A Pension Double Header: Reforming Hybrid and Multi-Employer Pension Plans
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Testimony

SUMMARY

1. AARP believes cash balance plans have a role to play in the private pension system if – and only if – they are designed and adopted in a manner that protects the millions of older workers who have given up wages in exchange for traditional defined benefit pensions. Provided that protections for older and longer-service workers can be adopted, AARP could support the enactment of a reasonable legislative solution that would provide legal certainty for cash balance plans.

2. Traditional defined benefit pension plan designs typically provide only small benefits early in a worker's career, and larger benefits later in the career for those who devote much or all of their working lives to the company. It is therefore unfair for employers that have sponsored this type of plan for years to pull the rug out from under older workers by eliminating these promised larger, late-career benefits just when long-serving workers are about to obtain them. Yet that is precisely the damage caused by conversions of traditional pensions to cash balance plans – unless older workers are given appropriate transition relief to address the impact of the "pension pay cut" brought about by conversions.

3. When conversions change the rules in the middle of the game, older, longer-service workers are the most vulnerable. They generally have less time to accumulate benefits under a new cash balance formula, are less able to leave their current job if benefits are cut because they typically have fewer job prospects, and are less able to adjust to changes that may dramatically reduce their retirement security (for example, they have less time to adjust by increasing their saving for retirement).

4. Worker outrage, adverse publicity and legal concerns have increasingly caused plan sponsors converting to cash balance plans to recognize the harm to older workers and to put in place more protective transition provisions. Congress should, in effect, codify the better practices many employers have already put in place in order to legitimize cash balance plans and protect older workers.

5. However, Congress should not legitimize conversions of a type that many employers have themselves found to be unfair and harmful to older, longer-service employees. The steps many employers have taken in conversions to preclude wearaway of benefits and to give older workers "choice" or "grandfathering" in the traditional plan formula and other protections have raised the bar with respect to cash balance conversions. Congress must

not now lower the bar by enacting weakening legislation that invites the market to return to the lower standards of the 1990s. Instead, Congress needs to hold all companies that voluntarily choose to convert to a cash balance plan to a standard many companies have been willing and able to meet on their own.

6. The cash balance format deserves protection from legal challenge only if it protects older workers from the harm caused by moving to that structure. We look forward to finally resolving this issue through legislation that will strengthen defined benefit pension plans, protect older workers, resume the IRS determination letter process, and address the legal uncertainty surrounding cash balance plans.

Chairman Dewine, Ranking Member Mikulski, distinguished Members of the Subcommittee, I am David Certner, Director of Federal Affairs, of AARP. AARP is a nonprofit membership organization of over 35 million persons age 50 or older, about 45% of whom are still working. AARP fosters the economic security of individuals as they age by seeking to increase the availability, security, equity, and adequacy of pension benefits. AARP and its members have a substantial interest in ensuring that participants have access to pension plans that provide adequate retirement income and that the benefits accrued under a plan are not reduced because of age.

I. WHAT ARE CASH BALANCE AND OTHER HYBRID PLANS?

Congress provided a detailed structure in defining retirement plans under ERISA and the Internal Revenue Code (“IRC”). All retirement plans are either defined benefit plans or defined contribution plans, even if they have features of both. A defined contribution (or “individual account”) plan provides an individual account for each participant, with the benefits at retirement consisting of contributions the employer and employees have made, plus income and gains, and minus expenses, losses, and forfeitures. [ERISA section 3(34)]. A defined benefit plan is defined as any retirement plan other than an individual account plan. [ERISA section 3(35)]. Traditionally, the benefit at retirement under a defined benefit plan is based on a benefit formula that takes into account years of service and, under many plans, final salary or wages.

Recognizing that defined contribution plans and defined benefit plans – and their methods of accruing or accumulating benefits -- are fundamentally different, Congress prescribed a different set of rules for each (including rules governing the timing of benefit accruals, valuation of benefits, certainty of benefit determinations, and expression of accrued benefits). A plan sponsor may not pick and choose which rules to follow, but must follow all the rules depending upon the plan design selected.

Cash balance pension plans (and other plans, such as pension equity plans) are so-called “hybrid” plan designs. Cash balance plans are defined benefit plans that have been designed to resemble defined contribution plans. Instead of presenting the benefit in terms of an annuity payable at retirement, as traditional defined benefit plans do, cash balance plans portray a participant's benefit as a lump sum amount that increases over time, and, in practice, pay most benefits in the form of lump sums.

