INITIAL COMMENTS OF
THE ERISA INDUSTRY COMMITTEE

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

January 30, 2003

Introduction

The ERISA Industry Committee ("ERIC")[1] hereby submits its initial comments 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]

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. ERIC is gratified that the proposed regulations recognize this fundamental point. The final regulations should recognize this point as well.

We believe, however, that the proposed regulations are fundamentally flawed -- with respect to both cash balance plans and defined benefit plans in general. If finalized in their current form, the proposed regulations would create a field day for regulators and lawyers, but a mine field for defined benefit plans. 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.

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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. The preamble to the proposed regulations states that comments on the proposed regulations must be submitted by March 13, 2003. Because ERIC feels so strongly about the proposed regulations, ERIC is submitting its initial comments well before the end of the comment period. ERIC reserves the right to submit additional comments.

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

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 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 regulation, 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.

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.

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.

It is simply not possible to create safe harbors that will accommodate all of the plan designs that should be considered permissible. Pension plans are vibrant and evolving programs. Employers, and the plans they provide, continually respond to changes in employee needs and business conditions. If the Treasury relies primarily on safe harbors, the Treasury will inappropriately become the architect of private-sector pension plans, and will stifle the ability of employers to adopt new plan designs that address evolving employee and business needs. The Treasury should adopt an appropriate general test that accommodates variety and evolution in plan design.

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2. The proposed regulations are inconsistent with the text of the statute. *See* p. 4, *infra.*

3. The proposed regulations are inconsistent with prior judicial decisions. *See* pp. 5 - 7, *infra.*

4. The proposed regulations use the wrong test to identify age discrimination. *See* pp. 7 - 8, *infra.*

5. The proposed regulations would outlaw many well-established pension plans that cannot reasonably be considered to be age-discriminatory. *See* pp. 8 -15, *infra.*

6. The Treasury should replace the proposed regulations' flawed rules with an appropriate generally applicable standard that is consistent with the text of the statute, Congressional intent, judicial decisions, and prevailing plan design. If the regulations include an appropriate generally applicable standard, it will not be necessary to include special rules for cash balance plans under either the § 411(b)(1)(H) age-discrimination provisions or the § 401(a)(4) nondiscrimination cross-testing rules. *See* pp. 15-16, *infra.*

II. Comments

1. <u>The proposed regulations would convert the straightforward path plotted by Congress into a dangerous minefield. The regulations would transform a statute with a narrowly targeted objective and modest compliance costs into a costly mandate requiring virtually every defined benefit plan sponsor to overhaul its plans -- encouraging employers to abandon their plans than rather than to expand or continue them</u>.

The proposed regulations would make compliance with the statute far more daunting than it was ever intended to be.

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." This provision imposes a straightforward requirement: a pension plan may not provide that participants stop earning benefits, or start earning benefits at a lower rate, once they attain a particular age.

This reading of the statute is confirmed by the Seventh Circuit's decision in *Lunn v. Montgomery Ward*, 166 F.3d 880 (7th Cir. 1999). *Lunn* involved a floor-offset

arrangement under which employees' accruals under the employer's defined benefit plan were offset by their account balances under the employer's defined contribution plan. The plaintiff, who retired at 69, four years past the plan's normal retirement age of 65, argued that the offset reduced his rate of benefit accrual in violation of ERISA § 204(b)(1)(H) because the offset grew larger as he grew older. The Seventh Circuit emphatically rejected plaintiff's argument:

> "[Montgomery] Wards could not say to Lunn, if you insist on working after you reach the age of 65, we're going to cut down your normal retirement benefits. But Wards did not say (or do) that. Lunn remained in the retirement plan(s), accruing benefits in exactly the same way he had been doing before he turned 65, until he retired. He was treated the same as all other workers; there was no forfeiture. Reverse age discrimination is not the theory of ERISA." *Id*. at 883.

The Treasury should follow the Seventh Circuit's lead. If a plan formula does not by its terms disfavor older participants, it does not violate § 411(b)(1)(H). This is based on the language of the statute: § 411(b)(1)(H) looks to whether "under the plan" an employee's benefit accrual is ceased, or the rate of benefit accrual is reduced, "because of age."

