Cynthia A. Rice 05/20/99 03:19:27 PM

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To: Bruce N. Reed/OPD/EOP, Elena Kagan/OPD/EOP, Laura Emmett/WHO/EOP

cc: Paul J. Weinstein Jr./OPD/EOP, Andrea Kane/OPD/EOP
Subject: FYI: NEC proposal re: Pensions and Employee Right to Know

Andrea and I attended the NEC deputies meeting yesterday to lend support to efforts we've been working on with NEC, OMB, and NPR to foster interagency cooperation in implementing workforce one stops.

FYI -- also on the agenda was a report from the NEC-led interagency working group on pensions, recommending the Administration put forth legislation to require employers who are amending defined benefit pension plans to provide more complete information to employees comparing the benefits of the new vs. old plan. This proposal would be a compromise between a Moynihan/Weller bill, which employers consider onerous, and a Portman/Cardin bill which makes only minimal changes to current law. DOL is the lead agency.

Pensions

THE WHITE HOUSE

WASHINGTON

Tom?
BR/EK

May 18, 1999

MEMORANDUM TO NEC DEPUTIES

FROM: for PENSIONS WORKING GROUP

RE: EMPLOYEES' RIGHT-TO-KNOW WHEN THEIR FUTURE PENSION BENEFITS ARE REDUCED

This memorandum outlines a new legislative proposal to improve the information employees receive when their defined benefit pension plans are amended to reduce significantly the rate of future benefit accruals or the value of early retirement benefits. The Department of Labor (DoL) deserves significant credit for developing a detailed proposal that balances the competing concerns of employers and employees. The working group has analyzed and refined the DoL proposal and reached consensus that the Administration should advance a proposal along the lines described below. There are some technical details that the group has yet to resolve. (See "Outstanding Issues" below.) However, we are confident that we can reach consensus on these issues if decision-makers are comfortable with the general approach and legislative strategy described below.

Background

The private pension system is a voluntary system under which employers are free to establish, terminate, or amend the pension plans they provide to their employees. The law, however, places some restrictions on these decisions. For example, employers may not reduce pension benefits that have already accrued, and pension plan administrators must provide participants with a notice of any amendment that significantly reduces the rate of future accruals. Recent media and congressional attention has focused on a particular type of amendment and its impact on older workers — the conversion of a traditional defined benefit plan to a cash balance plan. (See, e.g., Wall Street Journal article attached. Other press reports will be available at the Deputies meeting.)

Cash balance plan conversions can be accomplished without change to the overall cost of benefits provided. In those cases, cash balance plans generally increase future benefits to younger workers and reduce future benefits to older workers. In some cases, however, employers may use the conversion as an occasion to reduce the total cost of pension benefits, often by reducing or eliminating early retirement benefits. Because of the complexity of both the original and new benefit plans, workers may not recognize either the reallocation or the reduction effect. Of course, many employers who are converting to cash balance plans do provide workers with decent information and provide older workers with special benefits to lessen the impact of the switch. But not all.

Cash balance plans have been in use for several years but recently have become more popular among employers. Twenty percent of the Fortune 500 companies (covering about 25% of all of the participants in defined benefit plans) reportedly have already converted from a traditional defined benefit plan to a cash balance plan; thirty to forty percent of large companies are considering converting. Cash balance plans are the only category of defined benefit plan that is increasing, rather than decreasing, in number.

There is much controversy around the impact of converting from a traditional defined benefit plan (especially on older workers) and the sufficiency of the information provided to employees about such conversions. The controversy has been fueled by a conversation, taped at a meeting of actuaries and widely replayed in the media, in which the participants laughed about how workers switched to cash balance plans do not understand how little they are receiving in benefits until after they retire. The employer community tells us informally that they plan to launch soon a major campaign to respond to the criticism of these plans and plan changes, arguing the benefits cash balance plans provide to many workers.

Two major legislative proposals have been introduced in Congress. (See "Comparison to Other Pending Proposals" below.) One imposes extensive (and some would say burdensome) requirements on employers, but provides employees with significant (some would say misleading) new information; the other is far less burdensome but provides employees with little relevant information. Our proposal attempts to strike a middle ground, improving disclosure for participants without subjecting employers to unreasonable burdens and costs. Our proposal does not address the merits of cash balance plans, which have their advantages as well as disadvantages; rather, it focuses on how we can provide better disclosure for participants who are affected by a change in plan benefits.

Current Law

Section 204(h) of ERISA generally requires defined benefit plan administrators to notify participants, alternate payees under qualified domestic relations orders, and employee organizations representing plan participants, if a plan amendment has been adopted that will significantly reduce the amount of future benefits commencing at normal retirement age. The notice must be given after the amendment is adopted but not less than 15 days before the effective date of the amendment. It must set forth the plan amendment and the effective date. Treasury/IRS has interpretative authority over § 204(h). They issued final regulations last year stating that § 204(h) may be satisfied by providing affected participants, alternate payees, and employee organizations either the text of the amendment or a summary "written in a manner calculated to be understood by the average plan participant."

Administration Legislative Proposal

The Administration's proposal would include four major improvements in the current disclosures required for plan changes under § 204(h).

1. *Timing for Notice:* The proposal would require that an expanded notice be furnished earlier than under current law (either 30 or 45 days before the effective date). (See "Outstanding Issues" below.) It would also permit the notice to be provided before the amendment is adopted.

2. *When Notice to be Provided:* The proposal would expand the circumstances under which notice would be required to be provided to include notice of a significant reduction of an early retirement benefit. (Electronic distribution would be allowed in accordance with DOL rules under Title I of ERISA).

3. *Content of Notice:* The proposal would require that the notice include a plain language summary of the amendment, a statement that a copy of the amendment is available on request, and a general explanation (including examples) of the impact of the amendment on participants and alternate payees.

4. *Right to Individualized Statement:* The proposal would provide each participant with the right to request an individualized statement showing the impact of the amendment on his or her benefits under the plan. Each participant would be able to make one such request at any time up to one year after the effective date of the amendment.

In addition to the four central changes from current law, other details of the proposal include:

- *Who Gets The Notice:* A notice would have to be furnished to plan participants and alternate payees who are reasonably expected to be adversely affected by the amendment. The plan administrator also would be required to send a copy of the notice to employee organizations representing affected participants.

- *Minimum Subject Matter Requirements for Notice:* The proposal would prescribe minimum subject matter requirements for the notice and individual statement. (Employers could provide additional information about the amendment, including advantages to participants and alternate payees expected to result from the amendment.) The notice would have to include a summary of the amendment and a general explanation of the impact of the amendment on participants and alternate payees. The general explanation would be required to include at least the following:

  - A statement that the plan is being or has been amended to reduce the future rate of benefit accrual (or reduce early retirement benefits), and, if the reduction would not affect all participants or alternate payees in the plan, a description of the class or classes affected.

