

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

Bill Number:

Hearing Date: June 7, 2005, 10:00 am

Location: SD430

Witness:

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Washington, DC

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Testimony

Chairman DeWine, Senator Mikulski, thank you very much for the opportunity to appear before you today. My name is James Delaplane, and I am a partner with the law firm of Davis and Harman LLP. I serve as Special Counsel to the American Benefits Council (Council), and I am appearing today on the Council's behalf. The Council is a public policy organization representing principally Fortune 500 companies and other organizations that assist employers of all sizes in providing benefits to employees. Collectively, the Council's members either sponsor directly or provide services to retirement and health plans covering more than 100 million Americans.

The Council is very pleased, Mr. Chairman, that you have called this hearing to examine the important policy issues involving hybrid defined benefit plans. Many of our members sponsor cash balance and pension equity plans, and the Council believes that the legal uncertainty currently enveloping these hybrid defined benefit plans is one of the most significant and pressing retirement policy issues presently before Congress. Congressional action to provide legislative clarity and certainty for hybrid plans is urgently needed to prevent (1) the demise of these plans, (2) the resulting exit from the defined benefit system by a large number of American employers, and (3) the harm to the retirement income prospects of millions of American families that will unquestionably result.

Mr. Chairman, we believe it is absolutely critical that the effort to craft hybrid legislation be led by the congressional committees of jurisdiction and we thank you for spearheading this effort. As you are well aware, pension policy is a notoriously complex and technical area, one in which it is easy to produce unintended results, such as disincentives for employers to remain in our voluntary pension system. The legislative process works best when those who are most knowledgeable about an area are the ones to tackle the complex issues. We applaud your commitment to avoid what has sometimes occurred in the past with respect to hybrid plans – haphazard and incomplete debate pursued outside of the committees of jurisdiction and as part of the appropriations process.

In my testimony today, I hope to convey the value of the defined benefit system and hybrid plans specifically for millions of Americans and their families. I will describe the current legal and regulatory landscape that is endangering the continued existence of hybrid plans, and set forth why the Council and its members believe congressional action is urgently needed to prevent the extinction of these retirement programs. Lastly, I will describe the Council's recommendations for resolving this hybrid pension crisis.

## The Value of the Defined Benefit System

The defined benefit pension system helps millions of Americans achieve retirement security. It does this by providing employer-funded retirement income that is guaranteed to last a lifetime. Employees are not typically required to make any contributions toward their benefits in these plans and the assets of the plan are managed by investment professionals. Employers, rather than employees, bear the investment risk of ensuring that plan assets are sufficient to pay promised benefits. And insurance from the Pension Benefit Guaranty Corporation means employees' retirement benefits are largely guaranteed even if the plan or the employer's business experiences financial trouble.

As of 1999 (the most recent year for which official Department of Labor statistics have been published), nearly 19 million retirees were receiving benefits from defined benefit plans, with over \$119 billion in benefits paid out in that year alone. Given that America's personal savings rate remains one of the lowest among industrialized nations and that average balances in 401(k) plans are quite modest, there is no doubt that in the absence of defined benefit pensions fewer Americans would be financially prepared for retirement. Furthermore, the absence of defined benefit pensions would result in increased strain on federal entitlement and income support programs, not to mention an increase in the number of American seniors living in poverty.

Given these statistics, the value of defined benefit plans to many American families is undeniable. Yet we have seen an alarming decline in defined benefit plan sponsorship and today is a particularly precarious time for the defined benefit system. Employers are increasingly exiting the defined benefit system for a variety of reasons, including uncertainty about how future pension liabilities will be measured, a flawed pension funding regime marked by complexity and volatility, the prospect of new and more onerous pension funding and premium requirements, potential changes to the rules governing pension accounting, and, most relevant for our discussion today, legal uncertainty surrounding hybrid defined benefit plans. Objective observers agree that policymakers must take action to address these threats to defined benefit plans and the income they provide to American retirees will become increasingly scarce.