In most cash balance plans, the benefit is defined by reference to a "hypothetical account." The hypothetical account is credited with an annual pay credit (usually a percentage of pay, such as 5% of pay each year) plus a hypothetical rate of return (usually tied to an index, such as a Treasury bond rate) on the account balance (an "interest credit"). As in all defined benefit plans – and consistent with the hypothetical nature of these "individual accounts" – the employer contributes assets to the plan, the assets are invested for the plan as a whole instead of earmarking particular assets or investments for the individual accounts of particular participants, the employer (including those to whom it delegates) manages the plan, and the employer is permitted flexible funding. This means that, at any given time, there may be more benefits promised in the hypothetical accounts than there are assets in the plan.

The employer's contribution obligation depends upon its estimate of the present value of total future benefit obligations and its investment gains and losses, not on fixed or promised annual contributions to individual accounts. Employers generally benefit from the "spread" between what the employer promises in interest credits and what the plan actually earns (the interest arbitrage) while assuming the investment risk if asset returns are less than needed to pay promised benefits. Since defined benefit plan rules allow for flexible funding, any investment shortfall can be made up over several years.

AARP also has long questioned the legal basis for the hybrid cash balance formula itself (in addition to the significant age discrimination issues that arise when employers convert defined benefit pension plans to a cash balance formula). We believe that a careful review of the legal distinction between defined benefit and defined contribution plans makes clear that the most common designs for hybrid cash balance plans do not fit within the current legal framework of the Internal Revenue Code (IRC), the Age Discrimination in Employment Act (ADEA) and ERISA (see Appendix A). In fact, the recent court decision in Cooper v. IBM agreed with this legal analysis. We urge the Committee to address the legal framework for cash balance plans and provide strong and effective protections for older workers involved in cash balance pension plan conversions.

II. CONVERSIONS OF TRADITIONAL PLANS TO CASH BALANCE PLANS

The growth of cash balance plans has resulted mainly not from new plan formation but from conversions of existing traditional defined benefit plans. Employers have converted to cash balance and other hybrid plan designs for a number of reasons, including a desire to reduce plan costs and limit future pension obligations as the bulge of "baby boomers" nears retirement and hence moves through the years of greatest pension cost to employers (and greatest pension value to employees); to increase employee appreciation (since many employers believe employees do not well understand or appreciate the traditional defined benefit plan); to eliminate costly early retirement subsidies and final average pay features; to increase pension surpluses that, in the 1990s, often contributed to reported corporate earnings; to redistribute benefits under the plan from older, longer-service employees to younger and newer workers; and to achieve these objectives without terminating the defined benefit plan and adopting a new defined contribution plan, which often would entail income and excise taxes and would terminate the interest arbitrage.

In general, the direct and immediate result of a conversion of a traditional plan formula to a cash balance formula is a reduction in future benefits for older workers. A 1998 survey by the Society of Actuaries found that in cash balance conversions, the average benefit reduction for an older employee was 70% to 85% of one year's wages, but younger workers saw a benefit increase of 10% to 40% of one year's wages. Moreover, the actuaries that design cash balance plans have been on record acknowledging that conversions to cash balance formulas “help employers cut pension benefits and change retirement plans,” especially for older workers. Ellen E. Schultz, Actuaries Become Red Faced Over Recorded Pension Talk, Wall St. J., May 5, 1999, at C-1. Indeed, plan actuaries have at times bluntly acknowledged this reality.

III. HOW CONVERSIONS HARM OLDER WORKERS: THE PENSION PAY CUT THAT BREAKS THE PENSION PROMISE

A. The General Adverse Impact on Older Workers from Conversion to a Cash Balance Pension Plan

For employees, the change in plan design from a traditional defined benefit pension plan to a cash balance plan can have significant impact. For older workers, absent transition relief, it is almost always highly detrimental, amounting to a significant “pension pay cut.”

By depriving older workers – especially long service older workers – of the benefit of their increased years of service and their peak earning years (including any early retirement subsidies), employers who make this dramatic change break the implicit promises made to older workers in the traditional defined benefit pension plan. These employees have given up wages and may have made career and retirement decisions based upon the expectation of a certain pension benefit, only to see that expectation disappear -- replaced by the new cash balance plan formula under which their age precludes them from earning comparable benefits.

