

Jon Kyl, Chairman

Lawrence Willcox, Staff Director
347 Russell Senate Office Building
Washington, DC 20510
202-224-2946
<http://rpc.senate.gov>

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A Broader Perspective on Social Security Reform

**Retirement-Income Security:
The Status of Hybrid-Pension Plans**

Executive Summary

- With Social Security reform as a top priority, President Bush has opened a debate on a critical aspect of a much broader issue – ensuring that Americans have adequate income for their retirement.
- At its inception, Social Security was viewed as one leg of a “three-legged stool,” with personal savings and pension benefits making up the vast majority of retirement income. Today, Social Security is the primary source of retirement income for two-thirds of the program’s beneficiaries.
- While the prevalence of defined-benefit plans has gradually declined over the past two decades, the use of hybrid-pension plans has continued to rise, covering more than 7 million Americans, according to government statistics.
- Hybrid pension plans – commonly known as “cash balance” or “pension equity” plans – are classified as defined-benefit plans. Participants receive guaranteed benefits and the sponsoring company bears the funding and investment risks. However, they look like defined-contribution plans – e.g., 401(k) plans – because of their individual-account feature.
- Employers favor hybrid plans because they are a valuable employee benefit they can use to recruit and retain today’s more mobile workforce. Employees value the guaranteed benefit and increased portability that such plans provide.
- While popular, hybrid plans may not remain viable if the questions surrounding their legal status continue. Congress could resolve this uncertainty by enacting legislation that:
 - clarifies that hybrid plans are not age discriminatory by their design; and
 - provides that conversions from a traditional defined-benefit plan to a hybrid plan will be permitted as long as the benefits that participants accrued under the prior plan are protected, as required by current law.
- Left unresolved, the uncertainty surrounding hybrid pensions puts millions of Americans’ retirement income at risk and threatens to force more companies to eliminate defined-benefit plans – a result that does not serve anyone.

Introduction

By embracing Social Security reform as a top priority, President Bush opened a debate on a critical aspect of a much broader issue facing this country – ensuring that Americans have adequate income for their retirement.¹

When the Social Security program was established in 1935, President Roosevelt stressed that the program was intended to be a safety net to protect seniors “against poverty-ridden old age.”² It was also a benefit that few were expected to receive since the life expectancy for seniors at that time was well below the 65-years-of-age necessary to qualify for Social Security benefits.³ Accordingly, Social Security at its inception was viewed as one leg of a “three-legged stool,” with personal savings and pension benefits making up the vast majority of an individual’s income in retirement.⁴

Despite its original intent, Social Security has become the primary source of retirement income for two-thirds of Social Security beneficiaries.⁵ With too little emphasis on the other two legs of the stool, individuals relying on Social Security are effectively planning for subsistence-level income on which to live out their retirement years. With a long history of rising standards of living in this country, Congressional policy should enable Americans to maintain as high a living standard in retirement as possible.

Ensuring the permanent sustainability of the Social Security system so that it can provide protection from poverty in retirement is a worthy objective. But in the larger context of ensuring income security for Americans in retirement, it is not sufficient. Congress has the opportunity to address the issue of retirement-income security in a comprehensive manner. Based on the Roosevelt-era analogy of the three-legged stool, that effort should include reform of Social Security, but also measures to eliminate barriers to personal savings and other changes to enable employers to strengthen and enlarge the private-pension system.

This paper – the third in a series – focuses on how the private-pension system in this country can expand if Congress clarifies the status of hybrid-pension plans, thus securing the retirement income of millions of Americans.⁶

¹President George W. Bush, Report on the State of the Union Delivered to a Joint Session of Congress, February 2, 2005, *Congressional Record*, page S878.

²Statement of President Franklin D. Roosevelt upon signing the Social Security Act, August 14, 1935.

³Center for Disease Control and Prevention, “Estimated Life Expectancy at Birth,” National Vital Statistics Reports, Volume 53, Number 6, November 10, 2004.

⁴Social Security Administration (SSA), “Research Note #1: Origins of the Three-Legged Stool Metaphor for Social Security” – <http://www.ssa.gov/history/historianoffice.html>.

