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THE CASH BALANCE PLAN: AN INTEGRAL COMPONENT OF THE DEFINED BENEFIT PLAN RENAISSANCE

BARRY KOZAK*

The world of tax qualified retirement plans is comprised of two types of plans: defined benefit plans and defined contribution plans. For various reasons, the overall utility of the defined benefit plan has diminished over the last three decades. However, this article proposes that, due to some statutory changes and economic trends over the last few years, the stage is set for a revitalization of the use of defined benefit plans. An integral component of this renaissance is the acceptance and proper use of a hybrid plan design commonly referred to as a cash balance plan.

This article will first detail the key characteristics of defined benefit and defined contribution plans, and will indicate which characteristics were borrowed from each to form the hybrid cash balance plan design. Although a hybrid, a cash balance plan is universally viewed as a defined benefit plan; therefore, the second part of this article will discuss the statutory requirements that all defined benefit plans must comply with. Cash balance plans have been the subject of litigation over the last few years; as such, the third part of this article will detail the specific issues that have to date been litigated. The fourth part will detail and summarize how the courts have cumulatively decided the issues. The courts are not the only parties that are looking at the cash balance plan issues; hence, the fifth part of this article will summarize the actions that have been taken in the various branches of government. Finally, the sixth part of this article will describe the defined benefit plan renaissance, will opine on how the cash balance plan is an absolutely integral component, and will attempt to show that individuals that oppose cash balance plans simply misunderstand the reasons employers convert to or adopt cash

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balance plans.

I. WHAT IS A CASH BALANCE PLAN?

Unfortunately, there is no good statutory definition of a cash balance plan.¹ However, employers that sponsor them believe (or at least hope) that they have a good tax-qualified retirement plan through which they deliver retirement benefits to their employees. Statutorily, there are only two classifications of qualified retirement plans:² a defined contribution plan and a defined benefit plan. A cash balance plan is actually a hybrid, where creative attorneys, actuaries, accountants, and other benefits professionals stole certain traits from each class of plan. A brief discussion of defined contribution and defined benefit plans is needed before exploring the blended characteristics of a cash balance plan.

A. What is a Defined Contribution Plan?

The statutory definition of a defined contribution plan is “a [pension] plan which provides for an individual account for each participant and for benefits based solely on the amount contributed to the participant’s account, and any income, expenses, gains and losses, and any forfeitures of accounts of other participants which may be allocated to such participant’s account.”³ There are several different types of defined contribution plans, such as:

- a *money purchase plan*,⁴ in which the plan document defines

1. As discussed later in this article, there is a statutory definition of “certain plans” which, arguably, might encompass cash balance plans.

2. Retirement plans that comply with all of the requirements of Section 401(a) of the Internal Revenue Code of 1986, as amended and as codified in Title 26 of the United States Code (hereafter referred to as “I.R.C.”), and including all regulations and other guidance published by the Department of Treasury, are deemed “qualified” plans. With a qualified retirement plan, the contributions made by the employer to fund the plan benefits are immediately deductible, the income taxation for the participants is deferred until the year that benefits are received from the plan, and neither the employer nor the participants pay income taxes in between since the assets must generally be invested in a special trust that meets the requirements of I.R.C. § 501(a) (2000).

3. I.R.C. § 414(i) (2000). A basically identical definition is found in Section 3(34) of the Employee Retirement Income Security Act of 1974, as amended and as codified in Title 29 of the United States Code, at 29 U.S.C. § 1001 *et. seq.* (hereafter referred to as “ERISA”), and including all regulations and other guidance published by the Department of Labor. 29 U.S.C. § 1002(34) (2000) also labels such a plan as an “individual account plan.”

4. Although there is no statutory definition, a money purchase plan is considered a “pension plan” under the Treasury Regulations, since the plan is established and maintained primarily to provide systematically for the payment of definitely determinable benefits to its employees, and where such contributions are fixed without being geared to profits. See Treas. Reg.