In addition, some older workers may suffer a wearaway period – a period of time when no new benefits are accrued under the new plan. Older workers thus experience a double whammy – loss of the more beneficial defined benefit formula, as well as the lack of time to benefit from the new plan formula (with the potential for no new benefits at all).

B. The Specific Adverse Impacts on Older Workers from Conversion to a Cash Balance Pension Plan

The conversion to a cash balance plan adversely affects older, longer service workers in at least four ways:

1. Conversion deprives older workers of the benefits derived from long service and a higher salary they would have received in the traditional defined benefit plan.

A traditional defined benefit plan often has a benefit formula that is based on number of years worked and final average salary. In addition, the annuity value is determined by number of years from retirement age, with greater value for those closest to normal retirement age. This final average pay benefit formula design provides smaller value in the early years of employment, with the greatest value coming in the last years of employment.

Because this plan is designed to benefit longer service workers, older workers generally can accrue larger benefits under this traditional type of formula, especially if they are long-service workers. Younger, more mobile workers receive less from this plan design. A younger worker covered by a traditional formula, in addition to being many years from retirement age, generally has a lower salary and a smaller number of years of service. The result is a small benefit after only a few years of work. As one begins to approach retirement age, and as one's salary and number of years in the plan increase, benefits begin to grow more dramatically. The bulk of benefits can be expected in the years just prior to retirement.

2. Conversion deprives older workers of early retirement subsidies often provided in traditional plans.

The effect of increasing age and higher salary can be magnified by eligibility for an early retirement subsidy. Many traditional defined benefit plans include such a subsidy, generally based on a combination of number of years of service and age. Older employees who become eligible for these subsidies can see an additional spike in the value of their pensions. Conversions commonly eliminate these subsidies.

3. Depending upon the conversion formula, older workers may be subject to a significant wearaway, causing them to work for many years before earning any additional retirement benefits.

Compounding the adverse impact of the change in benefit formula, the benefits under the new plan, in essence, may take many years to catch up to the benefits already earned under the old plan formula. During this catch-up period, the employee would accrue no new benefits. This freeze of pension accruals stands in sharp contrast to employees' expectation that their final years of service would result in the greatest increase in their retirement benefits.

Such a wearaway can occur if the employer designs the conversion to give employees an ultimate pension benefit equal to the greater of (i) their old formula benefit (earned based on service before the conversion and fixed as of the conversion) and (ii) their cash balance earned under the new formula. Under this "greater-of" approach, as long as the frozen old formula benefit exceeds the new formula benefit, the participant is not actually earning any additional benefits under the plan. The participant's total benefit is effectively frozen after the conversion until the new formula benefit grows larger than (wears away) the old. This could take 10 years or more. In the meanwhile, older participants suffer an age-based cessation of accruals.

A wearaway can affect participants who retire early as well as those who retire at the "normal retirement age" (typically 65). This is especially true if the old benefit formula provided a subsidized early retirement benefit before the conversion. In such a case, a participant who qualifies for the early retirement subsidy (before or after the conversion) might experience a period of years after conversion in which continued service for the plan sponsor generates no net increase in the early retirement benefit. This freeze of early retirement accruals would continue for as long as the new-formula (cash balance) benefit the participant would receive at early retirement age remains less than the old-formula benefit she would receive at that age.

Older participants commonly will have more to lose from wearaway of subsidized early retirement benefits than from wearaway of the normal (typically age 65) retirement benefit. There may be more dollars at stake, and most employees retire before age 65.

Wearaway is neither required nor necessary in a conversion. In any event, because wearaway is always based in part on age, it runs afoul of the prohibitions against age discrimination. A plan sponsor can, and often does, prevent wearaway by providing that the ultimate plan benefit is the sum of the participant's benefits accrued under the traditional plan (the old formula frozen benefit) and the cash balance formula. (This is often referred to as the "sum-of" or "A+B" approach.)

4. Older workers are disadvantaged because they have fewer years in which to accumulate significant pension amounts under the cash balance formula.

A typical cash balance formula provides for a much larger accrual of benefits at an earlier age than a traditional defined benefit plan. Since a younger employee has a longer period of time before normal retirement age, the amount in the plan's hypothetical account will continue to earn interest credits for a much longer period of time, leading to greater benefits. Fewer years until normal retirement age means older workers have less compounding and thus smaller benefits.