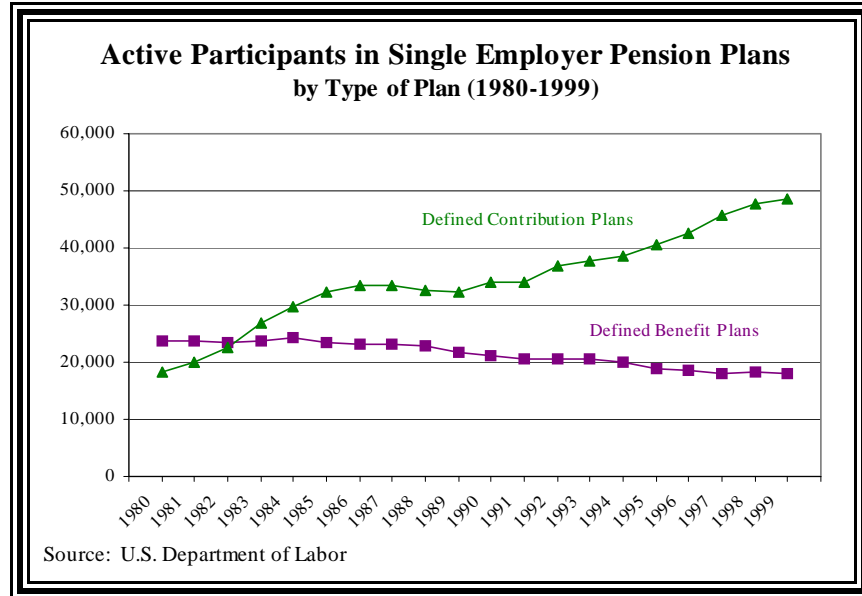
⁵SSA, “Income of the Aged Chartbook, 2001,” April 2003, p. 4 – http://www.ssa.gov/policy/docs/chartbooks/income_aged/2001/iac01.pdf. SSA estimates that Social Security benefits provide 50 percent or more of total income for 65 percent of the beneficiaries, 90 percent or more of income for one-third of the beneficiaries, and are the only source of income for 20 percent of beneficiaries.

⁶For a discussion of personal savings and the private-pension system in retirement-income security, see the first two papers in this series, “Retirement-Income Security: The Role of Personal Savings,” February 28, 2005 – <http://rpc.senate.gov/files/Feb2805RISavingsMW.pdf>; and “Retirement-Income Security: Strengthening the Private-Pension System,” April 7, 2005 – <http://rpc.senate.gov/files/Apr0705RetIncomeSecMW.pdf>.

Expanding the Private-Pension System

Over the past two decades, the prevalence of traditional defined-benefit plans has gradually declined.⁷ This trend is the result of changes in the nation’s economy and workforce, as well as the administrative complexities, funding requirements, and investment risks associated with such plans. In contrast, as Figure 1 illustrates, the number of employees participating in defined-contribution plans – such as 401(k) plans – has steadily increased.⁸

Figure 1



As Congress considers changes to the current rules governing pension liabilities and funding, attention should be given to alternatives that would stem the decline of defined-benefit plans and encourage companies to adopt new ones. One important step toward accomplishing that goal would be for Congress to clarify the status of “hybrid” pension plans.

The Importance of Hybrid-Pension Plans

While taking a variety of forms, hybrid pensions generally refer to so-called “cash balance” and “pension equity” plans. From a legal perspective, a hybrid plan is a defined-benefit pension plan. Benefits, however, are defined in terms of a participant’s notional account

⁷American Benefits Council, “Pensions at the Precipice: The Multiple Threats Facing Our Nation’s Defined-Benefit Pension System,” May 2004, p. 6 – http://www.americanbenefitscouncil.org/documents/definedbenefits_paper.pdf. Defined-benefit plans generally provide lifetime retirement benefits to an employee of the sponsoring company based on the employee’s tenure and compensation. The plan sponsor bears the responsibility of funding the plan and the risk of investing the plan assets to ensure that the benefits can be paid when the employee retires.