- the exact employer contribution that must be allocated to each participant each year they are credited with a year of service;⁵
- a *profit sharing plan*,⁶ in which the plan document defines the exact method of allocating⁷ the annual discretionary employer contribution, if any, among the various participant accounts;
 - an *Employee Stock Ownership Plan ("ESOP")*, which is a profit sharing plan where the assets consist entirely of employer stock;⁸
 - a *401(k) plan*,⁹ in which participants voluntarily elect to defer a portion of their salaries into the plan, on a pre-tax basis, and in which the employer may match a portion of the deferrals;
 - a *thrift plan*, in which participants voluntarily elect to defer a portion of their salary into the plan, on an after-tax basis; and
 - a *target benefit plan*,¹⁰ which is a hybrid plan similar to a cash balance plan, but which is actually classified as a defined contribution plan.¹¹

In discussing the general class of defined contribution plans, regardless of type, there are three main plan characteristics that will become relevant in the subsequent discussion of a cash balance plan. The first is the benefits that participants will be entitled to. The second is the exposure to investment and market risks. The third is the communication of plan benefits to the participants (and their perceived understanding).

Regarding the benefits, as the statutory definition indicates, every participant is entitled to her respective account, whatever it is worth. In all defined contribution plans, the employer contribution made to the plan on an annual basis, if any, is allocated among the participant accounts, as are forfeitures from other participants who terminate without being fully vested.¹²

§ 1.401-1(b)(1)(I) (2000).

5. A year of service is defined in I.R.C. § 411(a)(5) (2000) and 29 U.S.C. § 1052(a)(3)(A) as any predetermined twelve month period where the participant has worked, or has been paid for, at least 1000 hours of service, as that term is defined in 29 C.F.R. § 2530.200b-2 (2000).

6. A profit sharing plan is defined in Treas. Reg. § 1.401-1(b)(1)(ii) (2003).

7. Different allocation methods are allowed to be defined in the plan document, as long as the allocations do not violate the nondiscrimination requirements of I.R.C. § 401(a)(4) (2000).

8. An ESOP must also meet the special requirements of I.R.C. § 401(a)(28) (2000).

9. Cash or Deferred Arrangements are defined in I.R.C. § 401(k) (2000).

10. A target benefit plan was originally described by the IRS in Rev. Rul. 76-464, 1976-2 C.B. 115, but such Revenue Ruling was obsolete by Rev. Rul. 93-87, 1993-2 C.B. 124. However, a safe harbor target benefit plan is described in Treas. Reg. § 1.401(a)(4)-8(b)(iii)(C)(3) (2003).

11. See H.R. Rep. No. 93-1280, at 344 (1974).

12. Vesting of employer contributions, as defined in I.R.C. § 411(a)(2) (2000) and 29 U.S.C. § 1053(a)(2) (2000), means the portion of the benefit that the participant has an unforfeitable right to receive, even if the individual's employment is terminated.

Fund earnings are also credited to the accounts (or debited if there is a loss of market value). There are no guarantees on the benefits, and the participants will only know what their respective benefits are upon actual retirement or termination.

Regarding the exposure to investment risk, the participants bear it all. In a defined contribution plan, either the employer invests the plan assets, or investment discretion is turned over to the plan participants themselves. Either way, the market risk is totally borne by the participants. Generally, the employer designates at least one individual as a fiduciary, who will invest the assets, and, as long as they are invested properly,¹³ the fiduciary cannot be held personally liable¹⁴ for any losses to the accounts. In many defined contribution plans, however, the fiduciary transfers the actual day-to-day investment decisions directly to the participants; the fiduciary selects the investment options, and if they are selected and administered properly,¹⁵ then the participants cannot hold the plan fiduciary liable for any losses to their respective accounts.¹⁶ Therefore, whether the employer (through the plan fiduciary) invests the defined contribution plan assets, or just selects the options available for the participants to self-direct the investments of their individual accounts, if accounts lose value right before a participant is set to retire, then that participant either has less of a retirement nest egg than was expected, or must choose to postpone retirement until a proper nest egg is finally accumulated.