    - A general explanation of how the amendment will result in a reduction in the rate of future benefit accrual (or in early retirement benefits).

    - A statement identifying the earliest date the amendment will become effective.

    - Explanatory hypothetical examples possibly comparing, both before and after the plan amendment, the value of a person's accrued benefits. The content of the examples is still being discussed. (See "Outstanding Issues" below.) Assumptions used in calculating future benefit accruals, including future compensation and interest credits, would have to be disclosed on the statement and would be required to be reasonable.

- *Statement on Right to Individualized Benefit Statement on Request for One Year:* The notice also would state that each participant has a right to request, within one year after the effective date of the amendment, one individualized benefit statement. The individualized benefit statement would have to be provided free-of-charge. The proposal would require the employer to furnish the individual statements within 30 days of receipt of a written request, but not earlier than 90 days after the effective date of the amendment, to allow employers sufficient time to collect the necessary individual information after the amendment.

- *Regulatory Authority.* The general advance notice would continue to be under the Treasury Department's regulatory jurisdiction as part of § 204(h). The individualized statement would be based on the requirements of § 204(h), but the Labor Department's current regulatory authority over other individual benefit statements would be expanded to cover this new requirement.

<u>Comparison to Other Pending Proposals</u>

Moynihan/Weller: Senator Moynihan (D-NY) and Representative Weller (R-IL) have introduced a cash balance plan disclosure proposal (S. 659 and H.R.1176). Under these bills, plan administrators would have to provide *<u>individualized statements to each participant</u>* and alternate payee not less than 15 days before the effective date of an amendment that has the effect of significantly reducing the rate of future benefit accrual under the plan. The individualized statements would compare the value of the benefits under the new and old plans at various dates. A general notice would be required for employee organizations representing participants in the plan. The business community has criticized this proposal as imposing substantially increased costs and burdens and providing misleading information. Our proposal would not require automatic preparation of individualized statements for all participants and alternate payees, only a general statement with examples and an individualized statement for those who request it. We also would require use of reasonable assumptions in projecting benefit values, while Moynihan/Weller requires use of specific rates set out in the Internal Revenue Code.

Portman/Cardin. Representatives Portman and Cardin include, in their broader pension bill (H.R. 1102), a proposal that would make only minimal changes to current law. It would amend § 204(h) to require that a notice of an amendment significantly reducing the rate of future benefits accrual be provided to affected participants, alternate payees, and employee organizations at least 30 days prior to the effective date of the amendment (rather than the current 15 days). The Portman/Cardin notice would include a copy or summary of the amendment and an understandable description of the reduction in benefit accrual. Our proposal would expand the scope of § 204(h) to apply to significant reductions in early retirement benefits, require explanatory examples as part of the general advance notice of the amendment, and add a right to get individualized information on request following the effective date of the amendment. (**Note:** The Association of Private Pension and Welfare Plans, a trade association representing large employers/plan sponsors, has a proposal that generally mirrors the timing and content of disclosures in the Portman/Cardin bill, although the language differs somewhat.)

Budget Impact

OMB staff advise that the proposal would not be subject to pay-as-you-go requirements and so would not require an offset.

Outstanding Issues

Although there is consensus on the approach described above, there are a number of important technical issues that the agencies in the working group need additional time to resolve. These include:

- **What information should be provided, if any, to compare projected benefits under the old and new plans.** On the one hand, workers have to make important life decisions based on their retirement benefits. The easiest way to explain the value of the new pension plan may be in comparison to the old. And employees have the right to understand exactly how their benefits have changed, which only may be accomplished by comparing current benefits with what benefits would have been prior to the amendment. On the other hand, such comparisons would be costly to produce and would be criticized as inconsistent with the voluntary character of the private pension system. Employers have the right to terminate all further benefits, if they so desire. Providing a comparison with the old plan implies an option that does not exist for the employee. Most members of the working group are inclined toward providing some form of comparison; they want to ensure, however, that we can defend the information compared as relevant and useful.

- **When to provide the notice of plan amendment.** Under current law, the notice is provided 15 days before the effective date of the amendment. We will propose that the notice be provided either 30 or 45 days before the effective date. We are studying the impact and feasibility of longer advance notice.

Legislative Strategy

There will be substantial interest on Capitol Hill in any cash balance disclosure legislation proposed by the Administration. A bipartisan group of Members in both Houses are committed to moving pension legislation as part of any tax bill. The budget resolution calls for the tax committees to report out tax legislation by mid-July.

Prior to any public announcement, the following actions should be taken:

- Brief the Democratic leadership in both Houses of Congress (including members who have been serving as point persons for the Leadership on pension issues, i.e., Rep. Gejdenson, Senator Daschle, and Senator Graham).

- Brief the Democratic staff of the four committees of jurisdiction (Senate Finance Committee, Senate Health, Education, Labor and Pension Committee, House Ways and Means Committee and House Education and the Workforce Committee). Special attention should be paid to Senator Moynihan's staff to explain why the Administration is adopting a different approach from his own.

- Identify one or two Democratic members on each of the four committees to take leadership on promoting the Administration's approach.

- Ask members who are going to take leadership to identify possible Republican supporters.

In addition, shortly prior to announcement of our proposal, we should:

- Brief Republican staff of the four relevant committees.

- Brief members/staff who have sponsored major pension legislation (e.g., Graham, Grassley, Portman, Cardin, Pomeroy, Neal, and Gejdensen). Both Portman's and Cardin's staff indicated that they may be interested in a more substantive approach.

- Meet with staff of Democratic and Republican members, who are willing to promote the Administration's approach, to discuss strategy and coordination.

Attachment

Motivation behind cash balance pension plans debated

By JERRY GEISEL

Which description is more accurate?

Cash balance pension plans are a vehicle in which companies can deliver benefits more equitably to a changing workforce and in a way employees can understand and appreciate. Or, companies have been adopting cash balance plans as a way to save pension costs and slash benefits to older workers.

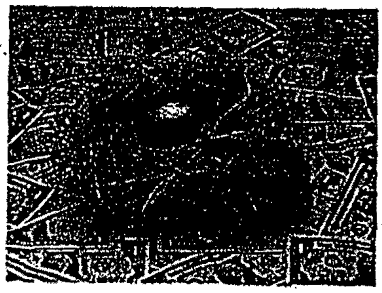
The latter description has been scarcely heard since the first cash balance plan was set up in 1985.

Employers for years have been singing the plans' praises. Many say the plans, which deliver bigger benefits to employees after a few years of service, are far better attuned to an ever-more-mobile workforce than are traditional final-average-pay plans. Traditional plans pay rich benefits for employees who work many years for one company but offer only skimpy benefits to employees who leave after a few years.

