



**THE ERISA INDUSTRY COMMITTEE  
SUMMARY OF CONSENSUS ON  
LEGISLATIVE PROPOSALS  
AFFECTING HYBRID PENSION PLANS  
August 10, 2004**

**INTRODUCTION:**

- ◆ **Congress should promote the creation and continuation of voluntary employer-sponsored retirement plans.**
- ◆ **Congress should foster the development and continuation of defined benefit retirement plans** by giving employers the flexibility they need to maintain defined benefit plans that meet employer and employee needs. Virtually all private sector defined benefit plans –
  - provide that employees earn benefits automatically without being required to make contributions,
  - protect employees against investment risk,
  - provide benefits that are guaranteed by the PBGC, and
  - provide that the normal form of benefit distribution is an annuity.
- ◆ **Hybrid defined benefit plans, such as cash balance and pension equity plans, meet the needs of many employers and employees in the 21st Century, including many older employees.**
  - They are the only type of plan that is stimulating greater interest among employers in retaining and expanding defined benefit plans.
  - They allocate benefits more evenly among long-service and short-service employees than do many traditional plans.
  - They are particularly attractive to women and other workers whose careers are interrupted to raise a family or for other reasons.
  - They are work-neutral: they do not penalize an employee for terminating employment before reaching retirement age
    - This helps not only employees who choose to change employers but also employees who are involuntarily laid off.
    - Benefits continue to grow even after an employee terminates.
  - They are work neutral: they do not penalize an employee for working beyond normal retirement age.
    - The value of the benefit for an older employee increases at the same rate

- both before and after normal retirement age.
- By contrast, under a traditional defined benefit plan, especially a plan that offers subsidized early retirement benefits, the economic value of an employee's benefit can actually decline when an employee works past the plan's early or normal retirement age.
- They provide benefits that employees understand and appreciate.
- They provide that the normal form of benefit distribution is an annuity.
- Most provide portable benefits that may be rolled over, on a tax-deferred basis, to an IRA or to another employer's plan for continued retirement savings.

◆ **In adopting hybrid plans, employers have reasonably relied on Government guidance, which has indicated on a number of occasions that hybrid plans are lawful.**

- Preamble to the final § 401(a)(4) regulations.
- Regulatory safe harbor for cash balance plans; *see* Treas. Reg. § 1.401(a)(4)-8(c)(3).
- Notice 96-8.
- IRS determination letters.

## **GENERAL PRINCIPLES:**

**A Any legislation must not impair employers' ability to change or terminate their plans in the future.**

- Employers are not required to adopt benefit plans; they offer plans voluntarily as part of a package of compensation and benefits.
- If employers lose their ability to change or terminate their plans, many employers will, when faced with changing business or economic circumstances, be locked into existing plans that put them at a competitive disadvantage and that do not meet employees' needs -- jeopardizing the employer's viability, the future employment of its employees, and the employer's ability to provide benefits to retirees in the future.
- If employers become concerned that they will not be able to change or terminate their plans in the future, they will terminate their existing plans and will not adopt new plans.
- There is no basis for enacting legislation to assure that "employee expectations" regarding the future of a pension plan are realized. Because pension plans are frequently modified, both to include enhancements and to limit or reduce the benefits to be earned in the future, there is a wide range of "employee expectations;" no single hypothetical "employee expectation" could serve as the basis for any such legislation.

**B Employees are adequately protected by current law, which prevents an employer from amending a pension plan to reduce accrued benefits or reducing vested rights.**

- Current law not only prohibits an employer from amending a plan to reduce the

pension benefits that employees have already earned, but also requires the plan, after it has been amended, to continue to give employees credit for their service for purposes of qualifying for any early retirement subsidy that applies to the pension benefits that the employees had earned at the time of the plan amendment.

- For example, if an employer amends a pension plan to provide that pension benefits earned in the future will not include an early retirement subsidy, employees are still entitled, after the amendment, to continue to earn service credit for purposes of qualifying for any early retirement subsidy that applies to the pension benefits they have already earned.

- C **Legislation must protect the past actions taken by employers as long as –**
- The plan’s benefit formula(s) was (were) not age discriminatory on their face, and
  - The plan complied with the anti-cutback rule.
- D **Legislation clarifying that hybrid plans are not inherently age discriminatory must be effective both retroactively and prospectively.**

## SPECIFIC PROPOSALS

1. **Compliance with Age Discrimination Law.** Confirm, both retroactively and prospectively, that plans that recognize the time value of money, such as cash balance plans, pension equity plans, contributory defined benefit plans, indexed career pay plans, and variable annuity plans, are not age discriminatory.
  - a. Enact legislation that states that a plan may not decrease or stop the accrual of benefits based on the attainment of a particular age. This would not prohibit a cessation or reduction of a participant’s accrual rate for reasons other than age (*e.g.*, because of a benefit limit, a ceiling on credited service, or a plan amendment that reduces the plan’s accrual rate).
    - i. Focus is on text of the plan; and
    - ii. Mathematical testing is not required.
2. **Standards Applicable to Conversions.** With respect to the age discrimination standards that apply to conversions of traditional plans to hybrid plans, a conversion would comply with the age discrimination standards if each of the following requirements was satisfied:
  - a. Neither the old benefit formula nor the new benefit formula discriminated, on its face, on the basis of age (*i.e.*, neither formula provided that a participant stopped earning benefits, or started earning benefits at a lower rate, once the participant attained a particular age); and
  - b. The conversion did not violate the anti-cutback rule as in effect on the date of the conversion.

3. **Elimination of Whipsaw.** Legislation should eliminate whipsaw both prospectively and retroactively (excluding cases that have been finally resolved).
4. **Amendments to Anti-backloading Rules.** Legislation should amend the anti-backloading rules, both prospectively and retroactively, to provide that if a plan provides participants with the benefit produced by two or more alternative formulas, the plan will comply with the anti-backloading rules if each of the formulas, tested separately, complies with those rules.
  - a. This allows an employer that converts its traditional defined benefit plan to a hybrid formula to offer generous transition benefits to affected plan participants.
5. **Offset for Benefits Provided by Another Plan.** The legislation should also clarify, both prospectively and retroactively, that if a plan provides for an offset for benefits provided by another plan, the plan will comply with the anti-backloading rules if the gross benefit formula (*i.e.*, before application of the offset) complies with the anti-backloading rules.
  - a. In the case of a floor-offset arrangement involving a defined benefit plan and a defined contribution plan, where the benefits under the defined benefit plan are offset by the actuarial equivalent of the benefits under the defined contribution plan, the defined benefit plan complies with the anti-backloading rules if its gross benefit formula (*i.e.*, before application of the offset) complies with the anti-backloading rules.
6. **Nondiscrimination Rules.** The legislative history should direct the Treasury not to revisit the nondiscrimination testing issue raised by the proposed § 401(a)(4) regulations that the Treasury has withdrawn.
  - a. Because hybrid plans are defined benefit plans, it should always be permissible to test them as defined benefit plans under § 401(a)(4) as well as to cross-test them as defined contribution plans.
7. **Determination Letters.** The legislative history should direct the Treasury to begin issuing, by a date certain, determination letters to plans that have been converted from traditional designs to hybrid designs.

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