⁸A defined-contribution plan typically involves contributions from an employee’s salary that are allocated to an account in the employee’s name, along with the associated earnings and any matching contributions offered by the company sponsoring the plan. Unlike a defined-benefit plan, however, the *employee* bears the risk of saving sufficient assets for retirement.

balance – essentially a bookkeeping mechanism – which makes hybrid plans resemble a defined-contribution plan.⁹

In a typical cash-balance plan, participants receive “pay credits,” based on a percentage of their annual salary, which are reflected in the notional account. In addition, they receive “interest credits,” which are applied to the accumulated balance in the notional account.¹⁰ In a pension-equity plan, a participant receives credits for each year of service, and the total credits are multiplied by the participant’s final pay (upon termination or retirement) to determine a lump-sum benefit amount.¹¹

A common misperception is that the use of hybrid-pension plans has become popular because they allow sponsoring companies to reduce their pension costs. While that may be the case in limited instances, recent survey results demonstrate that companies adopting such plans actually realize *increased* retirement-plan costs by an average of 2.2 percent.¹²

In reality, hybrid plans are popular because they allow employers to meet the needs of today’s more mobile workforce.¹³ A traditional defined-benefit plan typically awards benefits based on an employee’s years of service and final compensation, which heavily benefits senior employees who have greater longevity and higher salary levels. In contrast, hybrid plans allow companies to spread pension benefits more evenly over a participant’s career by granting pay credits based on each year’s compensation, not just the highest salary levels prior to retirement.¹⁴

In fact, a recent study found that an employee changing jobs just three times during his or her career will receive 17.6 percent more in retirement benefits from a cash-balance plan than from a traditional defined-benefit plan.¹⁵ Additionally, because of the notional-account feature, hybrid plans generally make it easier for employees to determine their benefits. Hybrid plans also typically allow employees to receive a lump-sum distribution when they leave a job.¹⁶

⁹Joint Committee on Taxation, “Present Law and Background Relating to Employer-Sponsored Defined Benefit Pension Plans and the Pension Benefit Guaranty Corporation (PBGC),” JCX-03-05, February 28, 2005, p. 9 – <http://www.house.gov/jct/x-3-05.pdf>. In a defined-contribution plan, such as a 401(k) plan, the participant has an actual account into which employer and employee contributions are deposited.

¹⁰Patrick J. Purcell, “Pension Issues: Cash-Balance Plans,” RL30196, *Congressional Research Service*, January 24, 2005, pp. 4-5 – <http://www.congress.gov/erp/rl/pdf/RL30196.pdf>.

¹¹James M. Delaplane, Jr., in testimony before the House Committee on Education and the Workforce, July 7, 2004, p. 4 – http://www.americanbenefitscouncil.org/documents/delaplane_testimony_070704.pdf.

¹²Watson Wyatt, “Hybrid Pension Conversions Post-1999: Meeting the Needs of a Mobile Workforce,” 2004, p. 3. This research was based on a sample of 55 hybrid conversions that have occurred since 1999. The research also found that when companies in severe financial distress at the time of conversion were excluded, pension costs increased by an average of 5.9 percent.

¹³Bradley D. Belt, Executive Director, PBGC, in testimony before the Senate Committee on Finance, March 1, 2005, p. 5 – <http://finance.senate.gov/hearings/testimony/2005test/bbtest030105.pdf>. Estimates show that baby boomers born between 1957 and 1964 held an average of 10.2 jobs before reaching age 38. BLS, “Number of Jobs Held, Labor Market Activity, and Earnings Growth Among Younger Baby Boomers: Recent Results from a Longitudinal Survey,” USDL 04-1678, August 25, 2004, Table 1 – <http://www.bls.gov/news.release/pdf/nlsoy.pdf>.

¹⁴American Benefits Council, “Pensions at the Precipice,” p. 7.

¹⁵Watson Wyatt, p. 7.

¹⁶A recent survey found that 95 percent of cash-balance plans offered a lump-sum option, while only 24 percent of the pre-conversion traditional plans offered such an option. Mellon Financial Corporation, “2004 Survey

(continued...)

Together with the hybrid plan’s guaranteed benefit, portability is one of the most attractive features for employees who do not plan to have a long-term career with a single employer.¹⁷

Hybrid plans also retain the security features of traditional defined-benefits plans.¹⁸ For example, they provide employer-funded retirement income for the participant’s lifetime, which is insured by the Pension Benefit Guaranty Corporation (PBGC).¹⁹ Moreover, the employer is responsible for the investment management and bears the financial risk of the plan, unlike defined-contribution plans, which shift those responsibilities to the employee.