But the positive view of cash balance plans shared by many employers and consultants is under attack.

The attacks began late last year with a front-page story—and several stories since—in The Wall Street Journal under the headline "Retirement Wrinkle: Employers Win Big with a Pension Shift; Employees Often Lose."

The article said switching to cash balance plans was a way big companies were saving millions of dollars on pension costs.



While the move to cash balance plans is the biggest development in the pension world in years, the article said that move has a "little-noticed dark side": a lot of older workers will be hit with deep cuts in their pension plans.

Pension activists also are voicing their objections. Older workers who counted on full benefits from their traditional final-average-pay plans now are finding the "rules of the game" being changed in midstream, when companies move to cash balance plans, says Karen Ferguson, director of the Washington-based Pension Rights Center.

"Potentially, employees have lost hundreds of thousands of dollars. From our perspective, that is the biggest thing going on," she said.

Pension attorneys representing employees in suits against employers with cash balance plans have leveled their own criticisms.

"While employers give many reasons for making the change to a cash balance plan, it appears that cost savings through a shift in benefits to younger workers drives most of the changes," said William K. Carr, an attorney in Denver.

But the increasing criticism in national media has not dampened employer interest in setting up cash balance plans, benefit consultants say.

"This is not slowing down the conversion process," said Scott Macey, senior counsel with benefit consulting company ASA Inc. in Somerset, N.J.

"I haven't seen anyone hold back," concurred Eric Lofgren, a consultant with Watson Wyatt Worldwide in New York.

If anything, the news accounts may have heightened employer interest in cash balance plans.

"The press in general has created more interest," said David Rosenblum, a principal with William M. Mercer Inc. in New York. When a company reads about another Fortune 500 company converting to a cash balance plan—even if the coverage is negative, an employer might say, "There must be another side; I want to find out more," he said.

Certainly, there have been plenty of cash balance plan conversions to read about. In recent weeks, such big-name companies as Aetna Inc., CBS Corp., Eastman Kodak Co. and International Business Machines Corp. have announced that they either have or will be setting up cash balance plans.

In all, as many as 500 cash balance plans now are operating, a number swelling almost weekly.

While negative publicity hasn't put a dent in plan formation so far, it has triggered employer anger at what they say is the misleading and unfair coverage of cash balance plans.

Most misleading, say employers with cash balance plans, is the implication that the move to cash balance plans has been principally motivated by a desire to cut pension costs.

Several employers say that charge is flat-out wrong.

"Senior management was adamant that if this was a cost-cutting measure, don't do it. In fact, cost was not a factor. We wanted more value for the dollars we spent and to provide benefits that better met the needs of today's workforce," said Bob Stock, manager-compensation and benefits at Raleigh, N.C.-based Carolina Power & Light Co. In January, the utility switched to a cash balance plan from a traditional final-average-pay plan.

"We were not looking to cut costs but wanted to distribute benefits more equitably," concurred Gerry Murray, director of employee benefits at the BOC Group in Murray Hill, N.J. The company set up a cash balance plan in the mid-1980s.

Some employers say their pension costs increased when they switched over to a cash balance plan. Insurer Atlantic Mutual Cos. says its pension costs climbed by $600,000 a year when it adopted a cash balance plan in 1997. Saving money obviously was not an objective, said Shirley Grill, Atlantic Mutual's vp-human resources in Madison, N.J.

"To say that cash balance plans are solely a vehicle to reduce costs is sheer nonsense. A cash balance plan can be designed to increase, decrease or keep pension costs the same," said Gordon Gould, chief actuary with Towers Perrin in Denver.

To be sure, other employers, such as CBS and BankAmerica Corp., which in 1985 created the first cash balance plan, have candidly said the cash balance plans they set up cost less than the plans they replaced.

But while those companies cut pension costs—compared with the traditional plans—the two employers boosted other benefits. BankAmerica, for example, sweetened a 401(k) plan, while CBS started a stock option plan.

Indeed, cash balance plan critics often overlook the context of plan conversions, plan supporters say.

See Cash balance

Cash balance

Continued

"You can't look at one plan in isolation. You have to look at the entire retirement compensation package," said Kerry Schmidt, a principal and consulting actuary with Buck Consultants Inc. in Atlanta.

Mr. Schmidt cites the example of a client whose cash balance plan did cost less than the traditional plan it replaced. But a beefed-up 401(k) plan offset that lower corporate cost.

Rather than cutting retirement plan costs, benefit executives say the overriding reason for moving to a cash balance plan has been the gradual but dramatic change in workplace mobility.

Decades ago, both employers and employees had a much greater expectation that workers would spend their careers at one company. For those workers, traditional plans in which the vast bulk of benefits were earned when an employee hit a certain cliff—such as age and service equaling 70—were a perfect match.

Such plans encouraged workers to stay with a company for decades and then when the age and/or service requirement was met, employees had a powerful financial incentive to retire.

But if traditional plans once were a perfect match for workers, many benefit managers with cash balance plans now view them as a benefit dinosaur.

That is because the design of traditional plans is skewed so that employees working a few years for one company earn only tiny benefits. The promise of a rich benefit after spending a career at one employer meant less and less to a workforce, which increasingly expects to stay only a few years with one company and then move on.

"The old plan was a perfect mismatch. The younger, productive employees were getting virtually nothing," said Robin Miklatek, director of New York-based Avon Products Inc., which adopted a cash balance plan in 1997.

By contrast, she said, cash balance plans with their smoother accrual of benefits mean shorter-service employees get greater benefits compared with the benefits of traditional plans.

The message conveyed by its cash balance plan is that "we will reward you for each year of service," said Atlantic Mutual's Ms. Grill.

With a cash balance plan, "you are going to get a meaningful benefit after a few years, and that has value to today's employees," said Michael Johnston, a consultant with Hewitt Associates L.L.C. in Lincolnshire, Ill.

Benefit managers and others acknowledge that older, longer-service employees may not earn the same benefits in a cash balance plan compared to a traditional final-average-pay plan. But, they add, traditional plan benefits may have been too rich for longer-service employees, especially when coupled with 401(k) plans that many employers added during the last decade.

"We had people retiring at 110% of pay," Ms. Grill said.

"Many companies realized they overprovided in terms of providing retirement income," said Karen Salinaro, a principal with PricewaterhouseCoopers Kwasha HR Solutions in Teaneck, N.J.

At the same time, companies switching to cash balance plans have been providing so-called transition benefits to current older employees to protect them from loss of benefits that could occur as a result of the switch.

AT&T Corp., for example, automatically gives employees with at least 15 years of service whichever plan benefit—from the cash balance plan or old plan—is greater. Other employers, aside from grandfathering certain older employees, also give older employees additional pay credits atop their base pay credits. BI

Business Insurance, May 10, 1999

Opinions

Plans fit today's workforce

IT WOULD BE DIFFICULT not to notice the revolution that is changing the pension landscape.