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As a result, the conversion to a cash balance formula has the practical and substantive effect of often dramatically reducing or ceasing accruals to the pensions of older and/or long service workers. Older employees have reported reductions in their expected benefits in the tens and even hundreds of thousands of dollars. In contrast, younger mobile workers, who had accumulated little under the prior plan design, may see a higher accrual rate.

In the early years of the traditional plan, an employee receives small benefits in return for the promise of greater benefits as the employee continues to work. The change in plan design to a cash balance plan undermines completely that benefit trade-off. Older workers find that having completed those years in the traditional plan when benefits were small – and having now reached the stage when benefits will begin to grow considerably – the conversion to the cash balance plan deprives them of those expected higher benefits. These conversions give new meaning to the term “sandwich” generation.

The pension laws generally prohibit plans from reducing accrued benefits that an individual has previously earned. However, the law does not require an employer to continue any particular plan design, nor indeed even continue any plan, into the future. The conversion to a cash balance plan uses this permissive nature of our voluntary pension system in a way that undermines the expectations of employees. Despite having worked for years under a plan design that gave small benefits at the beginning but promised higher benefits at the end of one’s career, the same employees are suddenly switched to a pension package that provides the very opposite. Unlike reductions in benefit formulas in which everyone may feel the pain equally, a conversion to a cash balance plan (absent special transition relief) produces clear winners and losers (the losers being the older, longer-serving employees). And, in some cases, this has been done in a manner that has masked the actual negative effects (as discussed earlier), at least for a time.

IV. WEARAWAY IN A CONVERSION IS AGE DISCRIMINATORY

The wearaway period often associated with cash balance conversions – the period of time after the conversion when no benefits are earned – is an unlawful and impermissible reduction or cessation in benefit accruals based on age. Because calculation of a wearaway following a conversion is based directly on age, it violates the pension accrual laws. While age is not the only factor in determining wearaway, it is always an essential element. See Appendix A.

V. BETTER PRACTICES BY PLAN SPONSORS

The harm to older workers caused by cash balance conversions has given rise to outrage on the part of older and longer-service employees who have been affected and a higher level of awareness by other employees, including those potentially affected by future conversions. (In some cases, employee anger has been exacerbated by the fact that some conversions have imposed painful reductions in future benefits – including wearaways on older workers -- even when the plan had substantial surplus assets, and the gains in pension surplus associated with this “pension pay cut” were used to improve reported corporate earnings and consequently increase performance-based executive pay.) The damage caused by conversions that pulled the rug out from older and longer-serving employees has also generated considerable adverse publicity, public and employee relations problems for plan sponsors, and major court challenges to the legitimacy of cash balance plans and practices.

As controversy erupted over cash balance conversions, the Internal Revenue Service in the fall of 1999 suspended its issuance of determination letters approving cash balance plan conversion amendments. Treasury and IRS announced that they were reviewing the age discrimination and associated legal issues raised by conversions, and received hundreds of public comments.

This controversy and related developments convinced many plan sponsors to address the transition problems raised by conversions. While conversions in previous years were often unprotective, many employers have more recently addressed the transition issue by providing relief to their older, longer-service workers. More and more companies – fearful of negative media attention and the reaction of a more knowledgeable workforce, and concerned that their actions might be age discriminatory or otherwise unlawful – have designed more and better transition protection. This protection has come in a number of forms. Many companies have simply permitted their older employees the option of staying under the old formula, while others have automatically grandfathered older and/or longer-serving employees in the old formula. Some, like CSX, whose CEO at the time was Treasury Secretary John Snow, did not apply the conversion to any existing employees. Other companies have provided added benefit protections such as significantly higher pay credits or opening balances for older workers. In short, many in the private sector have responded to the problems with cash balance conversions by raising the bar for transition protection.

VI. ACTIVITY IN THE EXECUTIVE BRANCH, CONGRESS, AND THE COURTS

In December 2002, Treasury and IRS proposed regulations that would have given a green light to plan sponsors to again convert their traditional plans to cash balance plans without adequate protection for employees. (67 Fed. Reg. 76123). The proposed regulations would have protected the cash balance design under the age discrimination and other statutory provisions without adequately protecting participants. The regulations had they become final would, in effect, have blessed conversions that are not protective--thus plan sponsors would have been less likely to offer their employees choice, grandfather employees in the old plan formula, or use other protective practices that many companies had already adopted. Worse yet, the regulations would have permitted age-based wearaway periods, a practice clearly contrary to the letter as well as the spirit of the age law, and simply bad retirement policy.