Mr. Chairman, we know that in addition to addressing the hybrid pension issues that are the subject of today's hearing, this Subcommittee and the Congress as a whole will be spending considerable time in the months ahead considering potential reforms to the funding rules for defined benefit plans. The Council recently published its recommendations for pension funding reform, and we would welcome the opportunity in a future setting to visit with you and other members of the Subcommittee on these important defined benefit plan issues.

## The Specific Advantages of Hybrid Defined Benefit Plans

Hybrid plans are defined benefit pensions that also incorporate attractive features of defined contribution plans. The most popular hybrid plans are the "cash balance" design and the "pension equity" design. In a cash balance plan, employers provide annual "pay credits" to an employee's hypothetical account and "interest credits" on the balance in the

account. In a pension equity plan, employers provide credits for each year of service and these credits are multiplied by an employee's final pay to produce a lump sum figure. Hybrid plans not only offer the security of employer funding and assumption of investment risk, federal guarantees and required lifetime and spousal benefit options, but also show account balances in lump sum format, are portable, and provide for a more even benefit accrual pattern across a worker's entire career. Hybrid plan participants are able to reap these rewards typical of defined contribution plans without bearing any concomitant loss of security (i.e., a decline in account balance due to stock market conditions).

Employers like hybrid plans primarily because the benefits in the plans are so tangible to employees, resulting in greater appreciation of the pension program. In fact, a survey found that the dominant motives for employer conversions to hybrid plans were employee appreciation of the plan, facilitating communication with employees, and the ability to show the benefit amount in a lump sum format. Many assume that conversions are pursued to cut employer pension costs. While this has been the case for some companies, for most employers it is neither the rationale for the conversion nor the reality that results. We trust you will agree that when employers do conclude that costs must be reduced, it is better for them to retain an affordable defined benefit plan (and one that fits the realities of the modern workforce) than to not have one at all.

Hybrid plans and their level benefit accrual pattern are also effective in helping employers attract and retain employees in today's fluid job market where few individuals plan or expect to stay with one employer for a career. Employees likewise appreciate hybrid plans because they are more transparent, more portable, and deliver benefits more equitably to short, medium and longer-service employees than traditional pensions, while also retaining the favorable security features of the defined benefit system.

The unique value of hybrid plans in meeting employee retirement plan preferences is demonstrated in a recent survey. The survey reveals that workers prefer two retirement plan attributes above all others – the portability of benefits and benefit guarantees. It is only hybrid plans that can deliver both these advantages. Traditional defined benefit plans typically do not provide for portability, and benefits in 401(k) and other defined contribution plans are not guaranteed. Indeed, if policymakers were working from a clean slate to produce the ideal retirement plan today, they would likely develop a hybrid plan. Clearly, preserving hybrid plans as a viable pension design is critical if employers are to maintain retirement programs that meet employee needs and preferences.

Perhaps most important of all, studies show that nearly 80% of participants build higher retirement benefits under a hybrid plan than a traditional plan of equal cost. Why? Traditional defined benefit plans tend to award disproportionate benefits (often as much as 75% of total benefits under the plan) to employees with extremely long service. Yet very few employees spend a career with a single employer. Hybrid plans were designed to respond to this reality. The advantage of hybrid plans for most workers is confirmed by a recent study that shows that if an employee changes jobs just three times in the course of his career, she or he can expect to receive in excess of 17% more in retirement benefits

from participating in cash balance plans than if his or her employers had provided traditional plans instead.

The advantages of the hybrid plan are not reserved for younger workers. Even longer-service workers often fare better under a hybrid plan. One of the many ways in which hybrid plan sponsors address the needs of longer-service and older employees is by contributing pay credits that increase with the age and service of employees. Recent surveys show that 74% of cash balance plan sponsors provide pay credits that increase with age or service, while 87% of pension equity plan sponsors do the same.