The legislative history of the 1986 amendments strongly supports this approach. The 1986 amendments originated in an amendment that was introduced on the Senate floor in September of 1986. The sponsors explained that their objective was to require employers to continue to accrue pension benefits for employees who remain employed past age 65,[3] that the cost of providing post-65 accruals was "relatively low" and would not necessarily require employers to increase their pension plan contributions, and that the amendment had been crafted to "minimize the impact on private pensions of the change contemplated by the amendment."[4] Senator Heinz explained that the amendment would "not significantly affect current practices."[5]

The Conference Report stated that the conference agreement "generally follows the Senate amendments with certain modifications," and explained that --

> "[u]nder the conference agreement, benefit accruals or continued allocations to an employee's account under either a defined benefit plan or a defined contribution plan may not be reduced or discontinued *on account of the attainment of a specified age*."[6]

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[3] 132 Cong. Rec. 24,903-05 (Sept. 19, 1986).

[4] Id. at 24,904.

[5] Id. at 24,905.

[6] H.R. Conf. Rep. No. 1012, 99th Cong., 2d Sess. 378 (1986) (emphasis added).

The legislative history thus confirms that § 411(b)(1)(H) was enacted to address a straightforward problem and that Congress did not intend to impose an intricate mathematical test to determine whether a plan complies with the statute.[7]

The regulations provide, however, that a plan fails to comply with § 411(b)(1)(H) if, under the terms of the plan, the rate of benefit accrual for any individual *who is or could be* a participant would be lower solely as a result of the individual being older. Under the proposed regulations' general rule, the rate of benefit accrual for any plan year that ends before the participant attains normal retirement age is defined as the increase in the participant's accrued normal retirement benefit for the year.[8]

The proposed regulations apply a different rule for participants who have attained normal retirement age. Under this rule, the rate of benefit accrual is equal to the excess of the annual benefit to which the participant is entitled at the end of the plan year over the annual benefit to which the participant would have been entitled at the end of the preceding year.[9]

To these two sets of rules, the regulations add a third set of rules for cash balance plans.[10]

There is no reason to think that Congress intended to impose this intricate regulatory regime. Section 411(b)(1)(H) reflects Congress's decision to impose a general rule prohibiting a plan from calculating benefits in a less favorable way based on an employee's attainment of a particular age. The statutory text and context make it evident that a plan does not violate § 411(b)(1)(H) if it does not negatively change the way an employee's benefit accruals are calculated when the employee attains a particular age.[11]

By contrast, the proposed regulations' intricate mathematical test requires a plan to examine whether there is any conceivable circumstance in which an actual or hypothetical participant's normal retirement benefit would be lower in any year if the participant were older. Because it requires the plan to be tested for every conceivable

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[7] The Conference Report indicates that the conferees intended that § 411(b)(1)(H) and its ADEA and ERISA counterparts would not even apply where the plan satisfies the normal benefit accrual requirements for employees who have not attained normal retirement age. *See* H.R. Conf. Rep. No. 1012, *supra,* at 379. This provides an independent reason why the Treasury should not adopt the approach taken by the proposed regulations. *See Eaton v. Onan Corp.*, 117 F. Supp. 2d 812 (S.D. Ind. 2000)*; Engers v. AT&T Corp.*, No. 98-3660 (D.N.J. 2001).

[8] Prop. Treas. Reg. §§ 1.411(b)-2(b)(2)(i), -2(b)(3).

[9] *Id.* § 1.411(b)-2(b)(2)(ii).

[10] *Id.* § 1.411(b)-2(b)(2)(iii).

[11] *See Lunn, supra,* 166 F.3d at 883-84.

circumstance, and makes the plan unlawful if it fails in just one case, this rule is a far cry from what Congress intended.

As we explain below, the proposed regulations would outlaw many conventional plan designs that Congress plainly did not intend to forbid. Many of the benefits that pension plans provide correlate with age. The text of the statute makes clear, however, that Congress did not bar a plan from providing benefits that *correlate* with age. Congress prohibited a plan only from providing lesser benefits to an employee *because of* the employee's attainment of any age. The proposed regulations, however, prohibit far more than that and therefore fail to carry out what Congress intended.

2. The proposed regulations are inconsistent with the text of the statute. The proposed regulations' test for age discrimination is based primarily on the annual increase in the amount of a hypothetical participant's normal retirement benefit. This approach is inconsistent with § 411(b)(1)(H)(iv), which allows the "subsidized portion of any early retirement benefit" to be disregarded in applying § 411(b)(1)(H).