Many employers are scrapping their traditional final-average-pay pension plans in favor of cash balance pension plans.

This is no passing fad, as roughly 500 employers now have or soon will have cash balance plans, including such corporate heavyweights as Aetna Inc., CBS Corp., Eastman Kodak Co. and International Business Machines Corp.

Is this a long-overdue revolution designed to offer retirement benefits that better meet the needs of today's workforce? Or is it a sinister trend, fueled instead by a crass desire to slash corporate pension costs and benefits, especially for older workers?

Some critics in recent months have sought to portray it in the media as the latter. But we believe those reports are misleading and do not accurately reflect the reality of how these plans work—and why employers are offering them.

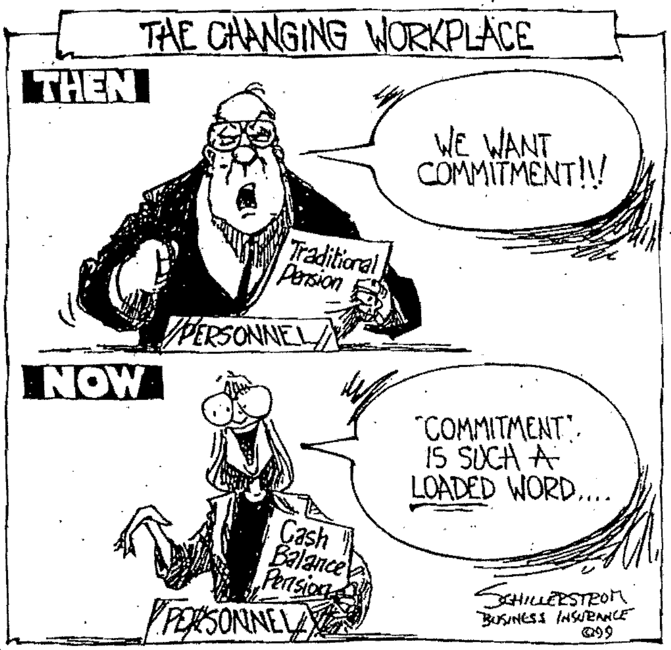
Certainly, some employers *are* adopting cash balance plans with a goal of reducing their pension costs. We do not, however, find that disturbing or startling. Indeed, companies may decide that their pension costs have become excessive or that corporate dollars could be better used elsewhere.

Based on extensive interviews with companies adopting these plans, however, we don't think pension cost reduction has been the prime motivator behind the shift.

After rigorous examination and consultation, corporations have concluded that their old-style pension plans have become increasingly irrelevant to their current employees.

Old-style pension plans—those in which employees only begin to earn significant benefits after many years of employment—were a great idea in an era when career employment was a realistic expectation. Those plans still make sense for companies that want to give employees a powerful financial incentive to stay with them for their full careers.

In an era of corporate downsizings, company spinoffs, company startups and vastly increased job mobility, however, this kind of employment has become the exception rather than the norm. Employers and employees alike know and understand this.



With increased mobility of the workforce, more companies have concluded that they need pension plans that provide greater benefits for employees who are likely to stay with them for only a few years. Cash balance plans, with their smooth accrual of benefits, help to meet that corporate objective. Indeed, Kodak's benefit manager says the company felt it needed a cash balance plan to help it compete for employees.

To be sure, a shift to cash balance plans from traditional plans is not easy. Older employees could be hurt because they may not have earned full benefits in the old plan and will not be covered in the new plan long enough to earn significant benefits.

But again the reality—contrary to what cash balance critics say—is that companies take great care to ensure their older workers are protected during such a shift. Corporate approaches to providing such protection include: giving older employees the opportunity to stay in the old plan; giving them the choice of earning benefits under either plan; and giving them extra credits in the cash balance plan.

Providing pension benefits more attuned to today's workforce is a welcome development and one that more employers should look at.

Remarks by
David M. Strauss
Executive Director
Pension Benefit Guaranty Corporation
at the
Cash Balance Pension Plans Conference
San Francisco, California
May 7, 1999

Good afternoon. The conference today is focused on cash balance plans, but I want to put cash balance plans in the larger context of defined benefit plans.

As the Executive Director of the Pension Benefit Guaranty Corporation, I have a statutory mandate to promote the continuation and maintenance of the defined benefit pension system.

I believe we must have a strong defined benefit system if we are ever to achieve the goal of retirement income security for the vast majority of Americans. But, I do not have to tell any of you that the defined benefit system has been in serious trouble for some time -- few new plans are being created and few new participants are coming into the system.

When I became Executive Director of the PBGC, I made promoting defined benefit plans my top priority. I am more convinced than ever that the guaranteed income for life that defined benefit plans provide makes the difference between a barely adequate standard of living and a comfortable retirement for many of today's retirees.

I personally know how valuable defined benefit plans are from my own experience. My father was typical of many Americans nearing retirement:

- He had no employer-provided pension plan;
- He hadn't been able to save very much;
- And, he was running out of time.

My father has spent all of his life in North Dakota. When he retired from his job as a meat cutter in a grocery store he was 62 years old and he never had a pension. He then took a part-time, minimum-wage job, as a janitor at the local high school. But for the first time in his life, he was covered by a defined benefit pension plan.

He retired a second time, 16 years later, at age 78 with a pension that now provides him with $169 a month -- a supplement of over 20 percent to his Social Security benefit. He would have had to have saved at least 15 percent of his minimum-wage salary over the entire 15 years to generate on his own the same benefit each month.

Recognizing the reality that pension plans are sold, not bought, we especially sought out those pension experts who make their living marketing pension plans. Virtually all of them told us the same thing: they believe in defined benefit plans, but they're a hard sell. They emphasized that our pension system is voluntary and employers have many different choices in whether and how they provide retirement benefits.

They said that, to keep defined benefit plans competitive in today's marketplace, two things in particular are needed:

- First, we must restore the employer incentives originally contemplated in ERISA;
- And second, we must make plan designs and rules more flexible to better meet the needs of today's workforce.

When ERISA was enacted, a balance was struck between benefits for executives and benefits for rank-and-file workers. Executives received their retirement benefits primarily from the same plan as the workers. They had a stake in the company's basic pension plan.

This all changed in the 1980s and early 1990s when the benefits of higher-paid executives were repeatedly cut back. In 1974 when ERISA was passed, the maximum benefit at age 55 was $75,000. Today, 25 years later, the maximum benefit at age 55 is around $60,000 -- about $15,000 less than the original ERISA limit. In real dollars, that's only about one-fourth of the 1974 figure.

As a result of these cutbacks, executives lost interest in defined benefit plans. But these executives still got their benefits -- they just got them outside the tax-qualified plan. The real losers were the rank-and-file workers.