Employers also devote significant energy and resources to developing transition assistance programs to help older and longer-service employees who may not accrue as much in benefits on a going forward basis under a hybrid plan as they would under the prior traditional plan. Successful conversion assistance techniques vary, but generally include one or more of the following: grandfathering some or all current employees in the prior pension plan, allowing certain employees to choose whether to remain in the traditional plan or move to the hybrid plan, providing whichever benefit is greater under either the traditional or new formula, providing additional transition pay credits in an employee's account over some period of time, or making extra one-time contributions to employees' opening account balances. Employers draw from these varying techniques and apply them to smaller or larger groups of employees as appropriate to suit the needs of their workforce and carry out the goals of the conversion. Studies conducted within the last few years show that employers provide older and longer-service employees with these special transition benefits in nearly all conversions. Indeed, employers' already significant focus on the needs of older workers has only increased in light of public and congressional interest in the effect of conversions.

As this data reveals, hybrid plans are proving extremely successful in delivering valuable, appreciated, and guaranteed retirement benefits to employees of all ages.

#### The Legal and Regulatory Landscape

Let me now turn to a discussion of the history of hybrid plans and how the current uncertainty in the legal and regulatory landscape came about. The first cash balance plan was adopted in 1985 and the first pension equity plan was adopted in 1993. For nearly fifteen years after adoption of the first cash balance plan, the Internal Revenue Service (IRS) regularly issued determination letters for hybrid plan conversions indicating that the plans and conversions satisfied all Internal Revenue Code requirements (including those related to age discrimination). In 1999, however, the IRS announced a moratorium on such letters partly in response to several high-profile conversions that were receiving significant congressional and media scrutiny. As a result of this scrutiny and after thorough review of the issues through numerous congressional hearings in the committees of jurisdiction, Congress in 2001 enacted legislation to require employers to provide a more detailed and more understandable advance notice to participants regarding any hybrid conversion (or any other defined benefit plan amendment) that significantly reduced future benefit accruals. At the time, some in Congress proposed various benefit mandates and design restrictions as a response to cash balance

conversions, but these proposals were all rejected. Congress concluded that the best response to the issues that had been raised was to ensure absolute transparency for employees about how their benefits would be affected by hybrid plan conversions.

Benefit Plateaus (“Wear-Away”). Let me now turn to a discussion of one of the conversion issues that has generated questions and concerns throughout the congressional review of hybrid plans – so called “wear-away.” At the outset, it is important to understand that parallel rules in ERISA and the Internal Revenue Code protect all benefits that an employee has already earned for service to date.

Thus, despite assertions to the contrary, existing benefits are never reduced in a hybrid plan conversion.

“Wear-away” is the term used for the benefit plateau effect that some employees can experience in conjunction with a cash balance conversion. When employers convert to a cash balance plan, they typically provide an opening balance in employees’ cash balance account. A benefit plateau results if the value of the employee’s cash balance account is less than the value of the benefit he or she accrued under the prior plan as of the date of the conversion. Until the value of the cash balance account catches up to the value of the previously accrued benefit, it is the higher accrued benefit to which the worker is entitled if he or she departs the company – hence the plateau. We believe that the term “wear-away” is, in fact, confusing and even misleading, as the employee always receives the higher of the two benefit levels and nothing earned is taken away. Thus, we use the term benefit plateau throughout the discussion below.

There have been three leading causes of this plateau effect in the conversion context.

- First, the plateau can result simply from a change in the rate of interest on 30-year Treasury bonds. Our pension laws require that when benefits earned in a defined benefit plan are converted from an annuity payable at retirement into a lump sum present value, this calculation must be performed using the 30-year Treasury bond rate. As interest rates on 30-year bonds fall, the lump sum present value of the benefit earned by the employee prior to the conversion will increase. The result can be that although a worker’s previously earned benefit and opening cash balance account were both equal to \$50,000 at the time of conversion, a decrease in 30-year bond interest rates can increase the value of the previously earned benefit to \$55,000. Until the cash balance account reaches \$55,000, this worker will experience a benefit plateau.

- Second, benefit plateaus can result when employers translate the previously accrued traditional benefit into an opening cash balance account using an interest rate higher than the 30-year bond rate. When this is done, the value of the opening cash balance account will be lower than what the employee would be eligible to take under the prior plan (since the present value of that benefit must be calculated using the 30-year bond rate). The result is that workers will plateau at the higher level until the cash balance account catches up. Employers generally use a higher interest rate when they believe the 30-year Treasury bond rate is historically low (which has been the case in recent years). Yet

because using a higher interest rate can produce benefit plateaus and plateaus have been of concern to employees, few employers have set opening balances in this way. The clear trend has been for employers to determine opening account balances using the Treasury rate or a rate more favorable for employees. Thus, this use of higher interest rates has not been a frequent cause of benefit plateaus in recent years.