There would be no need for § 411(b)(1)(H)(iv) if § 411(b)(1)(H) applied only to the normal retirement benefits under the plan. Because normal retirement benefits are not paid early, they cannot include an early retirement subsidy.[12] The approach adopted in the proposed regulation thus violates an established principle of statutory construction by adopting an interpretation of the statute that causes one of the provisions of the statute to be superfluous.[13]

Consistent with the decision in *Eaton v. Onan Corp.*,[14] and the legislative history of the statute,[15] the regulations should recognize that an employee's rate of benefit accrual may be determined by reference to the benefit that is payable immediately, rather solely by reference to the normal retirement benefit. Although it should be permissible to measure an employee's rate of benefit accrual by reference to the normal retirement benefit payable under the plan, this should not be the *only* standard of reference.

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[12] *See Laurenzano v. Blue Cross & Blue Shield of Mass., Inc.*, 134 F. Supp. 2d 189, 201 (D. Mass. 2001).

[13] *See TRW Inc. v. Andrews*, 534 U.S. 19, 31 (2001) ("It is a cardinal principle of statutory construction that a statute ought, upon the whole, to be so construed that, if it can be prevented, no clause, sentence, or word shall be superfluous, void, or insignificant. . . . We are reluctant to treat statutory terms as surplusage in any setting . . .") (internal quotation marks and citations omitted).

[14] 117 F. Supp. 2d 812, 833-34 (S.D. Ind. 2000).

[15] The only illustrative example given by the conference report focuses on benefits payable immediately, not on normal retirement benefits. *See* H.R. Rep. No. 1012, 99th Cong., 2d Sess. 381 (1986).

3. The proposed regulations are inconsistent with prior judicial decisions. The mathematical "hypothetical participant" test adopted by the proposed regulations is completely inconsistent with the way the courts have interpreted and applied ERISA § 204(b)(1)(H) and ADEA § 4(i)(1) (the ERISA and ADEA counterparts to Code § 411(b)(1)(H)).[16] None of the courts has relied on a test that is remotely like the mathematical test adopted by the proposed regulations. The courts have looked to (a) whether the plan is, by its terms, age-discriminatory[17] and (b) whether the plan discriminates against participants *after* they attain normal retirement age.[18] The proposed regulations cannot be reconciled with these decisions.

The proposed regulations are also inconsistent with the weight of judicial authority under other provisions of ADEA. Section 411(b)(1)(H)(i) was one of three substantially identical amendments that Congress made to ADEA, ERISA, and the Code in 1986. All three provisions bar the cessation of benefit accruals or the reduction of the rate of benefit accrual "because of age."[19] Congress made clear its intention that these three provisions be interpreted consistently.[20]

Even before the 1986 amendments, § 4(a)(1) of ADEA made it unlawful for an employer --

> "to fail or refuse to hire or to discharge any individual or otherwise discriminate against any individual with respect to his compensation, terms, conditions, or privileges of employment, *because of such individual's age.*"

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[16] *See Lunn, supra,* 166 F.3d at 883-84; *Campbell v. BankBoston, N.A.*, 206 F. Supp. 2d 70, 78 (D. Mass. 2002) (rejecting claim that a facially nondiscriminatory cash balance plan was age discriminatory, on ground that ADEA does not permit "disparate impact" claims); *Eaton v. Onan Corp.*, 117 F. Supp. 2d 812 (S.D. Ind. 2000) (rejecting claim that a facially nondiscriminatory cash balance plan violated ERISA § 204(b)(1)(H)); *see also Engers v. AT&T*, No. 98-3660 (D.N.J. 2001) (ERISA § 204(b)(1)(H) prohibits freezing or reducing benefit accruals after normal retirement age).

[17] *See Lunn*, *supra*; *Campbell*, *supra*; *Eaton*, *supra.*

[18] *See Eaton, supra*; *Engers, supra*.

[19] *See* ADEA § 4(i)(1), 29 U.S.C. § 623(i)(1) ("because of age"); ERISA § 204(b)(1)(H)(i); 29 U.S.C. § 1054(b)(1)(H)(i) ("because of the attainment of any age"); Code § 411(b)(1)(H)(i) ("because of the attainment of any age").

[20] H.R. Conf. Rep. No. 1012, 99th Cong., 2d Sess. 378-79 (1986) ("The conferees intend that the provisions of ADEA, ERISA, and the Code that are amended to prevent the reduction or cessation of benefit accruals on account of the attainment of age are to be interpreted in a consistent manner and do not intend any differences in language in the provisions to create an inference that a difference exists among such provisions."); *see also Id.* at 382.

Thus, like the age discrimination provisions that Congress included in the 1986 legislation, ADEA § 4(a)(1) prohibited discrimination "because of . . . age."

