New Pension Rules: Do They Cut It?

Critics Question A Treasury Proposal to Protect Employees For Five Years

- By Trish Nicholson (AARP Bulletin March 2004)

The retirement benefits of workers at companies converting from traditional pensions to cash balance plans would be somewhat better protected under a proposal before congress.

The U.S. Treasury Department's plan requires that benefits remain at east as valuable as they would have been for five years after the switch.

But the safeguards don't last long enough, critics say, and thousands of workers who need to work another decade or so could still see their nest eggs diminish.

Cash balance plans – which, like traditional plans, are funded completely by employers – have become increasingly popular in recent years.

Employers say the plans are better suited to today's worker, who typically moves from job to job, because the payout can be rolled over into another employer's plan when the worker changes jobs. And, although employers are loath to admit it, these plans are generally cheaper to maintain.

But thousands of older workers caught in cash balance conversions claim to have lost 20 percent to 50 percent of their benefits. That's because benefits accrue differently in the two types of plans. The new proposal, developed by the Treasury Department at the urging of Congress, "will make sure that every company converting to a cash balance plan deals fairly with its older workers," Treasury Secretary John Snow said in a statement.

But workers' advocates say five years' protection won't do the trick.

"Five years might be enough f you're on the brink of retirement," says Evelyn Morton, AARP's director of economic issues. "But most workers age 50-plus could still lose a big chunk of their pension – and would not have time before they retire to recoup the loss."

The Treasury's proposal is the latest attempt to resolve a long-standing imbroglio between employers and their long-term employees.

The Internal Revenue Service quit approving cash balance plans in 1999, after a flurry of class action lawsuits and claims filed with the Equal Employment Opportunity Commission raised questions about whether the plans violated federal age discrimination laws.

In December 2002 the Treasury Department issued proposed regulations saying cash balance plans did not discriminate by age.

Last summer a federal court disagreed, ruling IBM's plan to be age-biased. IBM plans to appeal.

Early this year congress barred the Treasury from moving forward with its rules. Instruction the department instead to propose legislation that would protect older workers' benefits when companies switch plans.

The Treasury's latest proposal is a step in the right direction, workers' advocates say. It would enforce the five-year protection through an excise tax equal to any savings a company gained by cutting benefits. Companies that let workers choose to stay in the old plan would b exempt.

But there's a loophole in enforcement, says Norman Stein, a law professor at the University of Alabama. A company losing money could avoid paying the tax.

Employers too, have had mixed reactions to the proposal. They are pleased it spells out that cash balance plans are not to be age-biased but frustrated that it does not sanction previous conversions says Lynn Dudley, vice president of the American Benefits Council

Forcing employers to maintain certain benefits is "a bad idea," Dudley adds. Companies don't have to sponsor pension plans at all, and this proposal, she says, gives them no incentive to stay in the game.

Where Does the Money Go?

Many older workers lose benefits in cash balance conversions, experts say, because of a change in the way benefits are calculated.

Traditional pension plans reward long-term service with a generous spike in benefits at the end of a worker's career

Cash balance plans build benefits more slowly but steadily, adding a little value each year.

When an employer changes plans, many older workers who have worked for the company for years miss out on the spike they'd been waiting for – and do not have enough time left in their careers to make up the difference with benefits that grow more slowly.