- Third, benefit plateaus can result when employers eliminate early retirement subsidies (on a prospective basis) from the pension. A plateau can result in this instance because workers who have already earned a portion of an early retirement subsidy prior to a conversion will typically have a previously earned benefit under the prior plan that is higher than the opening cash balance account (which is typically based on the normal retirement age benefit earned under the prior plan as of the date of the conversion and does not include the value of any early retirement subsidy). Presuming an employee leaves the company at a time when he or she is entitled to receive the early retirement subsidy, the prior plan benefit may be greater than the cash balance account. Elimination of the early retirement subsidies on a prospective basis is the primary cause of benefit plateaus in most conversion cases where plateaus are seen today. It should be noted that benefit plateaus can also occur in cases where early retirement subsidies are eliminated from traditional defined benefit plans.

While some may be concerned about the plateau effect resulting from subsidy removal, Mr. Chairman, we feel strongly that employers must maintain their flexibility to eliminate these early retirement subsidies on a going forward basis. Early retirement subsidies are certainly a preferable alternative to layoffs and can help a company manage its workforce in a humane way. But employers will never adopt such features in their plans if policymakers make it difficult or impossible to eliminate these subsidies prospectively when they no longer make sense. Today, for example, given the significant shortages that employers experience in certain job categories, it makes no sense for them to continue to offer highly-productive employees rich financial incentives to retire in their 50s. While current law protects any subsidy that employees have already earned for their service to date, it wisely allows employers to remove such incentives from their plan going forward.

Moreover, any legislative requirement that employers maintain ongoing early retirement subsidies in their pension plans would be out of step with congressional actions regarding our nation's public pension system, Social Security. Congress has raised the Social Security retirement age -- and may once again consider doing so as part of the current effort to address the system's solvency -- and repealed the Social Security earnings test, partly in order to encourage older Americans to work longer. Requiring employers to continue to offer private pension plan incentives to retire early would be flatly inconsistent with these actions.

Although we understand that benefit plateaus can be confusing and even upsetting to some employees, they result from interest rate anomalies and valid actions taken by employers to eliminate early retirement subsidies. Nonetheless, given the employee concern, many employers design their conversions to mitigate these plateaus or eliminate them altogether. Moreover, the disclosure requirements enacted by Congress in 2001

(and implemented by the Treasury Department through regulations) ensure that employees are fully aware of the possible benefit plateau effects of a conversion. The Council believes these steps appropriately respond to the concerns that have been raised about plateaus.

**Age Discrimination Principles.** Subsequent to Congress' enactment of disclosure legislation, the Treasury Department and IRS drafted proposed regulations in consultation with the Equal Employment Opportunity Commission addressing retirement plan design and age discrimination principles. These proposed regulations were issued in December 2002. Among other items, the proposed regulations established the validity of the cash balance design under the pension age discrimination statute and provided guidelines on how employers could convert from traditional to hybrid pension designs in an age-appropriate manner.

Disregarding the interpretation contained in the proposed regulations and other legal authorities, one federal district court judge dramatically shifted the focus of the debate surrounding hybrid plans by declaring in July 2003 in the case of *Cooper v. IBM* that hybrid plan designs were inherently age discriminatory. According to the court's flawed logic, simple compound interest is illegal in the context of defined benefit pension plans. Under the *Cooper* court's reasoning, a pension design is discriminatory even if the employer makes equal contributions to the plan on behalf of all its workers and, ironically, even in many instances where the design provides greater contributions for older workers. Such a conclusion flies in the face of common sense. It would hold all 1,200 plus hybrid pension plans, regardless of whether adopted as new plans or through conversion from traditional plans, to be in violation of the pension age discrimination laws.