Regarding the communication of benefits, each year the participant receives a reconciliation of her account from last year to this year. It is apparent that participants easily understand the current value of their benefits. However, as the benefits from the plan are supposed to represent funds to be used during their actual retirement, it is also quite apparent that the average individual likely does not understand how a single sum of money

13. The fiduciary duties are defined in 29 U.S.C. § 1104(a) (2000), and a fiduciary must discharge his duties in the sole interest of the plan participants and beneficiaries: exclusively; prudently; with the intent to diversify and protect against large losses; and in accordance with the written plan document and relevant laws.

14. A breach of fiduciary duty is defined in 29 U.S.C. § 1109 (2000), and the civil cause of action available against the fiduciary, as an individual, is described in 29 U.S.C. § 1132(a) (2000).

15. The selection of and future monitoring of the actual investment choices available to the participants, including the use of employer stock, are all, in and of themselves, fiduciary decisions subject to 29 U.S.C. § 1104(a).

16. Under 29 U.S.C. § 1104(c), and 29 C.F.R. § 2550-404c-1 (2003), all investment options must provide the participants with an opportunity to exercise control, such as the delivery of prospectus and the pass-through of voting rights, and there must be at least three different investment alternatives to choose from, which collectively represent a broad range of risk and return characteristics.

currently should be invested and annuitized over her future life expectancy so that it will properly fund the retirement expenses.

B. What is a Defined Benefit Plan?

The statutory definition of a defined benefit plan is “any plan which is not a defined contribution plan.”¹⁷ Obviously, Congress was a little less clear in this definition, but certainly made it a catch-all for any plan that does not fit neatly within the statutory definition of a defined contribution plan. Some different rules apply to defined benefit plans sponsored by single employers than apply to defined benefit plans sponsored by multi-employers or multiple employers. However, for the remainder of this article, unless indicated otherwise, any reference to a defined benefit plan will suggest a single employer sponsored defined benefit plan.

There are generally three types formulas that are drafted into a traditional defined benefit plan document:

- A *flat benefit formula*, where salary is irrelevant and every participant gets a stated monthly benefit multiplied by her years of service with the employer;
- A *fixed benefit formula*,¹⁸ where every participant will get a stated replacement percentage of her final average salary, expressed as a monthly benefit; or
- A *unit benefit formula*,¹⁹ where every participant will earn a stated replacement percentage of her salary for each year of service with the employer, expressed as a monthly benefit.

Regarding the benefits, every participant is entitled to receive whatever benefit is promised under the terms of the defined benefit plan document. All defined benefit plans must provide a retirement benefit expressed in the form of an annual benefit commencing at normal retirement age.²⁰ The plan may provide alternate forms of a distribution, such as a joint and survivor annuity²¹ or a life annuity with a term certain,²² and may even

17. I.R.C. § 414(i) (2000). A basically identical definition is found in Section 3(34) of the Employee Retirement Income Security Act of 1974, as amended and as codified in Title 29 of the United States Code, at 29 U.S.C. § 1001 *et. seq.* (hereafter referred to as “ERISA”), and including all regulations and other guidance published by the Department of Labor. 29 U.S.C. § 1002(34) (2000) also labels such a plan as an “individual account plan.”

18. This design is sometimes referred to as a final average pay plan since there is always a rolling average of salaries to which the formula is applied.

19. This design is sometimes referred to as a career average pay plan since all salaries, even the lower salaries during an employee’s earlier years, are included in the overall benefit determination.

20. I.R.C. § 411(a)(7)(A)(i) (2003) and 29 U.S.C. §§ 1002(23)(A) and 1054(b)(1)(C).

21. Unlike a life annuity which is paid as long as the participant is alive, a joint and survivor annuity will be paid as long as the participant is alive, and upon her death, if the named second life is still alive, then the annuity will be paid until the death of the second life. In order to take advantage of this

provide a single lump sum distribution;²³ however, the plan document must state the actuarial equivalents used to convert the life annuity into any other form of distribution in a manner that prevents any type of discretion on the part of the plan administrator.²⁴

Other features of defined benefit plans include the ability to provide benefits based on employment with the employer before the plan was actually established (referred to as a past service liability), or service with a predecessor employer (such as service with a different employer that ultimately gets merged into or is acquired by the current employer sponsoring the plan). Defined benefit plans can also offer early retirement subsidies and early retirement windows that offer enhanced benefits in exchange for a voluntary termination of employment.²⁵ Since defined contribution plans are based on annual allocations rather than a benefit promised at retirement, they cannot be designed to provide these extra benefits²⁶ that are characteristic to defined benefit plans.