Because both § 4(a)(1) and § 4(i)(1) rely on the "because of age" standard, basic principles of statutory construction establish a presumption that Congress intended these words "to have the same meaning in all subsections of the same statute."[21] The law under § 4(a)(1) is therefore extremely relevant in determining what "because of age" means in ADEA § 4(i)(1) and in its counterpart provisions in ERISA and the Code.

Age discrimination claims under ADEA fall into two categories: disparate treatment and disparate impact. The first looks to the employer's intent; the second looks only to consequences. Since both ADEA § 4(i)(1) and the general prohibition on age discrimination in ADEA § 4(a)(1) require a causal relationship between age and the unfavorable treatment (*i.e.,* a showing that the unfavorable treatment occurred "because of age"), both require a showing of either disparate treatment or disparate impact.

The case law under § 4(a) strongly suggests, however, that the disparate impact theory is not available under ADEA. The Supreme Court has stated that "disparate treatment" claims capture the essence of what ADEA prohibits,[22] and the prevailing case law is that disparate impact claims may not be asserted under ADEA § 4(a)(1).[23]

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[21] *See, e.g., Commissioner v. Keystone Consolidated Indus., Inc.,* 508 U.S. 152, 159 (1993) ("It is a 'normal rule of statutory construction,' . . . that 'identical words used in different parts of the same act are intended to have the same meaning.'") (citations omitted); *Morrison-Knudson Construction Co. v. Director, Office of Workers' Compensation Programs*, 461 U.S. 624, 633 (1983) ("[A] word is presumed to have the same meaning in all subsections of the same statute."); *Mohasco Corp. v. Silver,* 447 U.S. 807, 826 (1980) ("we cannot accept respondent's position without unreasonably giving the word 'filed' two different meanings in the same section of the statute").

[22] *Hazen Paper Co. v. Biggins,* 507 U.S. 604, 610-11 (1993) ("Whatever the employer's decisionmaking process, a disparate treatment claim cannot succeed unless the employee's protected trait actually played a role in that process and had a determinative influence on the outcome. Disparate treatment, thus defined, captures the essence of what Congress sought to prohibit in the ADEA. . . . . When the employer's decision *is* wholly motivated by factors other than age, the problem of inaccurate and stigmatizing stereotypes disappears. This is true even if the motivating factor is correlated with age, as pension status typically is.").

[23] The First, Seventh, Tenth, and Eleventh Circuits have held that disparate impact claims may not be asserted under ADEA. *See Adams v. Florida Power Corp.*, 255 F.3d 1322, 1324-26 (11th Cir. 2001); *Mullin v. Raytheon Co.,* 164 F.3d 696, 699-704 (1st Cir. 1999); *Salvato v. Illinois Dep't of Human Rights*, 155 F.3d 922, 926 (7th Cir. 1998); *Ellis v. United Airlines, Inc.,* 73 F.3d 999, 1009 (10th Cir. 1996). The Third, Fifth, and Sixth Circuits have expressed substantial doubt that the disparate impact claims are available under ADEA. *See Gantt v. Wilson Sporting Goods Co.*, 143 F.3d 1042, 1048 (6th Cir. 1998) (dictum); *Rhodes v. Guiberson Oil Tools*, 75 F.3d 989, 1004 (5th Cir. 1996) (en banc) (concurring opinion); *DiBiase, supra,*, 48 F.3d at 734. Only in the Eighth and Ninth Circuits and, on a very

(Footnote continued)

Accordingly, there is a strong presumption that when Congress amended ADEA, ERISA, and the Code in 1986 to prohibit reductions in the rate of benefit accrual "because of age," Congress intended to prohibit plans from deliberately treating older employees less favorably than younger employees. That is, a 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.

The proposed regulations, however, adopt a standard that differs sharply from either "disparate treatment" or "disparate impact." Under the proposed regulations, a plan violates § 411(b)(1)(H) if, for any participant, *or for any individual who could be a participant,* the rate at which normal retirement benefits accrue -- calculated on a year-by-year basis -- would be lower solely as a result of the individual being older. This test does not depend on either the terms of the plan or the impact of the plan on older workers: it requires *neither* disparate treatment *nor* disparate impact. The proposed regulations are thus completely at odds with the case law under ADEA and have the effect of writing the causation requirement out of the statute altogether.