According to the most recent government data, more than 7 million Americans receive benefits from approximately 1,200 hybrid plans as of the year 2000, as illustrated by Figure 2.²⁰

Figure 2
Estimated Number of Participants in Hybrid-Pension Plans
By Plan Size in 2000

Plan Size (by number of participants)	Total Participants in Defined-Benefit Plans* (in thousands)	Estimated Number of Participants in Hybrid Plans (in thousands)	Estimated Percentage of Participants in Hybrid Plans
Less than 100	456	10	2
100 - 999	3,080	148	5
1,000 - 4,999	6,045	691	11
5,000 - 9,999	3,661	696	19
10,000 or more	21,100	5,609	27
Total	34,342	7,155	21

*Single-employer defined-benefit plans insured by the PBGC.
Source: PBGC, “Pension Insurance Data Book 2002,” p. 6.

While there has been a steady decline in traditional defined-benefit plans in recent years, hybrid plans have been one of the few positive developments.²¹ Within the universe of defined-

¹⁶(...continued)

of Cash Balance Plans,” June 2004, p. 14 – http://www.mellon.com/hris/pdf/cash_balance_report_highlights.pdf.

¹⁷Delaplane, p. 4.

¹⁸American Benefits Council, “Hybrid-Pension Plans Deliver Secure and Meaningful Benefits to Employees and Their Validity under Current Law Must be Confirmed,” March 17, 2005, p. 1.

¹⁹A principal purpose of the PBGC is to provide an insurance system for defined-benefit plans, including hybrid plans. The PBGC assumes responsibility for paying benefits when a terminated plan has insufficient assets to fulfill its benefit obligations. Benefits paid by the PBGC, however, are subject to a statutory cap – currently up to \$45,613.68 yearly (\$3,801.14 monthly) when a participant reaches age 65. PBGC, “General Pension Information” – <http://www.pbgc.gov/about/benefits.htm>.

²⁰PBGC, “Pension Insurance Data Book 2002,” Number 7, Winter 2003, p. 5 – <http://www.pbgc.gov/publications/databook/databook02.pdf>.

²¹Barry Kozak, “The Cash Balance Plan: An Integral Component of the Defined-Benefit Plan Renaissance,” 37 *John Marshall Law Review* 753, Spring 2004 (“The cash-balance design itself is responsible for at (continued...)”).

benefit plans, hybrid plans have shown significant growth. For example, the number of cash-balance plans increased from 4 percent of defined-benefit plans in 1996 to 23 percent in 2000.²²

Legal Uncertainty Surrounding Hybrid Plans

Despite the beneficial features and growth of cash-balance and pension-equity plans, recent uncertainty about their legal status has called into question their continued viability, threatening the pension benefits of millions of Americans. This legal uncertainty centers on the conflicting judicial interpretations of federal law, which prohibits a company from reducing the rate of benefit accruals based on a participant's age.²³

Following IBM's conversion of its pension plan to a cash-balance plan in 1999, a group of employees brought suit in federal court alleging that the conversion violated the age-discrimination statutes. The court in *Cooper v. IBM Personal Pension Plan* found that the design of the cash-balance plan was age discriminatory – reasoning that, while the plan granted equal pay and interest credits to all participants, older workers were subject to discrimination simply because they had fewer working years to earn interest credits on their benefits.²⁴

Commentators have noted that, in reaching this conclusion, the court did not cite or distinguish the relevant judicial precedents (including a case in the same circuit),²⁵ which found that the hybrid-pension plans in those cases were not age discriminatory.²⁶ The court's reasoning also conflicts with the legislative history of the age-discrimination statute, which references various pension-plan designs that would likely be deemed illegal under the logic employed in *Cooper*, even though Congress intended to permit those types of arrangements.²⁷ Moreover, if the court's reasoning were to be applied to defined-contribution plans – like 401(k) plans – their

²¹(...continued)

least the defined-benefit plan preservation, if not for the renaissance [of such plans].”).

²²U.S. Department of Labor, Bureau of Labor Statistics, “National Compensation Survey: Employee Benefits in Private Industry in the United States, 2000” – <http://www.bls.gov/ncs/ebs/cashbalance.htm>.

²³Section 411(b)(1)(G) & (H) of the Internal Revenue Code of 1986 (26 U.S.C. § 411(b)(1)(G) & (H)); Section 204(b)(1)(G) & (H) of the Employee Retirement Income Security Act of 1974 (29 U.S.C. § 1054(b)(1)(G) & (H)); and Section 4(i) of the Age Discrimination in Employment Act of 1967 (29 U.S.C. § 623(i)).

²⁴274 F. Supp. 2d 1010, 1013, 1021 (S.D. Ill. 2003).