Regarding the exposure to investment risk, the employer bears it all. In a defined benefit plan, there is a pool of plan assets rather than a collection of individual accounts. It is up to the employer to properly fund the plan so that, each year, there are always enough assets to pay out the liabilities (i.e., plan benefits). Each year, an enrolled actuary²⁷ is required to use reasonable

protection for the second life, the participant must pay a "premium" in the form of a lesser monthly annuity. If the second life, which is irrevocably selected before distributions begin, dies before the participant, then the participant "loses" out on the premium paid.

22. In a similar manner, if the participant needs a certain term that the annuity will be paid, regardless of whether she is alive, then a premium must be paid in order to receive the protection of the desired term certain.

23. A lump sum distribution represents the actuarial present value that is mathematically equivalent to the life annuity, based on the Plan's actuarial equivalents (such as life expectancies and interest rates). The single lump sum distribution may prove to be inadequate for a participant that actually outlives her life expectancy. Therefore, the irrevocable election to receive a lump sum distribution in lieu of any form of annuity is a gamble, and healthy individuals that outlive their assumed life expectancies will "lose" out on any future plan benefits once the lump sum distribution has been wholly depleted.

24. I.R.C. § 401(a)(25) (2002).

25. Oftentimes, when an employer is faced with the need to reduce its workforce, the offering of early retirement incentives through a defined benefit plan might encourage enough older employees to voluntarily leave so that there is no need to fire anyone.

26. A single exception to this statement is that under I.R.C. § 414(v) (2002), employees who are older than age fifty are allowed to make additional "[c]atch up contributions" to make up for past years in which they might not have taken full advantage of their annual deferral limits.

27. 29 U.S.C. § 1241 (2000) established the Joint Board for the Enrollment of Actuaries, and Regulations were published in 40 Fed. Reg. 18,776 (Apr. 30, 1975) which define the requirements for an individual to be certified as an

assumptions²⁸ to estimate expected liabilities of the plan, compare them to the current assets, and determine the minimum funding requirement for the year.²⁹ The employer has little flexibility, and unless the IRS approves a funding waiver,³⁰ the employer must contribute whatever amount is determined by the enrolled actuary. Therefore, in years that the assets lose value because of poor investment performance, the contribution due to the plan will be greater than expected.

Another aspect of defined benefits plans is the protection by the Pension Benefit Guaranty Corporation ("PBGC"),³¹ which guarantees³² the benefits promised to employees through defined benefit plans. Almost all defined benefit plans need to pay premiums into the PBGC, but only those plans in dire financial straits will receive help from the PBGC.³³ This governmental protection for all defined benefit plans makes them more attractive to employees because even in a poorly funded plan, the employees generally do not risk forfeited benefits due to poor investment performance.

Finally, regarding the communication of benefits, the participant usually receives a statement each year showing her expected benefit that will be paid upon retirement (assuming that she continues working for the rest of her career with the employer), and the portion of the benefit that has been accrued to date.³⁴ Arguably, the average participant in a defined benefit plan might not understand or appreciate the true value of her benefits until she approaches retirement age and the accrued benefit starts

enrolled actuary.

28. I.R.C. § 412(c)(3) (2000) and 29 U.S.C. § 1082(c)(3) (2000).

29. I.R.C. § 412(b) and 29 U.S.C. § 1082(b).

30. I.R.C. § 412(d).

31. 29 U.S.C. § 1302 (2000) established the Pension Benefit Guaranty Corporation, which is a federal corporation that insures the retirement promises made by employers through defined benefit plans.

32. 29 U.S.C. § 1322 (2000) sets the statutory limits for such guarantees, which are updated annually for cost of living adjustments.