4. The proposed regulations use the wrong test to identify age discrimination. The decided cases under ADEA make it evident that the proposed regulations use the wrong test to identify age discrimination. The ADEA case law makes clear that, in order to show age discrimination, it is not sufficient to show a simple statistical correlation with age. It is essential to correct for potentially explanatory variables other than age. In order to show age discrimination, it is necessary to compare employees who are similarly-situated in *all respects* other than age.[24] The proposed regulations do not do this.

The proposed regulations' general test analyzes a plan's treatment of employees on the basis of the increases in their *normal retirement benefits* -- even if the plan's normal form of benefit is not a normal retirement annuity (as in a cash balance plan or a pension equity plan). As a result, the proposed regulations fail to take into account a

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(Footnote continued)

limited basis, in the Second Circuit is there case law indicating that ADEA permits disparate impact claims. *See Smith v. City of Des Moines,* 99 F.3d 1466, 1470 (8th Cir. 1996); *EEOC v. Local 350, Plumbers & Pipefitters*, 998 F.2d 641, 646, 648 n.2 (9th Cir. 1993); *Criley v. Delta Air Lines, Inc.,* 119 F.3d 102, 105 (2d Cir. 1997) (plaintiffs may succeed on a disparate impact theory only if they show "a disparate impact on the entire protected group, *i.e.,* workers aged 40 and over").

[24] *See, e.g., Smith v. Xerox Corp.,* 196 F.3d 358, 371 (2d Cir. 1999) (statistics showing age-related differences do not establish disparate treatment unless they "account for other potential causes of the age-related disparity between employees"); *Achor v. Riverside Golf Club,* 117 F.3d 339, 341 (7th Cir. 1997) (critical question is "the effect of age, isolated from other influences"); *Sheehan v. Daily Racing Form, Inc.,* 104 F.3d 940, 942 (7th Cir. 1997) ("equating a simple statistical correlation to a causal relation" does not satisfy ADEA's causation requirement); *Lyon v. Ohio Educ. Ass'n & Prof. Staff Union*, 53 F.3d 135, 140 (6th Cir. 1995) (time and age are analytically distinct factors).

crucial difference between a younger employee and an older employee: while the younger employee might have to wait, say, 30 years, until his or her normal retirement age, the older employee is subject to a shorter waiting period (five years, for example). The proposed regulations thus fail to compare two employees who are similarly situated in *all respects* other than age.

Consider, for example, the case of an ineligible cash balance plan (*i.e.*, a plan that does not qualify under the regulations as an "eligible cash balance plan") or a pension equity plan that credits interest between the participant's termination of employment and his or her benefit commencement date. In these circumstances, the proposed regulations require a comparison between (a) the increase in the normal retirement benefit for an employee who must wait for 30 years to receive the benefit and (b) the increase in the normal retirement benefit for an employee who must wait five years to receive the benefit. This is an apples-and-oranges comparison. The two employees are *not* similarly situated: the older employee will be entitled to receive a normal retirement benefit in five years, while the younger employee must wait 30 years in order to receive a normal retirement benefit. It is a mistake to conclude that a plan is age-discriminatory based on a comparison between the normal retirement benefits of two employees whose circumstances vastly differ.

In addition, if the regulations mandate that older employees receive greater pay credits under an ineligible cash balance plan or more points under a pension equity plan, the regulations could cause the plan to violate the nondiscrimination requirements of Code § 401(a)(4). Because older employees tend to be more highly paid than younger employees, requiring greater benefits for older employees could cause the plan to violate § 401(a)(4). The Treasury and the Service should not place plans in a "Catch-22" predicament in which they can comply with § 411(b)(1)(H) only by violating § 401(a)(4). This problem is not solved by § 1.411(b)-2(e)(2) of the proposed regulations, which provides relief under § 411(b)(1)(H) only *to the extent* necessary to avoid a violation of § 401(a)(4). By providing relief only to this extent, the regulations would require a plan to go right up to the limit permitted by § 401(a)(4), but not beyond it. This puts an inordinate burden on employers and plan administrators by requiring them to identify precisely the outer limits of what is permitted by § 401(a)(4) (which is often extremely difficult to discern) and is inconsistent with the purposes of § 401(a)(4).

5. <u>The proposed regulations would outlaw many well-established pension plans that cannot reasonably be considered to be age-discriminatory</u>. As we have explained, the sponsors of § 411(b)(1)(H) explained that their objective was to require employers to continue to accrue pension benefits for employees who remain employed past age 65, that the cost of providing post-65 accruals was "relatively low" and would not necessarily require employers to increase their pension plan contributions, that the amendment had been crafted to "minimize the impact on private pensions of the change contemplated by the amendment." and that the legislation would "not significantly affect current practices."[25] In

[25] *See* p. 2*, supra*.

light of Congress's limited objective in enacting § 411(b)(1)(H), Treasury regulations that outlaw numerous well-established plans cannot be consistent with Congress's intent.