²⁵Judicial precedents include: *Eaton v. Onan Corp.*, 117 F. Supp. 2d 812 (S.D. Ind. 2000); and *Campbell v. BankBoston*, 206 F. Supp. 2d 70 (D. Mass. 2002), *aff'd*, 327 F. 3d 1 (1st Cir. 2003). Subsequent to the *Cooper* decision, the federal district court in Maryland also concluded that the cash-balance plan in question was not age discriminatory. *Tootle v. ARINC*, 222 F.R.D. 88 (D. Md. 2004).

²⁶Commentators on the *Cooper* decision include: Delaplane, p. 12 (“[P]rior to the *Cooper* decision, numerous other federal district courts addressed and rejected charges that the basic hybrid plan designs were age discriminatory [citing the *Eaton* and *Campbell* cases]. These too were ignored in the *Cooper* decision.”); Alvin D. Lurie, “Murphy’s Law Has IBM Singing the Big Blues,” [Benefitslink.com](http://benefitslink.com/articles/lurie20030924.pdf), September 24, 2003 – <http://benefitslink.com/articles/lurie20030924.pdf> (“What the court does not mention (or even cite) was the thoroughly reasoned opinion in [*Eaton*], which completely supported the position maintained by IBM.”); see also Kozak, p. 793-94 (“There is a lack of cited legal authority in the [*Cooper*] opinion. . . . [T]he *Eaton v. Onan Corp.* case, previously decided by another district court in the same Seventh Circuit, issued a totally opposite opinion. Even though *Eaton* has been settled, its logic remains valid. Therefore, until settled by the Court of Appeals for the Seventh Circuit, [the age-discrimination] issue is now left unresolved.”).

²⁷H. Conf. Rept. No.1012, 99th Cong., 2d Sess., pp. 376-379. See American Benefits Council, “Pensions at the Precipice,” pp. 9-10.

legal status arguably would be called into question,²⁸ since such arrangements are normally based on equal contributions by the employer sponsoring the plan.²⁹

While the *Cooper* decision is awaiting appeal,³⁰ it has had far-reaching results. In 2002, prior to the case, the Treasury Department issued proposed regulations setting forth structural requirements that a hybrid-pension plan must meet in order to satisfy the age-discrimination law.³¹ The controversy surrounding the *Cooper* case, however, emboldened Democrats to insert a provision in the 2004 Consolidated Appropriations Act that prevented the Treasury Department from completing the hybrid-pension regulation.³² The proposed regulations were subsequently withdrawn in June 2004.³³

The lack of guidance on the legal standards applicable to hybrid plans is an untenable situation. In fact, according to a 2003 survey, more than 40 percent of companies sponsoring hybrid pensions expected to terminate or freeze their plans if the legal status were not resolved within a year.³⁴ For participants, that would result in a suspension of pension-benefit accruals, thereby limiting the ability of participants to build income for retirement.

Clarifying the Status of Hybrid Plans

To clarify the status of hybrid plans, Congress must resolve two fundamental issues: (1) whether a hybrid plan by design is age discriminatory; and (2) whether a company's conversion from a traditional defined-benefit plan to a cash-balance or pension-equity plan is age discriminatory.

²⁸Jason Hammersla, "Pension System Future May Turn on Cash Balance Decisions," *Employee Benefit News*, November 2004 – <http://www.benefitnews.com/retire/detail.cfm?id=6643>.

²⁹*Cooper*, p. 1020. The court in *Cooper* even suggested that IBM could have achieved the same practical result by replacing its traditional defined-benefit plan with a new defined-contribution plan. *Cooper*, p. 1022. Using the court's logic, however, the legal validity of such a defined-contribution plan would be in question since the value of a participant's account, although credited with a uniform contribution, increases with age.

³⁰The parties have agreed to a settlement of certain tangential issues involved in the case and to a cap on potential damages relating to the age-discrimination issue if the case is upheld on appeal. IBM expects to file its appeal to the Seventh Circuit on the central age-discrimination issue once the settlement is approved by the district court. IBM, Statement on Pension Settlement Announcement, September 29, 2004 – <http://www.ibm.com/investor/ircorner/2004/attachments/04-09-29-1.pdf>.

³¹67 *Federal Register* 76123, December 11, 2002.

³²Section 205 of the Consolidated Appropriations Act, 2004, Public Law 108-199.