The conclusion that all hybrid plan designs are inherently age discriminatory begs the question why the Internal Revenue Service issued favorable determination letters for fifteen years blessing hybrid plan designs and issued proposed regulations providing that the cash balance plan design is not inherently age discriminatory. It is surprising, at a minimum, that the *Cooper* decision completely ignored this history. Even more astonishing is the fact that the *Cooper* decision ignores the legislative history of the pension age discrimination statute adopted in 1986. That legislative history makes clear that the intent of Congress was limited to prohibiting the practice of ceasing pension accruals once participants attained normal retirement age. Moreover, an example in the 1986 legislative history that clarifies a separate but related pension issue describes approvingly a type of plan (a "flat dollar" plan) that would be deemed age discriminatory under the *Cooper* decision. It makes absolutely no sense that Congress would use as an example of a viable pension design one that would fail the age discrimination prohibition it was enacting at the very same time. Lastly, prior to the *Cooper* decision, numerous other federal district courts addressed and rejected charges that the basic hybrid plan designs were age discriminatory. These too were ignored in the *Cooper* decision. Importantly, another federal district court decision decided subsequent to *Cooper* has rejected its logic and concluded that the cash balance pension design is age appropriate.

Spurred on by the Cooper decision, cash balance critics in Congress pushed through an appropriations prohibition preventing the Treasury Department from finalizing its age regulations addressing hybrid plan designs and conversions. Congress at the same time directed the Treasury Department to make legislative recommendations regarding conversions from traditional to cash balance plans. In the relevant legislative history, however, Congress did make clear that “[t]he purpose of this prohibition is not to call into question the validity of hybrid plan designs (cash balance and pension equity). The purpose of the prohibition is to preserve the status quo with respect to conversions through the entirety of fiscal year 2004 while the applicable committees of jurisdiction review the Treasury Department’s legislative proposals.”

While the Cooper decision is an isolated one, and there is clear and significant authority to the contrary concluding that hybrid plans are age appropriate, Cooper is a high-profile case that has led to copycat class action lawsuits being filed against a number of other employers for the alleged discriminatory nature of their plan design. Applying the rationale in the Cooper rulings, ultimate damages against the defendant were projected to be between \$1 and \$6 billion dollars. It is this range of figures that are required to overcome and “correct for” the natural operation of compound interest. Indeed, should the defendant in the Cooper case lose its planned appeal on the cash balance plan and related design issues, it has agreed to settle these two particular claims for \$1.4 billion. Employers are understandably extremely anxious about the crippling effect of such lawsuits and potential damage awards, and are concerned that they will be next on the growing list of companies targeted for class-action suits. While employers certainly expect the anomalous Cooper decision ultimately to be overturned on appeal, such a result is many months, if not years, away and many hybrid plan sponsors are likely to find the intervening risks to their businesses and shareholders to be unbearable.

#### The Need for Congressional Action

Mr. Chairman, the operation of the hybrid pension system is at a standstill. Employers cannot get determination letters from the IRS regarding the compliance of their plans with legal guidelines. The regulatory agencies that normally assist the smooth functioning of the system through issuance of periodic interpretive guidance have been told by Congress through the appropriations process not to do so. Any final resolution of the age discrimination question by the federal appellate courts is years away at a minimum.

Moreover, the judicial system is not the appropriate forum for resolving an issue of this sort, which has far-reaching public policy ramifications. The very nature of the judicial process makes it difficult for these types of broad public policy issues to receive thorough examination much less appropriate handling. Not all stakeholders are present before the court and the system-wide ramifications are intentionally given less weight than the narrow legal issues.

Perhaps some are tempted to view this current legal uncertainty and regulatory standstill as a victory of sorts. Perhaps they will see the slowdown in the number of hybrid plan conversions as a positive development for employees. They should not. As we noted earlier, other pressures in the defined benefit system are already prompting employers to



consider freezes or terminations of their plans. Indeed, a recent survey reported that 27% of defined benefit plan sponsors have already frozen at least some element of their defined benefit pension program. The hostile climate for hybrid plans and the litigation risks and extreme damage potential are unfortunately starting to make the decision to freeze an easier and easier one for corporate decision-makers. If employers are pushed to abandon hybrid plans, we will lose a retirement vehicle that delivers higher benefits to the vast majority of employees and meets workers' key retirement plan needs – for portability and benefit guarantees – all while utilizing transition methods that protect older workers. How, exactly, is this good for employees and their families?