The following list illustrates the types of plans and plan provisions, including but not limited to cash balance plans, that would be outlawed by the proposed regulations. There is nothing in the statute's text or legislative history that even remotely suggests that Congress intended to outlaw these commonplace plans and plan provisions.

a. Traditional defined benefit plans (*e.g.*, career-average plans) with automatic pre-retirement indexing. The proposed regulations would outlaw these plans because a younger participant would be deemed to earn a larger increase in his or her normal retirement benefit than a similarly-situated older participant -- due to the longer interval between the current year and the younger participant's normal retirement date. Similarly, because social security benefits are indexed for increases in average national wages and the cost of living,[26] the proposed regulations would treat the social security system as age-discriminatory. It is implausible that Congress intended to prohibit voluntary pension plans from doing the same thing that the social security system does: indexing benefits prior to retirement.

b. Variable annuity plans. The proposed regulations would outlaw variable annuity plans for the same reason that they would outlaw plans with automatic pre-retirement indexing: a younger participant would be deemed to earn larger increase in his or her normal retirement benefit than a similarly-situated older participant due to the longer interval between the current year and the younger participant's normal retirement date.

c. Contributory plans. The proposed regulations would outlaw many contributory plans because a younger participant would be deemed to earn a larger increase in his or her normal retirement benefit than a similarly-situated older participant due to the longer period over which interest will accrue for the younger participant in accordance with Code § 411(c). (Contributory plans generally will not qualify as eligible cash balance plans under the proposed regulations.)

d. Floor-offset plans. The proposed regulations would outlaw most, if not all, floor-offset plans because, according to the proposed regulations, a participant who works beyond the plan's normal retirement age will accrue a smaller benefit under the defined

[26] Social security benefits are indexed for increases in average national wages and the cost of living. *See* 42 U.S.C. §§ 415(a)(1)(B) & (C), 415(i).

benefit plan than will a similarly-situated younger participant who has just attained normal retirement age This is so because the offset produced by the balance in the defined contribution plan at an older age exceeds the offset produced by the balance in the defined contribution plan at normal retirement age. This result is directly contrary to the Seventh Circuit's decision in *Lunn v. Montgomery Ward*, *supra*.

e. Defined benefit plans with an offset for another defined benefit plan. If the benefits under one defined benefit plan (Plan A) are offset by the benefits under another defined benefit plan (Plan B), Plan A will violate the proposed regulations if the benefits under Plan B favor older participants and cause the rate of benefit accrual under Plan A to be reduced.[27]

f. Plans that are amended to reduce or eliminate an integration feature based on individual covered compensation. Because a younger participant's covered compensation exceeds a similarly-situated older participant's covered compensation, the proposed regulations will treat a plan amendment that replaces the integrated formula with a nonintegrated formula as producing a lower rate of accrual for the older participant (who accrued a large benefit under the old formula) than for a similarly-situated younger participant (who accrued a smaller benefit under the old formula). This will cause the plan to violate the proposed regulations.

g. PIA offset and § 401(*l*) offset plans that actuarially adjust the offset after social security retirement age. A social security offset plan or a plan that uses a permissible offset allowance in accordance with § 401(*l*) may increase the offset to reflect the delayed commencement of benefits.[28] Such plans appear to violate the proposed regulations because an older participant will be deemed to have a lower rate of benefit accrual than a similarly-situated younger participant.

h. Plans that accelerate the accruals of participants who have attained a designated age. Some employers amend their plans to provide accelerated accruals to participants who have attained a specified

[27] For example, if Plan A allows all eligible employees to participate in Plan A regardless of age, but Plan B admits only eligible employees who have attained age 21, Plan A will violate the proposed regulations because Plan A will be deemed to treat participants under age 21 more favorably than participants age 21 or older.