What virtually everyone told us -- from employer groups at one end of the spectrum to unions at the other end -- was that, if we want to help these rank-and-file workers, we must provide greater incentives to business owners and top executives.

They also told us that employers need greater flexibility to design plans that meet the needs of today's workforce. They made three suggestions:

- Allow 401(k) plans and defined benefit plans to work better together;
- Allow partial or phased retirement for older workers;
- And clarify how the existing pension rules apply to cash balance and other types of hybrid plans.

needs of many of today's employers and workers because they combine some of the best features of both defined benefit and defined contribution plans

Like traditional defined benefit plans, hybrid plans contain many of the same elements that make these plans valuable to workers:

- Benefits do not depend on how much a worker is willing or able to contribute;
- The employer bears the investment risk;
- Plans must offer an annuity for life at group annuity rates with surviving spouse protection;
- And benefits are insured by PBGC.

Plus, hybrid plans offer several advantages that traditional defined benefit plans do not:

- Workers understand and appreciate benefits because they are expressed as an account balance;
- Because of this, employers get credit for the pension dollars that they are spending;
- Younger workers and shorter-service workers such as women often receive higher benefits; and
- Workers who do not spend their full careers with one employer have more portable benefits.

It is clear from the growing number of employers who are converting to hybrid plans that these plans meet the needs of a fairly large segment of today's workforce.

While conversions to hybrid plans are a way to keep employers in the defined benefit system, these conversions have become quite controversial. There seem to be two major concerns: the effect on older workers and adequate disclosure.

For older workers, a conversion to a hybrid plan may often reduce their future benefits, because, when a plan's benefit formula changes, only the worker's accrued benefit is protected -- not any future benefits. So, when an employer converts from a traditional final average pay plan to a career average hybrid plan, the benefits that some older workers were expecting can be greatly reduced.

It is important that workers get as much useful information as possible. But, at the same time, we do not want to create burdensome record keeping and reporting requirements for employers. Legislation has been introduced to address the disclosure issue, and it is getting careful attention in Congress and the Administration.

Hybrid plans can fill the needs of both employers and workers in many situations. But, so far, hybrid plans have been adopted mostly by very large employers. Many consultants have told us that they could sell new hybrid plans to small and mid-sized employers if the rules were clearer and more flexible.

The lack of clear rules forces employers to go through all sorts of costly contortions to establish these plans. And often at the end of the day there is still a question about their legality. As a result, only very large employers have been willing to take the risks of adopting hybrid plans.

Some guidance has been provided on hybrid plans, but it is not enough. Attempts to apply the current pension rules to hybrid plans can seem like trying to fit a square peg in a round hole. Ultimately, I believe additional legislative authority is probably going to be needed.

To sum up, hybrid plans are key to strengthening and expanding the current defined benefit pension system. I believe that without a strong defined benefit system, we will never achieve the goal of retirement income security for the vast majority of Americans.

I want all workers to be able to enjoy the advantages of a defined benefit plan -- whether it is a traditional pension plan or a hybrid plan -- because it is the only way we are going to be able to provide retirement income security for millions of Americans who won't have it otherwise. Thank you very much.

PRESS REPORT ON

CASH BALANCE

PLANS

FIRST KEYWORD ▶ HELP ?

'Cash' Pensions Trigger Protest Of New Allies

Wall Street Journal; New York; Jan 21, 1999; By Ellen E. Schultz;

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Start Page: C1
ISSN: 00999660
Subject Terms: Pension plans
Labor relations
Labor unions
Management
Conversion

Abstract:
As hundreds of large employers convert the traditional pensions of salaried employees to "cash balance" and other hybrid pension plans, a second wave of conversions have been following-for the collectively bargained workers, especially in the telecommunications and utilities industries.

Cash ▶▶ ***-balance plans*** *are pensions that look somewhat like 401(k)s, but they are far different: Under them, employees get hypothetical "accounts" into which contributions are made each year. The accounts earn interest, and employees can take the money with them when they leave. While employees generally like the portability feature, older and longtime employees are often dismayed when they learn that their pensions effectively have been reduced. Under a cash-balance plan, it could take some workers many years before they begin to earn new pension benefits.*

That's too bad for nonunion employees: Employers can unilaterally reduce or eliminate future pension- and retirement-plan benefits for nonunionized workers. But collectively bargained employees generally have the option of rejecting a cash-balance plan, or can negotiate for better provisions than what nonunion workers get -- if they know what to ask for.

Full Text:

Unlikely allies are forming at some companies as union and management employees compare notes about a new style of pension plan -- and don't like what they see.

As hundreds of large employers convert the traditional pensions of salaried employees to "cash balance" and other hybrid pension plans, a second wave of conversions have been following-for the collectively bargained workers, especially in the telecommunications and utilities industries.

Cash-balance plans are pensions that look somewhat like 401(k)s, but they are far different: Under them, employees get hypothetical "accounts" into which contributions are made each year. The accounts earn interest, and employees can take the money with them when they leave. While employees generally like the portability feature, older and longtime employees are often dismayed when they learn that their pensions effectively have been reduced. Under a cash-balance plan, it could take some workers many years before they begin to earn new pension benefits.

That's too bad for nonunion employees: Employers can unilaterally reduce or eliminate future pension- and retirement-plan benefits for nonunionized workers. But collectively bargained employees generally have the option of rejecting a cash-balance plan, or can negotiate for better provisions than what nonunion workers get -- if they know what to ask for.

Some union locals, however, now say that employers deliberately misled them in negotiations. Take the case of Niagara Mohawk Power Corp., a Syracuse, N.Y., utility, which adopted a cash-balance plan for salaried employees this past July, and convinced the union that it was a good deal for them, too.

Now, several members of Local 97 of the International Brotherhood of Electrical Workers have filed charges against the company and the union with the National Labor Relations Board, saying the company didn't provide sufficient information for the union to make an informed decision, and that the union failed to protect employee interests. "They were sold a bill of goods," says Thomas Primero, the new local president, who took office after the plan was ratified.

Meanwhile, midlevel managers at the utility are still trying to learn how their old pension benefits stack up to their new ones. A group of managers are working with the union to construct computer models, and they estimate that pensions for some longtime employees have been reduced by 40%. David Arrington, a Niagara senior vice president, says the company provided full information to union and nonunion members.

Increasingly, unions nationwide are seeking greater disclosure. "Instead of giving me this rosy picture, show me the spreadsheets," says Jim Schlosser, a representative in the utilities division of the IBEW in Washington. The United Food & Commercial Workers union rejected cash-balance proposals from a food processor and a large grocer when the companies refused to provide plan documents and disclose actuarial formulas and assumptions.