The prospect of hybrid plan freezes and terminations poses another risk – to the Pension Benefit Guaranty Corporation (PBGC). We must be mindful that many of the companies that sponsor hybrid plans are financially strong companies in healthy industries. These strong companies today pay insurance premiums to the PBGC. If these employers are forced to exit the defined benefit system, the loss of premiums could aggravate the long-term financial challenges faced by the agency. Hybrid plan participants comprise 21% of all plan participants protected by the PBGC insurance program. Hence employer insurance premiums on these participants comprise 21% of the revenue generated by the PBGC through its per-participant premium program. If hybrid plans were removed from the defined benefit system, future premiums to the PBGC would be reduced significantly.

Mr. Chairman, the situation today is distressingly clear. The harms that result from today's legal uncertainty are unmistakable. The regulatory agencies and courts are unable to act effectively to prevent these harms. Only through prompt legislative action can Congress rescue hybrid defined benefit plans and prevent the damage to the retirement security of millions of American families that will unquestionably result from their demise.

#### Recommendations

**Clarify the Age Appropriateness of the Hybrid Plan Designs.** The first and most important step for Congress to take is to clarify that the cash balance and pension equity designs satisfy current age discrimination rules. Congress must make clear that the legal interpretation holding these designs discriminatory merely because the accounts of younger workers have more years to earn interest is unfounded. Rather, Congress must clarify that age discrimination in defined benefit plans is measured by reference to the formula spelled out in the plan document. If, under the formula, benefits do not decline on account of age, then the plan meets the legal requirements. In hybrid plans, this approach would look to the pay credits contributed on workers' behalf under the plan formula. If the pay credits for older workers are the same, or greater, than the pay credits for younger workers, then the pension age discrimination rules are satisfied. This clarification is consistent with the legal authorities and with plain common sense. It will end the needless legal jeopardy in which every hybrid plan sponsor today finds itself and will preserve the important benefits that millions of employees today earn under these plans.

**Provide Legal Certainty for Past Hybrid Conversions.** In addition to clarifying the age

appropriateness of the hybrid plan designs, the Council believes it is essential for Congress to provide legal certainty for the hybrid plan conversions that have already taken place. These conversions were pursued in good faith and in reliance on the legal authorities in place at the time. Transition methods, such as benefit plateaus, that have not given rise to concerns about age discrimination in other contexts should not now do so merely because of the context of hybrid plan conversions.

**Resolve Legal Uncertainties with Anti-Employee Effects.** Beyond resolving the questions about the basic hybrid designs and the treatment of past conversions, the Council believes Congress should take a number of additional steps to provide legal clarity regarding hybrid plans. Addressing these additional issues will very concretely aid the employees who participate in hybrid plans.

- **Whipsaw.** First, we recommend that you make clear that, so long as a cash balance plan does not credit interest in excess of a market rate of return, the proper benefit payment to a departing employee is that employee's account balance. This will remedy the so-called "whipsaw" problem that has forced employers to reduce the rate of interest they pay on employees' cash balance accounts.
- **Inclusion of Early Retirement Subsidies.** Second, we recommend that you make clear that employers may include some or all of the value of early retirement subsidies in employees' opening account balances. A number of employers have chosen to do this as a conversion technique to assist those nearing early retirement eligibility, but some in the regulatory agencies are suggesting that to do so is problematic under our current pension age discrimination rules.
- **Protection of "Greater Of" Transition Method.** Third, we recommend that you make clear that employers that voluntarily choose to offer employees the greater of the benefits in the prior traditional or new hybrid plan do not run afoul of the pension back-loading rules. Some regulators have suggested this "greater of" conversion approach violates these rules.
- **Protection of Employee-Friendly Transition Techniques.** Fourth, some conversion approaches that employees and Members of Congress have praised (choice, greater of, grandfathering in the prior plan) are likely to violate the non-discrimination rules over time. Why? The group of typically older employees who remain under the prior plan formula will over time and very naturally have a greater and greater proportion of so-called highly-compensated employees (those making \$95,000 and above) and may well be the only group eligible for continued accrual of benefit features exclusive to the prior traditional plan (e.g., early retirement subsidies). This creates a problem under the non-discrimination rules. We urge you to make clear that these employee-friendly conversion techniques can be pursued.

