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ON BEHALF OF
THE ERISA INDUSTRY COMMITTEE

AT THE TREASURY DEPARTMENT HEARING
ON THE PROPOSED REGULATIONS
ON
AGE DISCRIMINATION

April 9, 2003

Good morning. My name is John Vine. I am a partner in the law firm of Covington & Burling. I appear today on behalf of The ERISA Industry Committee, commonly known as ERIC.

ERIC very much appreciates the time, effort, and thought that the Treasury and the Service have devoted to the proposed regulations. ERIC is gratified that the Treasury and the Service have adhered to their long-standing position that cash balance plans are not inherently age-discriminatory.

ERIC has submitted two sets of detailed comments on the proposed regulations as well as a letter addressed directly to Secretary Snow. ERIC commends the Treasury and the Service for their willingness to examine carefully the criticisms of the proposed regulations -- criticisms that have come from all sides.

ERIC believes that the proposed regulations are fundamentally flawed. The regulations' rigid mathematical approach is inconsistent with the text of the statute, inconsistent with Congressional intent, inconsistent with the case law, and inconsistent with prevailing plan design. Under the approach taken by the regulations, the social security system would be considered age-discriminatory. It is implausible that Congress intended to impose a standard on voluntary plans that would treat the social security system as age-discriminatory.

ERIC urges the Treasury and the Service to adopt the following clear and straightforward rule: 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. Unlike the proposed regulations' mathematical approach, this rule is consistent with the text of the statute, Congressional intent, the case law, and prevailing plan design.

Although we understand the drafters' intent in creating a special rule for cash balance plans, we think this is the wrong way to go. A special rule would not be necessary if the regulations' general rule were the right one.

Having special rules for Government-approved plans puts the Government in the position of designing pension plans. But the Government should not be in the business of designing plans. The focus should be on getting the general rule right and letting the private sector design the plans that best meet employee and business needs. Relying on special exceptions for Government-approved approved plans to make

up for the general rule's deficiencies will stifle the ability of employers to innovate and to adopt new plan designs that meet evolving employee and business needs.

Opponents of cash balance plans have leveled numerous erroneous charges. Let me respond to some of them:

Opponents claim that cash balance plans cut workers' benefits. But under existing law, it is impermissible for a cash balance conversion to reduce the benefits employees have already earned.

Opponents claim that employers adopt cash balance plans in order to save money. But independent research contradicts this claim. Federal Reserve Board researchers found that in 25 of the 32 cases they studied, the employer's pension costs actually *increased*.

Opponents claim that cash balance plans weaken workers' retirement security. But Federal Reserve Board researchers found just the opposite: that cash balance conversions *increase* pension benefits for the majority of workers. A recent Urban Institute study came to the same conclusion.

Opponents claim that cash balance plans discriminate against older workers. But the federal courts have consistently come to the *opposite* conclusion, and the Urban Institute's researchers found that cash balance plans distribute pension wealth *more equally* across the population than do traditional defined benefit plans.

Cash balance plans -- and other hybrid plans -- have helped to strengthen and expand the defined benefit system.

A word about "choice." Many opponents of cash balance plans have asked the Treasury to adopt regulations giving employees the right to

choose either to stay under their plan's existing formula or to move to a new cash balance formula. You've heard from some of them here today.

But if choice is the solution, what is the problem? The problem cannot be age discrimination. If cash balance plans were really age-discriminatory, the solution would *not* be to allow employees to elect to move into those plans.

The choice proponents' fundamental complaint is based, not on age discrimination, but on the belief that employees have the right to earn additional benefits under their existing pension formulas indefinitely.

But it is clear that the law gives employees no such right. The law protects the benefits an employee has earned to date, but allows the employer to reduce the rate at which employees earn new benefits in the future. Congress took a careful look at this two years ago and decided to impose new disclosure requirements when a plan is amended to reduce

the rate at which employees earn future benefits. Congress did *not* give employees the right to stay under the plan's old formula -- nor should it: few companies would be willing to maintain a plan if employees were given the right to continue earning benefits under the plan's current formula indefinitely. In any event, the Treasury is not authorized to grant this right by regulation.

I'd also like to comment on the regulations' treatment of the "always-cash-balance" approach -- a technique many plans have used to transition from a traditional pension formula to a cash balance formula.

When a traditional plan is converted to a cash balance plan, an employee's opening account balance often is set as the greater of the present value of his accrued benefit under the plan's old formula or the account balance he would have accumulated if he'd always been covered by the new cash balance formula from the date he entered the plan.

The second prong -- the always-cash-balance prong -- gives the same opening account balance to every employee with the same pay and service. But because the benefits under traditional formulas are economically backloaded, the second prong is worth more to younger employees than to older employees.

Under the proposed regulations, if an employee's opening balance exceeds the present value of his previously accrued benefit, the excess must be tested for compliance with § 411(b)(1)(H) along with the pay credits that are added to the employee's account in the same year. This means that, as a practical matter, plans using the always-cash-balance approach will violate § 411(b)(1)(H) under the proposed regulations.

There are many things wrong with this result:

First, it is inconsistent with the regulations' general acceptance of cash balance plans. If a plan can adopt a cash balance formula on a prospective basis, there is no reason to forbid it from being adopted on a retroactive basis.

Second, it is inconsistent with long-standing Treasury regulations under § 401(a)(4) -- which have explicitly blessed the always-cash-balance approach.

Third, it forbids a plan from doing something that is favorable to mid-career employees who might otherwise be harmed by the conversion to a cash balance formula.

Fourth, it is inconsistent with the Seventh Circuit's decision in *Lunn* and with the ADEA cases holding that an increase in benefits that has a disproportionate impact on younger employees is not age-discriminatory

as long as -- after the increase -- the younger employees are no better off than the older employees.

In conclusion, ERIC urges the Treasury and the Service to propose new regulations that incorporate the approach I have outlined -- an approach that is consistent with the text of the statute, Congressional intent, the case law, and prevailing plan design.

ERIC also urges the Treasury and the Service to act promptly. Failure to do so will subject employees, employers, and the defined benefit system as a whole to excessive uncertainty and risk. Revised regulations should be issued as soon as possible.

That completes my prepared remarks. I'll be happy to respond to any questions that the members of the panel might have. Thank you.