Why would a union accept a cash-balance plan at all? Primarily because the plans enable younger workers to build up benefits faster and they are portable. "Worker mobility, business uncertainty and employment insecurity -- economic realities of the 1990s that make cash-balance appealing to salaried employees -- should have the same effect on unionized work forces," notes a PricewaterhouseCoopers brochure for employers about cash-balance plans.

As a result, the lump-sum feature is the biggest carrot that companies have to get unions on board. Unionized employees at U S West wanted a lump-sum option for their traditional pension. But the company said the union could have the option only if it agreed to adopt a cash-balance-type plan ("pension-equity plan") that its salaried workers have.

This was initially tempting. "Our folks always think management plans are better than ours," says John Thompson, bargaining chairman for the Communications Workers of America in Denver. But once the union analyzed the plan, "we opted to run from it," he says. U S West says the company and the union are continuing to discuss the matter.

Some unions have negotiated better benefits for their workers than management gets. Southern New England Telephone, now part of SBC Corp. in San Antonio, reduced the annual interest credit to salaried employee accounts to 3% from 7% on Jan. 1. But union members still get 7%. Similarly, AT&T Corp.'s 40,000 unionized employees obtained higher opening-account balances and better transition features than did management.

Credit: Staff Reporter of The Wall Street Journal

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Transcript

DATE May 17, 1999
TIME 6:30-7:00 PM (ET)
NETWORK CBS-TV
PROGRAM CBS Evening News

Dan Rather, anchor:

Tonight's Eye on America is a hard-news look at pension plans. A CBS News poll finds more than half of Americans are in a pension plan, and about three quarters of them expect the money to be there for them at retirement. But it may not be nearly as much as they thought. In this Guarding Your Money report, Ray Brady finds that more and more companies are switching from traditional pensions to what are called cash balance plans.

Ray Brady reporting:

Climbing utility poles: It's tough, back-breaking work, which is why forty-year-old Mike Murphy was hoping to hang up his tool belt and retire by the age of fifty-eight.

Mike Murphy (Forty Year Old): We work all--all our lives to--to- -to retire, to kickback and do what you--wh--what you enjoy.

Brady: But dreams of a life beyond Niagara Falls came to an end when Murphy's employer, Niagara Mohawk Power, took away the traditional pension plan that he'd been counting on. In came a new plan. In ten years on the job, Murphy never got shocked...

Murphy: Dear Niagara Mohawk pension plan participant...

Brady: ...until he did the math.

Murphy: I planned on retiring when I was fifty-eight. And at age fifty-eight, under the old plan that I no longer participate in, my pension would have been worth three-hundred-seventy-two thousand dollars. Under the new plan, it's two-hundred-sixteen thousand dollars.

Brady: If my math is right, that's a loss to you of one-hundred-fifty thousand dollars.

Murphy: Correct.

Come on, Bud.

Brady: Mike and his wife Carmel couldn't believe it. Under Niagara Mohawk's rules, which his union agreed to, Murphy missed the age and time of service requirements by just eleven weeks--one-hundred-fifty thousand dollars gone.

Murphy: It's just appalling to think that--that one day you can be worth this much money, and the next day it's right out the window.

Brady: Mike Murphy is just one of thousands of workers in their 40s and 50s caught in the middle of two pension plans. The old plan builds up credits near the end of your career, and that's when salaries usually are the highest. Under the new plan, called cash balance, the credits come early, but that's when salaries are at their lowest. And for those with time on the job, that difference can cost big money.

Unidentified Woman: Well, how much money do I need to start retirement with?

Brady: But not all workers are complaining. At another company, Kodak, everyone gets a choice: stick with the old plan or go with the new program, the cash balance plan.

Woman: Lots of companies have made this transition to cash balance.

Brady: Lots of young workers like what they see.

You're thirty-four years old. How many companies have you worked for?

Miller: I've worked for two companies prior to this.

Brady: For thirty--somethings like Kodak manager Mike Miller, the new plan has one big advantage: If they change companies, they can take their pension with them.

Miller: It's not likely we're going to spend thirty, thirty-five years at one company and recire--retire from the same company that we joined on with at the start of our career.

Brady: Critics say companies are out to save a buck, big bucks, but for Miller, cash balance may mean money in the bank now.

That's an incredible difference for you.

Miller: Yes.

Brady: For Mike Murphy, though, the difference may mean more years on the job. Remember, he was planning to call it quits at fifty-eight.

Murphy: When you're that age, you're broke-up, busted-up, your elbows are shot, your shoulders are shot, your back's shot, your knees are shot.

Brady: Now Mike Murphy says to retire with the pension he'd been planning on he'll have to keep climbing those poles until he's sixty-five. In Niagara Falls, New York,

I'm Ray Brady for Eye on America.

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Transcript

DATE May 6, 1999
TIME 6:30-7:00 PM
NETWORK NBC-TV
PROGRAM NBC Nightly News

Brian Williams, co-anchor:

And now to our special series here tonight, Retiring Smart. Even as the economy soars, corporate America is looking for more ways to cut costs. Now, a new trend that threatens the once-sacred American workers' pension plan. Here with that, NBC's chief financial correspondent, Mike Jensen.

Mike Jensen reporting:

After twenty-five years working for the electric company, Jim Bruggeman looked forward to retiring with a good pension and plenty of time to work on his golf swing. (Visual of Jim Bruggeman on golf course)

James Bruggeman (Electric Company Worker): My wife and I had plans to travel, play golf.

Jensen: Then his company switched over to a new type of pension plan called cash balance. (Visual of booklet, Charting a new course for the Retirement Income Program)

Bruggeman: The company indicated to the employees that there really wasn't any change in their benefits.

Jensen: But Bruggeman did his own arithmetic. (Visual of Bruggeman running program on laptop computer showing the difference in his old and new plans in dollars and percentage amount)

Bruggeman: It was a shock and I was angry, felt betrayed also. I am losing over four hundred thousand dollars.

Jensen: Millions of other older Americans are also losing as more than five hundred American corporations switch over to cash value plans, including twenty percent of the nation's biggest companies. (Visual of large buildings)

Ten million workers affected so far. Older workers like Bruggeman suffering most because they're being dumped out of their traditional pension plans, the kind that give you a bonus for long years of service, base your monthly pension benefit on your final salary, usually the highest of your career. (Graphic: Traditional Plans: Bonus For Long Service; Based on Final Salary)

The new cash value plans favor younger workers because the company puts money away for them right off the bat and they can take it with them if they change jobs. Why are companies doing this? (Graphic: Cash Value Plans: Retirement Money Early; Take It With Them)

Michelle Varnhagen (Pension Rights Center): The real bottom line here is that employers are looking to cut costs over time.