**Reject Benefit Mandates That Prevent Employers from Modifying Benefit Programs.** Some in Congress are seeking to impose specific benefit mandates when employers convert to hybrid pension plans. For example, some have proposed requiring employers

to pay retiring employees the greater of the benefits under the prior traditional or new hybrid plan. Others have proposed requiring employers to provide employees the choice at the time of conversion between staying in the prior traditional plan or moving to the new hybrid plan. Pursuant to a directive from Congress, the Treasury Department has also made legislative recommendations regarding requirements for hybrid plan conversions undertaken in the future. Despite earlier proposed regulations that would have clarified the legality of the hybrid plan designs and made clear that conversions could be undertaken without special benefit requirements, the Treasury's legislative proposal would require employers to pay benefits at least as high as were provided under the prior traditional plan for a period of five years following the conversion.

These proposals may perhaps sound innocuous to some, and indeed some employers have voluntarily adopted the transition techniques that would be mandated under these proposals, but each of the proposals embraces a fundamental and truly radical shift in the rules of the game for our nation's voluntary employer-sponsored benefits system. Under these proposals, Congress would be (1) guaranteeing employees future retirement plan benefits for service that the employees have not yet performed, and (2) preventing employers from changing the benefit programs they voluntarily offer. Indeed, Congress would be converting the natural and understandable hopes and wishes of employees that their benefits will remain the same into concrete legal rights. Such enshrinement of expectations is a fundamental departure from the existing rules of the voluntary benefits system. The Council believes this would be an extremely unwise – and extremely counterproductive – step for Congress to take.

Under such regimes, it is unfortunately clear what actions employers will take in our voluntary benefits system. If they conclude that a traditional defined benefit plan is no longer meeting business and employee needs, they will not remain in the defined benefit system through conversion to a hybrid plan. They will exit the defined benefit system altogether knowing they can avoid these unprecedented mandates by simply utilizing a defined contribution plan going forward. As discussed above, this is typically not the response that best serves employees' retirement income needs.

Perhaps even more damaging than pushing employers from the defined benefit system is the dangerous precedent that would be set by these mandates that seek to enshrine expectations. Employers will naturally ask themselves whether, if other developments in the benefits and compensation landscape come in for heightened scrutiny, Congress will respond by preventing them from making changes to those programs (through imposition of greater of, mandated choice or hold-harmless requirements). Will employers be unable to redesign their health plans? Will they be unable to remove early retirement subsidies from their traditional defined benefit plans? Will they be unable to reduce cash bonuses? Will they be unable to shift from profit-sharing to matching contributions in their defined contribution plans? Will they be unable to reduce the degree of price discount in their stock purchase programs? Where exactly will it end? There appears to us to be no principled stopping point.

Given the extremely significant administrative burdens, financial costs and legal

exposure that already accompany voluntary employer sponsorship of benefit programs today, we hope all who believe in employer-provided benefits as we do will see that these are not the questions you want stirring in the minds of corporate decision-makers. They can only result in a world where employees are offered fewer benefits.

#### Conclusion

The American Benefits Council believes that hybrid defined benefit plans play an invaluable role in delivering retirement income security to millions of Americans and their families. Nevertheless, hybrid plans are facing legal uncertainties that threaten their continued existence. Of these, the most pressing threat is a rogue judicial interpretation that declares all hybrid plans in the nation illegal. To prevent widespread abandonment of hybrid plans by employers and the resulting harm to employees, we hope Congress will provide the legislative certainty and clarity for hybrid pension plans we have recommended above.

Thank you again, Mr. Chairman and Senator Mikulski, for the opportunity to appear today. I would be pleased to answer any questions you may have.