33. There are three ways that a defined benefit plan is allowed to terminate under 29 U.S.C. §§ 1341, 1342 (2000): a standard termination, where the plan has enough assets to pay out all current liabilities (and therefore will not receive any financial assistance from the PBGC); a distress termination, where the plan assets are insufficient, the economic viability of the sponsoring employer is in doubt, and the employer asks the PBGC to assume trusteeship of the assets; or a PBGC-initiated termination, where the PBGC assumes trusteeship of a problematic plan regardless of whether the employer wants it to or not. Most defined benefit plans are terminated under a standard termination.

34. An employee is hired with no benefits in the plan, and if she continues working until retirement, she will enjoy the full retirement benefits as promised under the defined benefit plan document. Every defined benefit plan document must describe how the benefit accrues along the way, and the accrued benefit formula and pattern must comply with I.R.C. § 411(b)(1)(A-C) and 29 U.S.C. § 1054(b)(1)(A-C) (2000).

to approximate the full normal retirement benefit promised through the plan.

C. What hybrid traits constitute a Cash Balance Plan?

Creative attorneys, actuaries, accountants, and other benefits professionals found clients that liked the ability to offer a variety of benefit promises and the single pool of assets found in a defined benefit plan, but also liked the perceived portability and the understanding of an individual account rather than a retirement annuity. This led to some of the earliest cash balance plan designs.³⁵ Generally, the defined contribution attributes of a cash balance plan include:³⁶ the communication of an individual account to each participant; accruals spread evenly over a participant's career instead of mostly in the final years before retirement (as in a traditional defined benefit plan); avoidance of periods of service where accruals in the pension plan might be the key factor an employee uses to choose between remaining employed and terminating service with the employer;³⁷ and the general availability of lump sum distributions. On the other hand, the general defined benefit attributes of a cash balance plan include:³⁸ the ability to provide early retirement subsidies, window benefits, and other special purpose benefits; the ability to provide benefits based on service with a predecessor employer or before the plan was adopted; a limitation on the annual benefit at retirement rather than a limit on the annual allocation to the account; the PBGC guaranteed benefits; the employer bears the investment risk rather than the individual participants and beneficiaries; and existing traditional defined benefit plans can be converted into cash balance plans instead of being terminated altogether.

As discussed below, the defined benefit traits of a cash balance plan outweigh the defined contribution traits, and as such, will be classified as a defined benefit plan. Therefore, the sponsoring employer will be subject to greater administrative costs (such as the required services of an enrolled actuary), will need to properly fund the plan (even in lean years when plan contributions might cause an economic strain), will generally need to pay

35. Bank of America is often credited as receiving one of the first IRS determination letters in 1985, indicating that the IRS believed that the plan document was in compliance with the qualified rules of I.R.C. § 401(a). See 1 Qual. Deferred Comp. Plans § 1.8, at n.1.

36. Stuart M. Lewis, *Cash Balance Plans—Overview and Issues*, American Bar Association National Institute on ERISA Litigation, Nov. 11-13, 1999, N99ELI ABA-LGLED H-1, at H-3.

37. This attribute of defined contribution plans, as well as the fact that employees can take an immediate lump sum when they terminate employment, lead many to view defined contribution plans as being more portable than traditional defined benefit plans. *Id.*

38. *Id.*

premiums to the PBGC, and will be restricted on when and how it can potentially terminate the plan. In addition, as discussed below, there are certain additional statutory requirements that all defined benefit plans must meet in order to be qualified.

The colloquial term, cash balance plan, is misleading because there are several distinctive designs that various employers have adopted. A few of the more common designs include:

- A *common cash balance plan*, which provides definitely determinable pension credits and interest credits into each participant's hypothetical individual account for each year of service; and the participant is entitled to the vested portion of her hypothetical account as a benefit;
- A *defined lump sum plan*, where participants earn definitely determinable credits for each year of service; the participant is entitled to the sum of credits accumulated multiplied by final average salary, expressed as a lump sum distribution, as a benefit;
- A *pension equity plan*, which is similar to the defined lump sum plan, but the definitely determinable credits are earned based on age rather than by years of service;³⁹ and
- An *indexed career plan*, which provides an accrual for each year equal to a specified percentage of that year's salary, and instead of interest credits, provides definitely determinable index rate conversion factors that improve each year's cumulative accruals to the following year.⁴⁰