[28] *See, e.g.,* Treas. Reg. § 1.401(*l*)-3(e)(2)(ii), (iv).

age. For example, an employer might amend its plan to provide that, as of January 1, 2003, each participant who is age 55 or older with at least 15 years of service will be immediately credited with five additional years of service. Under the amendment, an eligible participant may elect to retire immediately with five additional years of service. On the other hand, an eligible participant who elects to continue to work for the employer will not receive any additional service credit under the plan for the next five years, since the participant has already received credit for those five years. Even though such arrangements benefit older workers, the proposed regulations would outlaw them, since an older participant will (according to the regulations) be deemed to earn a smaller increase in his or her normal retirement benefit in subsequent years than will a similarly-situated younger participant.

i. Plans that shift from a project-and-prorate approach to a full accrual approach at early retirement age. Some plans use a fractional accrual method under which benefits accrue on a project-and-prorate basis until the participant attains early retirement age and on a full accrual basis upon attaining early retirement age. Because a participant has a higher rate of accrual in the year he or she attains early retirement age than in subsequent years, the proposed regulations will treat the plan as failing the general test -- even though this plan design actually benefits older workers.

j. Fractional rule plans that are amended to provide additional benefits. Under the anti-backloading rules, if a plan under which participants accrue benefits under the fractional rule is amended to increase benefits, the plan must provide an additional accrual (a "bump-up accrual") in the year of the amendment in order to bump up the participant to a ratable share of the benefit under the new benefit formula. The bump-up accrual will cause the plan to violate the proposed regulations' general test.[29]

k. Plans offering age-bracketed QPSA subsidies. Some defined benefit plans reduce a participant's accrued benefit to reflect the cost of the plan's qualified preretirement survivor annuity

[29] The ERISA conference report provides that the bump-up is required when a plan that accrues benefits fractionally is amended to increase benefits. *See* H.R. Rep. No. 1280, 93d Cong., 2d Sess. 275 n.3 (1974). A bump-up accrual will violate the test in the proposed regulations because participants with the same pay history and the same number of years of service, but different ages in the year of the amendment, will accrue different bump-up amounts. The bump-up amount will be smaller the closer the participant is to normal retirement age in the year of the amendment.

("QPSA") coverage in accordance with Code § 417(f)(4). Some of these plans subsidize the QPSA coverage by absorbing a portion of the cost. In some cases, the cost charged to each participant is fixed for five-year periods, so that the amount of the subsidy gradually increases during each five-year period. When a participant moves from one five-year age-bracket to the next, the cost of QPSA coverage to the employee increases. Such plans appear to violate the proposed regulations because the regulations will deem an older participant to have a lower rate of benefit accrual than a similarly-situated younger participant.[30]

l. Post-normal-retirement-age accruals. The proposed regulations would change the way plans must calculate the benefit accruals of participants who work past normal retirement age. The year-by-year approach in the proposed regulations is a major change from the approach that the Treasury took in its 1988 proposed regulations -- nearly 15 years ago. Plans have been amended and administered for approximately 15 years on the basis of the 1988 proposed regulations, which the Treasury told employers they could rely on. Unlike the 1988 regulations, the new proposed regulations do not permit a plan to reduce a participant's benefit accrual in a year to reflect the fact that in the preceding plan year, the plan gave the participant an actuarial increase that exceeded the accrual under the plan's benefit formula.[31] This is a mistake. As the 1988 proposal recognized, a plan that takes this approach *benefits* older participants; it does not discriminate against them.[32]

m. Pension equity plans. Under a typical pension equity plan, a participant accumulates points based on his or her age and years of service (with more points often being given to older participants than to similarly-situated younger participants), and the points are then converted to a percentage of the participant's final average pay. The participant's annuity benefit is the actuarial equivalent of the lump-sum amount that is equal to the designated percentage of the participant's final average pay. Under many pension equity plans, if a participant does not elect to receive (or to commence receiving) his or her accrued benefit immediately following termination of employment, the participant is entitled to a benefit at his or her

[30] This arrangement does not appear to be covered by the narrow exception in Prop. Treas. Reg. § 1.411(b)-2(d)(2) for reasonable assumptions to calculate the cost of providing a QPSA.

[31] 67 Fed. Reg. 76,125 (Dec. 11, 2002).

[32] *See also* paragraph h, *supra.*

benefit commencement date that is the actuarial equivalent of the lump-sum amount at the participant's employment termination date. Because the interval between the participant's employment termination date and normal retirement date is longer for a younger participant than for an older participant (and because the younger participant will, in consequence, receive the benefit of interest-compounding for a longer period of time before normal retirement date), the proposed regulations would outlaw such arrangements -- even though the interest credits merely adjust participants' benefits to reflect the time value of money.