³³Treasury Announcement 2004-57, Treasury Release JS-1724, June 15, 2004 – <http://www.treas.gov/press/releases/js1724.htm>.

³⁴Hewitt Associates LLC, "Current Retirement Plan Challenges: Employer Perspectives 2003," December 2003, p. 2. For a majority of the companies surveyed, the alternative to hybrid plans, if they cannot be continued, would be to provide benefits through a defined-contribution plan – only 11 percent indicated that they would reestablish a traditional defined-benefit plan for all employees.

New Hybrid-Pension Plans

The legislative history and the majority of judicial interpretations of the age-discrimination statute make clear that hybrid pensions are not discriminatory by design.³⁵ A typical new plan does not place a 25-year-old employee who works five years for the sponsoring company in any different economic position than a 60-year-old who works for the company until retirement at age 65. In fact, many hybrid plans provide *increasing* pay credits as a participant's tenure with the company grows in order to encourage individuals to stay with the company.³⁶

Additionally, as noted above, the benefit structure of most hybrid plans parallels that of a defined-contribution plan. Accordingly, if Congress fails to uphold the legal status of hybrid plans, the status of defined-contribution plans could be open to question. And, by extension, it could suggest that the calculation of Social Security benefits also are age discriminatory, since they are predicated on level benefit accruals that increase with an individual's years in the workforce.³⁷ These are two results that Congress never intended and that would clearly undermine sound retirement policy.

Hybrid Pension Conversions

The conversion from a traditional defined-benefit pension to a hybrid plan raises slightly more complex issues, which also should be resolved in favor of finding that such conversions are not age discriminatory.

A fundamental tenet of the law governing defined-benefit plans is that the sponsoring company cannot cut back on benefits that a participant has already accrued, but it may modify *future* benefits at any time, provided that the change is not predicated on an individual's age.³⁸ In other words, pension benefits cannot be reduced once they have been earned, but expected pension benefits that have not yet been earned can be changed for the future. This permits companies to alter future pension benefits in order to respond to changing business conditions, such as increased global competition, threats of layoffs or bankruptcy, or worker preference for other types of benefits.³⁹ It is an option, however, that is used cautiously because of the potential ill will it could engender with employees and the negative connotations it could hold for recruitment of new ones. From this perspective, converting to a hybrid pension should not be prohibited as long as the benefits that participants accrued under the old plan are protected, as required by current law.⁴⁰

Realizing that hybrid-plan conversions can disrupt future benefit expectations for certain older workers, many companies have structured their conversions to hybrid plans to help

³⁵See footnotes 25 and 27.

³⁶Watson Wyatt, p. 2; Mellon Financial Corporation, p. 12.

³⁷See American Benefits Council, "Pensions at the Precipice," p. 10; Delaplane, p. 11.

³⁸See footnote 23.

³⁹American Benefits Council, "Pensions at the Precipice," p. 13.

⁴⁰In some hybrid-plan conversions, the participant's opening account balance is less than the value of the benefits accrued under the prior plan on the conversion date. Until the new account catches up to the old benefit level – often referred to as the "wear-away" period or a "benefit plateau" – the participant is entitled under current law to receive the higher of the two benefit levels. Treasury Blue Book, p. 81; Delaplane, p. 7.

participants who might realize smaller future benefits under the new plan. In fact, a 2004 survey found that 90 percent of companies that converted to hybrid pensions provided special transition benefits.⁴¹ These benefits include grandfathering older workers into the prior plan, giving participants the choice of the old plan or the new hybrid plan, or providing participants with extra transitional contributions to their accounts.

While transition benefits make good business sense, requiring them by statute does not. Doing so would effectively change the law to compel employers to continue paying benefits in perpetuity once a pension plan is established, effectively converting future benefit expectations into legal rights. That result would be devastating to pension sponsorship in this country. To quote one of the leading pension-policy groups: “If forced to make such unalterable benefit commitments, prudent businesspeople will simply choose to make minimal benefits promises or abandon the voluntary defined-benefit system altogether.”⁴²

The Administration’s Hybrid-Plan Proposal

The Administration’s Fiscal Year 2006 budget includes a proposal concerning hybrid-pension plans. With respect to the validity of hybrid-plan design, the Administration offers a reasonable solution: A hybrid plan, like a cash-balance plan, does not violate the age-discrimination rules if it “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.”⁴³

On the issue of hybrid-plan conversions, the Administration proposes to create a safe harbor that would protect converted hybrid-pension plans.⁴⁴ To qualify, a new cash-balance plan, for example, would have to provide its participants with benefits that are at least as valuable as the benefits the participants would have earned under the old traditional defined-benefit plan if the conversion had not occurred. These equal benefits would have to occur for each of the first five years following the conversion.