In 2003, many thousands of individual contacts regarding the proposed regulations were made to Treasury by workers concerned about the impact of conversions on their pension benefits. (Over 60,000 contacts were made to Treasury and elected officials through the AARP web site after the proposed regulations were issued.) In July 2003, while Treasury was considering comments on its regulatory proposal, a federal district court ruled that the basic common cash balance plan design impermissibly reduced the rate of benefit accrual on the basis of age and thus violated ERISA’s age discrimination provisions (Cooper v. IBM Personal Pension Plan and IBM Corp., 274 F. Supp. 2d 1010 (S.D. Ill. 2003)). (See Appendix A.) IBM appealed the decision to the Seventh Circuit Court of

Appeals, where the appeal is still pending.

Following the IBM decision, Congress responded to Treasury's proposed regulations by passing amendments to the Treasury appropriations legislation that, directed Treasury and IRS to stop work on the regulations and instead to put forward a legislative proposal providing transition relief for older and longer-service participants affected by cash balance conversions. In response, Treasury withdrew the proposed regulations and made a legislative proposal (included in the Administration's FY 2005 and FY 2006 budgets). We were pleased that Treasury's legislative proposal recognized the problem with wearaway and the unfair treatment of older workers and recommended a ban on any wearaway of benefits at any time after a cash balance conversion.

In recognition of the transition problem faced by workers, the Treasury proposal also included a five-year "hold harmless" period after each cash balance plan conversion. This would require that each participant's benefits under the cash balance plan for each of the five years after the conversion be at least as valuable as the benefits the participant would have earned under the traditional plan had the conversion not occurred. While the proposal is a step in the right direction, it is not sufficiently protective of older, longer-service workers, and it fails to reflect ongoing trends in the marketplace. In addition, because the transition problem is largely one that impacts older and longer service workers, any proposal can be tailored more narrowly to protect this more vulnerable class of workers. More recent conversions have afforded more protection to older workers. These trends, not adequately reflected in Treasury's proposal, are further confirmation that employers can and should do the right thing for their employees. Instead of lowering the bar, Congress now needs to hold all companies that voluntarily choose to convert to a cash balance plan to a standard that many companies have been willing and able to meet on their own.

One approach that AARP has supported was introduced by Senator Harkin in the 108th Congress. It would require employers that convert to cash balance plans to allow employees who are at least age 40 or have at least 10 years of service the choice to remain under their traditional pension formula until retirement instead of switching to cash balance. In addition, other approaches have been discussed, such as choice or grandfather treatment for employees whose combined age and service exceed a specified number of "points" (e.g., 55).

VII. WHAT CONGRESS SHOULD DO NOW

AARP believes hybrid plans have a role to play in the private pension system if – and only if – they are designed and adopted in a manner that protects the millions of older workers who have given up wages in exchange for traditional defined benefit pensions. Provided that protections for older and longer-service workers can be adopted, AARP could support the enactment of a reasonable legislative solution that would provide legal certainty for cash balance plans.
Legislative protections should codify the better practices that many employers have already chosen to follow when converting to cash balance, such as eliminating wearaway

of early as well as normal retirement benefits and adequate grandfathering or hold-harmless protection for those workers who are vulnerable in conversions. Treasury's proposal is a step in the right direction. However, its five-year hold harmless period falls short of what would be adequate and of the better practices many employers have followed. At the same time, the more adequate protections could be crafted to preserve flexible options for plan sponsors. Among other things, the protections could appropriately be limited to a narrower class of employees than the Treasury proposal would cover – to those employees whose age and years of service exceed a specified level. In addition, we are open to considering other alternatives that adequately protect older, longer-service employees.

Of course, AARP would oppose legislation that would legitimize hybrid plans that are unfair and harmful to older, longer-service employees. The cash balance structure deserves protection from legal challenges only if it protects older workers from the harm caused by moving to that structure. Now that many employers have recognized the harm and have raised the bar by providing reasonable protections, Congress must not now lower the bar by enacting weakening legislation that invites the market to return to the lower standards of the 1990s. Instead, Congress now needs to hold all companies that voluntarily choose to convert to a cash balance or other hybrid plan to a standard that many companies have been willing and able to meet on their own.

We look forward to working with Congress, the Administration, employees and retirees, plan sponsors, and other stakeholders to forge legislation that will strengthen defined benefit pension plans, protect older workers, resume the IRS determination letter process, and address the legal uncertainty surrounding cash balance pension plans.