II. WHAT STATUTORY RULES MUST A CASH BALANCE DEFINED BENEFIT PLAN COMPLY WITH?

Most of the statutory rules under I.R.C. § 401(a) are applicable to all qualified retirement plans, but there are certain rules that specifically affect defined benefit plans. It is been widely accepted that the cash balance plan design represents a hybrid defined benefit plan, and, must therefore comply with these additional rules. However, the reasons for such acquiescence need to be explored, since Congress has never classified cash balance plans in the statute, the Department of Treasury indicated their classification of cash balance plans as defined benefit plans through guidance unrelated to the interpretation of the statutory definitions, and the appellate courts that have made such a conclusion generally include no legal basis. The author does not believe that a cash balance plan is improperly classified as a

39. Pamela C. Scott, *Qualified Defined Benefit Plans: The Essentials*, Practising Law Institute Tax Law and Estate Planning Course Handbook Series, July, 1998, 421 PLI/Tax 33, at 40.

40. Strella, 352-3rd T.M., *Specialized Qualified Plans—Cash Balance, Target, Age-Weighted and Hybrids*, at V.A. § 2, available at http://www.bnatax.com/tm/authors_s.htm.

defined benefit plan, but feels compelled to lay out the inconclusive basis upon which this determination has been made.

A. *Is a cash balance plan truly a defined benefit plan?*

A cash balance plan has no statutory definition. As indicated previously, there are only two statutory definitions of the class of qualified retirement plans: defined contribution and defined benefit plans.⁴¹ Congress has, however, included a quasi-definition/quasi-requirement in the statute, which is simply labeled "certain plans."⁴² Under this definition/requirement, a defined benefit plan which provides a benefit derived from employer contributions which is based *partly*⁴³ on the balance of the separate account of a participant shall be treated as a defined contribution plan for purposes of the minimum participation standards,⁴⁴ shall be treated as a defined benefit plan for purposes of an excise tax on prohibited transactions,⁴⁵ and then shall be viewed as a bifurcated plan consisting of a defined contribution portion, where the defined contribution rules apply to certain aspects of the plan design *to the extent the benefits are based on the separate account of the participant*, and a defined benefit portion, with respect to the remaining portion of the benefits.⁴⁶ A § 414(k) plan is generally thought of as a single plan that provides both traditional defined benefit and defined contribution promises through a floor-offset arrangement,⁴⁷ and does not accurately

41. See *supra* note 3 and 17, respectively.

42. See I.R.C. § 414(k) and 29 U.S.C. § 1002 (35)(A) and (B) (providing basically similar definitions, however, the provision in the Code has more cross-references than the provision in ERISA, and the term "certain plan" is not contained in the ERISA provision).

43. *Id.* (emphasis added).

44. I.R.C. § 414(k)(1), referencing I.R.C. § 410, and 29 U.S.C. § 1052 (2000).

45. I.R.C. § 414(k)(3). There is a similar definition of Prohibited Transaction in 29 U.S.C. § 1106 (2000), but this ERISA provision is not cross-referenced anywhere within 29 U.S.C. § 1052. The definitions of Prohibited Transaction are basically identical, except that under the ERISA definition, the term "party in interest" (which includes certain relatives of individuals deemed parties in interest) replaces the term "disqualified person" (which does not include those relatives). The definition/requirement provision at § 414(k) of the Code, which indicates how the Department of Treasury will treat the plan for tax purposes, arguably does not affect whether a similarly designed retirement plan will be deemed a defined benefit or a defined contribution plan or how it will be treated by the Department of Labor and the courts for civil and criminal enforcement purposes of ERISA-defined prohibited transaction violations.

46. I.R.C. § 414(k)(2) and 29 U.S.C. § 1052(B) (emphasis added). The only common provision that is similarly referenced in both the Code and ERISA is the definition of accrued benefit, which, as referenced by I.R.C. § 414(k)(2), is limited to I.R.C. § 411(a)(7)(A), but as referenced in 29 U.S.C. § 1052(B), applies more generally to 29 U.S.C. §§ 1002(23) and 1054 (2000).

