's length of service and compensation, not on the employee's age. Under a typical cash balance plan, two employees with the same compensation and the same periods of service will have identical balances in their cash balance accounts when they terminate employment -- regardless of whether one employee is older than the other.

The Treasury and the Service also should be commended for their willingness to examine carefully criticisms of the proposed regulations. ERIC also appreciates the willingness of the Treasury and the Service to examine the serious concerns that ERIC and others have voiced regarding the proposed regulations. ERIC looks forward to continuing discussions with the Treasury and the Service regarding the proposed regulations.

The proposed regulations are fundamentally flawed. As explained in ERIC's initial submission, ERIC believes that the proposed regulations are fundamentally flawed -- with

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[1] ERIC is a nonprofit association committed to the advancement of the employee retirement, health, incentive, and welfare benefit 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 costs and effectiveness, and the role of those benefits in the American economy.

[2] The proposed regulations were published in the December 11, 2002, issue of the Federal Register. 67 Fed. Reg. 76,123.

respect to both cash balance plans and defined benefit plans in general. The proposed regulations would --

- outlaw many commonplace pension plans, including plans that cannot reasonably be considered to be age-discriminatory,
- subject plans and employers to the risk of years of costly litigation,
- impose enormous economic costs on the employers that sponsor defined benefit plans, and
- threaten the future of all defined benefit plans.

These are consequences that neither plan participants nor the economy as a whole can afford.

The proposed regulations should be revised to incorporate a rule that is consistent with the text and legislative history of the statute. The statute imposes a simple and straightforward requirement. Section 411(b)(1)(H)(i) provides that a plan does not satisfy the Code's qualification requirements "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."

Consistent with the text of the statute, the Treasury and the Service should adopt the clear and straightforward rule that a pension plan may not provide that a participant stops earning benefits, or starts earning benefits at a lower rate, once the participant attains a particular age. This rule is consistent with Congressional intent, the text of the statute, the case law, and prevailing plan design. Unlike the rule in the proposed regulations, it presents no traps for the unwary; it can be readily understood and enforced; and it does not require elaborate testing or mathematical calculations. Like the proposed regulations, the rule we propose would make clear that a cash balance plan is lawful as long as it does not reduce pay credits or interest credits once a participant attains a particular age.

By contrast, the proposed regulations adopt an intricate mathematical approach that is inconsistent with Congressional intent, the text of the statute, the case law, and prevailing plan design. Under the proposed regulations' mathematical approach, the social security system would be considered to be age-discriminatory. It is implausible that Congress intended to impose a standard on voluntary pension plans that would treat the social security system as age-discriminatory.

It is a mistake to rely on a "safe harbor" approach. The proposed regulations also include a narrow "safe harbor" for certain cash balance plans. This is the wrong approach. Diversity and dynamism are fundamental strengths of our nation's economy. Employers vary greatly in their size and mission, in their ways of doing business, in the size and demographics of their workforces, and in their compensation and benefit arrangements. Employers should not be compelled to conform their plans to the rigid requirements of narrow, Government-imposed "safe harbors." A rigid "safe harbor" regime will deprive the voluntary pension system, and the economy as a whole, of their fundamental strengths: diversity and dynamism.

The proposed regulations' prospective effective date does not solve the problem. The proposed regulations' prospective effective date does not diminish ERIC's concerns. Because the regulations do not address the requirements of § 411(b)(1)(H) *before* the effective date, they make it possible for the Service, the EEOC, and private plaintiffs to claim that the regulations reflect the law that was previously in effect. Although ERIC would vigorously oppose any such claims, ERIC is concerned that the proposed regulations do not explicitly foreclose such claims.

Because the general test that ERIC has proposed is consistent with the text, purpose, and legislative history of the statute, the case law, and prevailing plan design, ERIC's proposed general test would fairly and appropriately address the concerns raised by the proposed regulations regarding the possible retroactive effect of the regulations. The Treasury and the Service should not allow the regulations to become a vehicle for unwarranted attacks on previously adopted plans and on plan provisions that are consistent with the text, purpose, and legislative history of the statute.

In addition, wholly apart from the possible retroactive effect of the regulations, the regulations do not address whether a plan's nonconformance with the regulations before they become effective "taints" the plan after the regulations become effective. For example, the proposed regulations do not address whether, after the regulations become effective, a cash balance plan can qualify as an "eligible cash balance plan" if, before the effective date, the cash balance plan was established on a basis that did not comply with the regulations' rules governing cash balance conversions.[3]

The proposed nondiscrimination cross-testing rules for "eligible" cash balance plans are both unnecessary and contrary to the interests of older and longer-service employees. There is no need to have the method used to test for age discrimination be parallel to the method used to test for § 401(a)(4) nondiscrimination under an "eligible" cash balance plan. As we have explained, the appropriate test for age discrimination is based on the terms of the plan, not on mathematical calculations like the test in § 401(a)(4). The two tests are quite different, and it makes no sense to insist on parallelism between them.

Cash balance plans have been designed, implemented, and tested as defined benefit plans under § 401(a)(4), and they should not now be subjected to new "gateway" requirements that could jeopardize their ability to satisfy the nondiscrimination requirements under § 401(a)(4). ERIC is not aware of any evidence that there have been problems in testing cash balance plans for nondiscrimination under the current § 401(a)(4) regulations, and it should continue to be acceptable to test a cash balance plan just like any other defined benefit plan under § 401(a)(4).

The issues raised by the proposed § 401(a)(4) nondiscrimination regulations are likely to be particularly troublesome for plans that have preserved pre-existing traditional formulas, or provided transition credits, for certain participants. These plan provisions are

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[3] *See* Prop. Treas. Reg. § 1.411(b)-2(b)(2)(iii)(B)(3).

generally intended to protect the benefit expectations of older and/or longer-service employees. Although these provisions have been adopted for sound reasons -- and are generally designed to honor the benefit expectations of older and longer-service employees -- the proposed § 401(a)(4) regulations jeopardize employers' ability to use them.

The Treasury and the Service should withdraw the proposed regulations and should propose new regulations. The current proposed regulations are so far off the mark that they are not an acceptable basis for final regulations. Assuming that the Treasury and the Service decide to make major changes in the proposed regulations, the public deserves an opportunity to comment on new proposed regulations before major changes are incorporated in final regulations.

The Treasury and the Service should withdraw the current proposed regulations and should propose new regulations that incorporate the approach ERIC has recommended -- an approach that is consistent with the text and legislative history of the statute.

The Treasury and the Service should act promptly. As we have explained, the proposed regulations raise issues of enormous economic significance. It is imperative, therefore, that the Treasury and the Service resolve these issues correctly.

It is also important that the issues be resolved promptly. Failure to resolve the issues promptly will prolong the great uncertainty and risk that currently afflicts defined benefit plans and the employers that sponsor them. The Treasury and the Service should put this project on a "fast track" and issue appropriately revised proposed regulations, and final regulations, as soon as possible.

ERIC would welcome additional discussions. Because of the great importance of the issues involved, and the enormous economic consequences to defined benefit retirement plans, to sponsoring employers, and to the economy as a whole, ERIC is prepared to meet with Treasury and Internal Revenue Service representatives at any time to hold additional discussions regarding the proposed regulations.

THE ERISA INDUSTRY COMMITTEE