Jensen: Experts says older workers like Jim Bruggeman can lose thirty to fifty percent of their pensions under the new plan and never know what hit them. (Visual of the Bruggemans in their kitchen and page from description of Thrift Plus Plan)

This audio tape was made as a meeting of actuaries, pension experts laughing about how easy it is to fool older workers. (Audio clip of actuaries; Graphic: It's not until they're actually ready to retire that they understand how little they're actually getting. But they're happy while they're employed. Yes.)

Bruggeman's company, CSW, refused to be interviewed, but said in a statement, most of its employees like the new plan. (Graphic: The majority of our employees have enthusiastically embraced the new plan)

But not Bruggeman who is fifty and filed an age discrimination complaint with the government. (Visual of Bruggeman golfing and Charge of Discrimination form)

Bruggeman: I estimate about six or seven years of additional work to make up for that shortfall.

Jensen: Dollars lost and years, along with the dream of an early retirement. (Visual of Bruggemans in golf cart)

Mike Jensen, NBC News, New York.

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Transcript

DATE May 5, 1999
TIME 5:30-6:00 PM (ET)
NETWORK CNNfn
PROGRAM Take It Personally

Susan Lisovicz, anchor:

IBM is scrapping its current employee pension system in favor of a cash balance plan, and it's not alone. In today's edition of Your Money, John Metaxas explains what they are and who they benefit. (Visual of IBM Corporate Headquarters exterior)

John Metaxas reporting:

Once you got a job at IBM you were set for life. But the world and IBM have changed and today companies are adapting their retirement plans to suit America's more mobile workforce. (Visual of IBM, CBS and Kodak exteriors)

IBM, CBS and Eastman Kodak are among companies now implementing so-called cash balance plans, a kind of portable pension.

Sam Albert (Technology Consultant): It will help to attract better people because it's more in tune with people's thinking. They're not thinking of longevity and staying at a single company for many, many years.

Metaxas: Under the cash balance plan, the company contributes money at a steadier rate than in traditional pensions in which the majority of benefits often do not accrue until just before retirement. The company saves money. IBM estimates about two hundred million dollars a year, and employees are able to take their cash balances with them if they leave before retirement.

Dallas Salisbury (Employee Benefit Research Institute): The Microsoft's of the world are offering people a great 401(k) plan plus stock options. They're saying we'll pay you now. You'll be rich at the end of a few years, and there's a pressure for the companies like IBM or Kodak who want to attract those same highly talented young people to give them the best deal today.

Metaxas: Under the cash balance plan, older employees who stay until retirement may see their benefits reduced. But the cash balance system provides greater protection for employees forced out of a company before retirement. Generally cash balance pensions are offered along with other kinds of retirement plans such as 401(k)s. Experts advise employees to consider the total retirement package when choosing a job.

That's Your Money. John Metaxas, CNN Financial News, New York.

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Transcript

DATE	May 4, 1999
TIME	6:00-8:00 AM
NETWORK	NPR
PROGRAM	Morning Edition

Jack Speer reporting:

Computer maker IBM has announced it will restructure the company's pension plan covering one hundred and forty-one thousand workers in the U.S. NPR's Elaine Korry reports.

Elaine Korry reporting:

Beginning July 1, IBM will phase out its traditional pension plan in favor of a new formula known as a cash balance plan. Under the old plan, long-term employees were rewarded for their years of service with a set monthly benefit when they retired. The old plan was backloaded, meaning that employees accrued most of their benefits in their later years of service.

Under the new cash balance plan, employees will start accumulating retirement benefits much earlier, although at a lower rate. And if they leave IBM before retirement, workers will be able to take those benefits with them in the form of a lump sum payment.

IBM's human resources chief says the change was undertaken to meet the needs of a younger, more mobile work force. But according to company documents, IBM also stands to save two hundred million dollars a year as a result.

Elaine Korry, NPR News, San Francisco.

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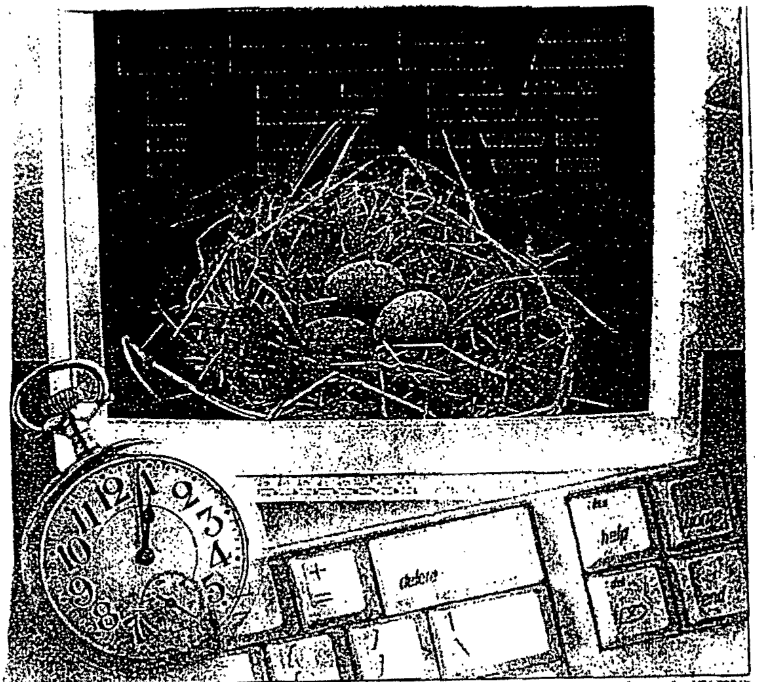
TUESDAY, MAY 4, 1999 · USA TODAY

IBM retools pensions

New plan sweeping Corporate America



Photos by H. Darr Beiser, USA TODAY, PhotoDisc

Photo illustration by Grant Jerding, USA TODAY

Controversial cash-balance benefits going mainstream

By Stephanie Armour
USA TODAY

COVER STORY

Say goodbye to the gold pocket watch and time-honored retirement plans.

Something new is taking hold.

IBM, long regarded as a leader in employee benefits, became the latest employer Monday to abandon its lifetime pension program in favor of a more flexible plan that lets workers take their retirement money with them from job to job.

It's called a cash-balance plan, and it's a phenomenon sweeping Corporate America. Employees who aren't familiar with it will probably be hearing about it soon. The move by IBM is a clear sign these benefit plans have hit the mainstream.

IBM, known for its cradle-to-grave care of employees, made the change because today's workforce is dominated by employees who job hop and see less value in traditional pensions, a spokesman says. The company also says it will save $200 million a year. About 140,000 of the company's U.S. employees learned of the change today through e-mail announcements and internal Web sites.

Cash-balance plans are controversial. Critics say they can hurt older workers by depriving them of retirement money they had expected under a traditional pension plan. And because the money can be paid out before age 65, workers may spend it rather than investing it for retirement. Or those who lack financial savvy may invest poorly.