APPENDIX A

CASH BALANCE PLANS VIOLATE THE AGE DISCRIMINATION LAWS BECAUSE THE RATE OF BENEFIT ACCRUAL DECREASES ON ACCOUNT OF AGE

Cash balance plans that incorporate a uniform allocation or interest credit rate formula – as they typically do – violate section 411(b)(1)(H) of the Code and the counterpart provisions of the ADEA and ERISA (ADEA section 4(i) and ERISA section 204(b)(1)(H)) because benefits accrue at a lower rate for older employees than they do for younger employees. See Cooper v. IBM Personal Pension Plan and IBM Corp., 274 F. Supp. 2d 1010 (S.D. Ill. 2003).

Cash balance plans reduce the rate of benefit accrual based on age in two ways. The first is the age-based reductions in benefit accrual rates inherent in the cash balance formula itself. This age-based decline in accrual rates affects all employees in a cash balance plan. The second is reductions in accrual rates suffered by older workers under the cash balance plan when compared to the old plan (due either to a wearaway or to the lower rate of accrual in the cash balance plan).

Because calculation of a wearaway following a conversion is based directly on age, it violates the pension accrual laws. While age is not the only element in determining wearaway, it is an essential element in determining the actuarial equivalence of the earned benefit. Moreover, declining accrual rates in cash balance plans based on age are the diametric opposite of the often increasing accrual rates in traditional defined benefit pension plans. For this reason, conversions to cash balance pension plans can have a dramatic impacts on the retirement security of older employees.

APPENDIX B

LEGISLATION SHOULD PREVENT THE POST-CONVERSION WEARAWAY OF EARLY RETIREMENT BENEFITS

1. Early Retirement Wearaway Should Be Prevented By Use Of The Sum-Of Approach For Subsidized Early Retirement Benefits.

As noted, a wearaway period can occur if, as is often the case, the traditional defined benefit plan provided a subsidized early retirement benefit before the conversion. In such a case, a participant who qualifies for the early retirement subsidy (before or after the conversion) might experience a period of years after the conversion in which continued service for the plan sponsor generates no net increase in the early retirement benefit because the value of the new-formula benefit at early retirement age remains less than the value of the old-formula benefit at that age.

Any cash balance plan legislation should make clear that this type of wearaway period (an “early retirement benefit wearaway”) as well as normal retirement benefit wearaway – is prohibited. Early retirement benefit wearaway can affect many participants in converted plans, including those who are subject to a wearaway of their normal retirement benefit. The harm to older workers and the age discrimination concerns raised by the normal retirement benefit wearaway also apply to the early retirement benefit wearaway. Moreover, an early retirement benefit wearaway can continue long past the time when a normal retirement benefit wearaway has ended.

The early retirement benefit wearaway can be prevented by grandfathering or by applying the “sum of” (or “A + B”) approach described above to early retirement benefits. (This could be done in tandem with a similar approach to normal retirement benefits or an adequately protective “greater of” approach with an appropriate opening account balance for normal retirement benefits.) As a result, a participant who retired while entitled to a subsidized early retirement benefit under the old formula would receive the sum of that subsidized early retirement benefit annuity and the excess of the cash balance account over its opening account balance (in other words, the subsidized early retirement annuity plus the increase in the cash balance account).

Consistent with the nature of subsidized early retirement benefits, this approach would be contingent. It would not apply unless the participant was entitled to a subsidized early retirement benefit under the terms of the old plan formula at the time the participant took his or her benefit under the converted plan (whether the participant first qualified for the subsidized early retirement benefit before or after the conversion).

The plan sponsor could offer the participant the choice of taking the increase in the account balance as a lump sum, as opposed to taking it in the form of an annuity that is added to the old-formula subsidized early retirement annuity.

2. Incorporating The Early Retirement Subsidy In The Opening Account Balance Would Be Inappropriate.

Incorporating the value of the early retirement subsidy in the opening account balance would violate the prohibition against age discrimination. If the opening account balance were allowed to incorporate the value of the early retirement subsidy from the old formula, older participants could be given smaller opening account balances – and also smaller lump sum distributions upon retirement -- than otherwise identical younger participants who qualify for the early retirement subsidy. In addition, because the subsidized early retirement benefit is contingent, including the subsidy in the opening account balance of all participants could create substantial windfalls for those participants who ultimately do not qualify to receive the subsidy.