n. Cash balance plans (1). The proposed rule for cash balance plans fails to cover many commonplace cash balance plan designs that are highly favorable to employees, and particularly favorable to older employees. To take just one example, many cash balance plans set the participant's opening account balance as the amount (or an approximation of the amount) that would have been in the participant's account if the cash balance design had been in effect throughout the participant's total years of service.[33] The proposed rule for cash balance plans does not accommodate this common and equitable plan design even though it was specifically approved in the Treasury's nondiscrimination regulations under Code § 401(a)(4).[34]

o. Cash balance plans (2). Many cash balance plan conversions and other conversions provide additional benefits to older employees that wear away as the employees continue to work (*see also* paragraph h, above). Although such additional benefits *favor* older employees, the wear-away feature causes the plan to violate the proposed regulations' rigid year-by-year accrual test.

p. Cash balance plans (3). The proposed rule for cash balance plan conversions requires the opening balance for a participant who has passed normal retirement age to be calculated as if the participant were at normal retirement age. There is no statutory basis for requiring a plan to provide a benefit that exceeds the actuarial

[33] Such plans also protect the participant's accrued benefit under the plan in accordance with Code § 411(d)(6). Because traditional pension plans favor older workers, the protected accrued benefit for an older worker is generally much greater than the protected accrued benefit for a younger worker with the same employment and compensation history when both workers' benefits are expressed as immediate lump sums.

[34] *See* Treas. Reg. § 1.401(a)(4)-13(f)(2)(B); *see also Id.* § 1.401(a)(4)-8(c)(3)(viii).

equivalent of the participant's accrued benefit under the plan's prior benefit formula.

This list is illustrative only. It does not purport to identify all of the plans and plan provisions that would be outlawed by the proposed regulations.

The illustrative examples reveal a number of fundamental deficiencies in the proposed regulations, including the following:

- Pre-retirement indexing: The proposed regulations fail to permit plans to provide for the pre-retirement indexing of benefits.

- Year-by-year testing: The proposed regulations insist on testing accruals on a year-by-year basis, and fail to permit testing on other bases, such as by using the accrued-to-date or projected methods.

- Benefit offsets: The proposed regulations fail to provide appropriately for benefit offsets.

- Employees who are past normal retirement age: The proposed regulations fail to provide appropriately for employees who have passed normal retirement age.

The proposed regulations' prospective effective date does not diminish our 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 we would vigorously oppose any such claims, we are concerned that the proposed regulations do not explicitly foreclose such claims.

Because the general test that we have proposed is consistent with the text, purpose, and legislative history of the statute, the case law, and prevailing plan design, our 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 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.[35]

Finally, the proposed regulations would, at a minimum, require major *prospective* changes in the way defined benefit plans are designed and administered. There is no basis for thinking that this is what Congress intended when it enacted § 411(b)(1)(H).

6. The Treasury should replace the proposed regulations' flawed rules with an appropriate generally applicable standard that is consistent with the text of the statute, Congressional intent, judicial decisions, and prevailing plan design. If the regulations include an appropriate generally applicable standard, it will not be necessary to include special rules for cash balance plans under either the § 411(b)(1)(H) age-discrimination provisions or the § 401(a)(4) nondiscrimination cross-testing rules.

For the reasons we have presented, the proposed regulations' intricate mathematical approach is inconsistent with Congressional intent, the text of the statute, the case law, and prevailing plan design. The intricate mathematical approach should be replaced with a straightforward, commonsense approach that is faithful to the text and purpose of the statute.

The Treasury 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 practice. 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. For example, in the case of a cash balance plan that credits interest for all future periods at a rate that does not decline with age, participants' accrual rates could be determined simply by looking at the rate at which pay credits accrue under the plan.

We caution against replacing the proposed general rule with what might be intended as a "new and improved" mathematical test. An alternative mathematical test might fix some of the problems with the current rule, but it is unlikely to fix all of them and might well create new problems. A mathematical test is certain to be inconsistent with Congress's intent in enacting § 411(b)(1)(H).

The Treasury should not rely on safe harbors to compensate for shortcomings in the regulations' general rule. It is not possible to create safe harbors that will accommodate all of the plan designs that should be considered permissible. Pension plans are dynamic arrangements. Employers continually respond to changes in employee needs and business conditions. If the Treasury relies primarily on safe harbors, the Treasury will inappropriately become the architect of private-sector pension plans, and will stifle the ability of employers to adopt new plan designs that address evolving employee and business

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

needs. The Treasury should adopt an appropriate general test that accommodates variety and evolution in plan design.

If the Treasury or the Service has any questions about our comments, or if we can otherwise be of assistance, please let us know.

THE ERISA INDUSTRY COMMITTEE