The safe-harbor aspect of the Administration’s proposal is problematic because it would alter a fundamental aspect of pension law. If enacted, this proposal would, for the first time, mandate future benefits under a pension plan. As a result, companies would have limited ability to adjust future benefits in response to economic and business changes through a conversion to a different type of pension plan, such as a cash-balance arrangement. Moreover, this proposal could create a slippery slope that leads to a requirement that companies with defined-benefit plans provide specific future benefits even if a conversion does not occur.

In short, this change will dramatically change the risk calculus for companies sponsoring defined-benefit plans. A likely result will be that many current and potential plan sponsors will shy away from offering such benefits, potentially threatening the ability of millions of Americans to secure their retirement income.

⁴¹Mellon Financial Corporation, p. 11; Watson Wyatt, p. 4.

⁴²American Benefits Council, “Pensions at the Precipice,” p. 13.

⁴³Department of Treasury, General Explanations of the Administration’s Fiscal Year 2006 Revenue Proposals (“Treasury Blue Book”), February 2005, p. 84 – <http://www.treas.gov/offices/tax-policy/library/bluebk05.pdf>.

⁴⁴Treasury Blue Book, p. 83.

A second problem with the Administration’s hybrid plan proposal is that it would only apply prospectively⁴⁵ – in other words, it would not resolve the legal status of existing hybrid plans.⁴⁶ Their status would continue to depend on the federal courts considering cases brought against such plans, which to date have produced conflicting results.⁴⁷ And, because the Supreme Court is not obligated to resolve those differences, a uniform resolution to the legal status of existing hybrid plans is nowhere in sight.

In the end, Congress must clarify the status of hybrid-pension plans as soon as possible to remove the threat to the retirement-income security of millions of participants affected by the current legal uncertainty. Moreover, Congress should make such clarification apply to all hybrid plans – new and existing ones. A prospective solution only prolongs the uncertainty for more than 7 million participants of existing hybrid plans.

Conclusion

With Social Security reform as a national priority, Congress has an important opportunity to take a broader view. By addressing the issue of retirement-income security for Americans, Congress can provide comprehensive solutions, including steps to enable employers to strengthen and expand the private-pension system in this country.

The absence of clear legal standards concerning hybrid-pension plans places the retirement income of millions of Americans at a greater risk. Left unresolved, the likely upshot will be an acceleration of companies eliminating their defined-benefit pensions, not to mention the collateral effect it will have on the PBGC – fewer defined-benefit plans contributing to the agency’s insurance fund, which already faces financial strains.⁴⁸ To avoid these outcomes and help Americans secure their retirement income, Congress should act this year to address the myriad pension issues facing the nation, including the legal status of hybrid-pension plans.

Prepared by RPC Policy Analyst Mark Warren, 224-2946

⁴⁵Treasury Blue Book, p. 84. The Administration recommends that the legislative history provide that the prospective relief would create no inference as to the legal status of hybrid plans and conversions under current law.

⁴⁶These hybrid plans were created in reliance on the legal authorities in place at the time, and many sponsoring companies received determination letters by the Internal Revenue Service approving their plans. Larry Zimpleman, Principal Financial Group, in testimony before the Senate Committee on Finance, March 1, 2005, p. 11 – <http://finance.senate.gov/hearings/testimony/2005test/lztest030105.pdf>; Delaplaine, p. 7.

⁴⁷See footnotes 24 and 25. Differing interpretations by the courts also enable plaintiffs to “cherry pick” the jurisdiction in which to bring their suit against a hybrid-pension sponsor in order to achieve the most favorable result. The resulting class-action lawsuits simply add to the financial strains that many companies are facing with respect to their pension plans and further jeopardize the participants’ retirement benefits. See Delaplaine, pp. 12-13.

⁴⁸For a discussion of the financial challenges facing the PBGC, see the second paper in this series, “Retirement-Income Security: Strengthening the Private-Pension System,” – <http://rpc.senate.gov/files/Apr0705RetIncomeSecMW.pdf>.