"The only caution would be human nature," concedes Burke Stinson, a spokesman at AT&T, which has a new cash-balance plan. "People may see six figures set aside and spend it and think they've won the lottery. It's not meant to be taken to the track."

Still, more cash-balance plans are expected to crop as other companies follow Big Blue's lead. "It's the way of the future, so get used to it," says Ken McDonnell, a research analyst at the Employee Benefit Research Institute in Washington, D.C. "All these companies like IBM are adopting this. It's a trend catching on and it will definitely be growing. It's all because the nature of work is

Please see COVER STORY next page ►

Older employees taking the pension hit, critics say

Continued from 1A

changing."

Companies such as AT&T, Bell Atlantic, Cigna, Cincinnati Bell, MCI Worldcom, Chase Manhattan, Xerox and others already have embraced the plans. Citigroup is converting to a

COVER STORY

cash-balance plan. Some unions want the plans. Studies by benefits consultant Hewitt Associates show the number of employers with cash-balance plans grew from 5% in 1995 to 12% last year.

How cash balance works

Under a traditional defined-benefit pension, retirees typically get monthly payments until they die. The amount is based on the retirees' years at the company and highest pay in the five years before retirement. Employees have to stay with a company most of their careers for the pension to be worth much.

But under cash-balance plans, money accumulates steadily over time.

Employers generally contribute 4% to 7% of a worker's pay each year into an account with a guaranteed rate of return. In most cases, the return is tied to the 30-year Treasury bond, but some companies are giving employees a choice of linking it to the Standard & Poor's 500 index of large company stocks, says Gordon Gould, chief actuary at Towers Perrin.

And when employees change jobs, they generally take a lump-sum payment from the cash-balance plan with them.

Cash-balance plans are a boon to younger workers. A typical person who works for a company at least five years and quits at age 31 would have pension benefits worth 37% of her final pay in a cash balance plan, vs. 7% in a traditional pension, according to a study by the Society of Actuaries.

By contrast, a typical worker who left at age 61 would have pension benefits worth 147% of his final pay in a cash-balance plan, vs. 213% under a traditional pension, the study says.

"Oftentimes older workers do get hurt," says Steven Feinstein, a finance professor at Babson College in Wellesley, Mass. "That issue comes up a lot."

The draw of the plans

Nonetheless, companies say they are drawn to cash-balance plans because they:

▶ **Are portable.** Employees usually can take the cash in the plan with them when they change jobs. "Employees who move around a lot will benefit," says David Rosenblum, a principal at consulting firm William M. Mercer in New York. "To the younger workforce, the traditional plans weren't very meaningful. If you are 25 and you quit, the promise of an annuity doesn't sound like much."

▶ **Empower employees.** Workers can see quickly, in regular statements mailed out by their employer, how much retirement cash they have.

"Our employees seem definitely to pay more attention to it," says Jeff Battcher, at BellSouth, which has had a cash-balance plan since 1993. "They know how much money they have in it."

And, in most cases, employees can invest the money as they wish when they leave a company. "Instead of being taken care of in your old age, it gives the responsibility to an individual," says Karen Way, 51, an AT&T management employee in Basking Ridge, N.J., who has a cash-balance plan. "It changes the feeling of retirement."

AT&T moved its $10.6 billion plan for management to a cash-balance plan in 1998. Union members also voted to convert to the new program.

AT&T

Has new cash-balance plan

▶ **Help in recruiting.** Younger employees tend to like cash-balance plans, experts say, because money accumulates steadily and the value of the benefit seems more tangible.

"If I have all young employees, they're going to be interested in cash balance," says Joe Sapora, a vice president with consulting firm The Hay Group in New York. "It's the sizzle on the steak. And we've been seeing huge companies make the change. Traditional plans are declining."

Adds Steve Marcus, at Bell Atlantic: "This plan, from our perspective, is more flexible and easier for employees to understand."

The transition from traditional pension to cash-balance plans can be painful for some employees.

Take Stephen Langlie, who spent nearly 40 years with his employer, Onan, which manufactures power equipment and is based in Fridley, Minn. He says he was told in 1979 that he would pull in between $1,100 to $2,200 under his traditional retirement plan.

But the company switched to a cash-balance plan in 1989, he says. Because of that, Langlie says he now draws just $424 a month. He and other employees have sued the company. Onan did not return a call Monday seeking comment.

"Instead of a plane trip overseas, we'll have to drive around locally. Instead of buying a new car, it will be used," says Langlie, who had worked as an engineer. "It victimized the older workers and took away benefits they'd been promised under the traditional plan."

Many companies try to help ease the transition for older employees.

Towers Perrin reviewed more than 100 recent cash-balance conversions and found that, in the vast majority of the cases, employers made transition arrangements to protect employees who would otherwise be caught in the middle.

IBM, for example, will let the roughly 35,000 workers with fewer than five years until retirement opt out of the new pension option and stick with the traditional program.

Other details:

▶ The company will open an account for employees that is equivalent to at least the present value of what they have under the traditional pension plan.

▶ They will pay at least 5% of an employee's gross pay into the account each year. Contributions for the 50,000 to 60,000 mid-career workers could be 6% to 9%.

▶ The plan will go into effect July 1. The company will save about $200 million a year in pension contributions. But it also is putting $2.5 billion into beefed-up compensation programs, such as stock options.

Changing workforce

In the USA, about 40% of IBM's employees joined the company in the last six years alone. More than 60% of hiring today is experienced professionals, with the rest coming from university campuses.

"We're going to still have programs at the top of the industry," says Josie Tsao, a vice president of compensation and benefits at IBM. "If you look at what's happening in the workforce, a lot of people are moving from place to place."

Debate still exists over whether an employee is better off or not under such a plan. The real answer, experts say, is what program a company sets up and why they are doing it.

"There is a lot of confusion about cash balance plans," says Carol Quick, a research analyst at the Employee Benefit Research Institute. "Enlightened companies will be honest and tell employees their reasons for converting. If they're doing it to save money they should say so."

Contributing: Beth Belton and Christine Dugas

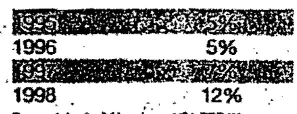
COMPARING THE TWO PLANS

Traditional programs: An employee gets a lifetime annuity starting at retirement based on their highest final average pay and years of service. The value starts low but rises sharply toward retirement.

Cash-balance plan: Employers pay the equivalent of 4% to 7% into an account for each employee, and the amount is guaranteed to earn an annual interest credit. The money accumulates steadily over time.

On the rise

Though cash-balance plans make up only 12% of defined benefit pension plans, their numbers are up from 1995. Percentage of plans that use the cash-balance method:



Research by April Umminger, USA TODAY
Source: Hewitt Associates