47. See *Berger v. Nazametz*, 157 F. Supp. 2d 998, 1002 (S.D. Ill. 2001) (explaining a typical floor-offset arrangement where a participant always

describe any of the known cash balance plan designs (which are based wholly, instead of partly, on individual accounts).

If I.R.C. § 414(k), and its corresponding provision in ERISA § 3(35)(A) and (B), does not encompass the true characteristics of a cash balance plan, then one of the two actual statutory definitions (defined contribution plans and defined benefit plans) must be complied with. Most will acquiesce that a cash balance plan does not fit completely within the definition of a defined contribution plan, since the interest is generally guaranteed, so it must, by default, fit within the catch-all definition of a defined benefit plan. This is the position that has been taken by the Department of Treasury.⁴⁸ Again, the author does not in any way disagree that a cash balance plan should be classified as a defined benefit plan rather than a defined contribution plan; however, the author wants to point out that Congress has never affirmatively promulgated this result, and that Treasury, instead of providing their interpretation through regulations published specifically on any of the definitions contained in I.R.C. § 414, only provided their interpretation through regulations discussing how defined benefit plans can use cross-testing methods to comply with the nondiscrimination rules⁴⁹ and through guidance discussing how defined benefit plans need to determine the present value of lump sum distributions.⁵⁰ The Department of Labor, as the other federal agency authorized to regulate ERISA plans,⁵¹ has not addressed how cash balance plans should be classified through any official guidance.⁵² Finally, as far as a judicial decree, only a few appellate courts have held that cash balance plans are indeed defined benefit plans,⁵³ and there remains a chance that defendant

receives at least the defined benefit promise, paid partly from the defined benefit trust and partly from the defined contribution trust; however, the participant might receive a higher benefit if the contributions and earnings attributable to the profit sharing account produce an enhanced benefit). In *Berger*, the employer previously maintained a separate defined benefit plan and a defined contribution plan, but then terminated the defined contribution plan and transferred those plan assets into the defined benefit trust, thus creating a plan described at I.R.C. § 414(k) and 29 U.S.C. § 1052(A) and (B).

48. See Treas. Reg. § 1.401(a)(4)-8(c)(3)(i) (2002) (defining a safe harbor testing method for cash balance plans); I.R.S. Notice 96-8, 1996-1 C.B. 359 (defining a cash balance plan and labeling it as a defined benefit plan).

49. I.R.C. § 401(a)(4) (2000).

50. *Id.* at § 417(e) (2000).

51. 29 U.S.C. § 1204 as further coordinated through various Executive Orders.

52. Upon visiting the website for the Department of Labor's Employee Benefits Security Administration, at <http://www.dol.gov/ebsa>, informal guidance such as "Frequently Asked Questions about Cash Balance Plans" clearly indicate that cash balance plans should be classified as defined benefit plans, but the author could not find more official guidance published by the DOL that provides support for this presumption.

53. See *Esden v. Bank of Boston*, 229 F.3d 154, 159 n.6 (2d Cir. 2000) (using

plans in other circuits could potentially argue that they are defined contribution plans, similar to money purchase pension plans or target benefit pension plans, rather than defined benefit plans.

The author believes that a main motivating factor for employer sponsors of cash balance plans to want to categorize them as defined benefit plans is because they want to avoid any tax penalties when converting from a traditional defined benefit plan into a cash balance plan.⁵⁴ Additionally, many of the conversions in the 1980's and 1990's allowed employers to use up some of the surplus by providing enhanced benefits to some participants, and due to the accounting rules that determine how defined benefit plan obligations are shown on the corporate income statement,⁵⁵ many employers enjoyed an improved earnings-per-share after the conversion only because the cash balance design was assumed to be a defined benefit plan. Therefore, while it is universally accepted that cash balance plans are classified as defined benefit plans rather than defined contribution plans, there is apparently no specific statutory basis, and the guidance from the Departments of Treasury and Labor, aggregated with the opinions of three Courts of Appeal, while not necessarily incorrect, do not seem to include formal and uncontroverted legal analyses in support of their respective conclusions.

B. What tax qualified rules apply only to defined benefit plans?

Assuming for the remainder of this article that cash balance plans are properly classified as defined benefit plans, then in

the catch-all definition of a defined benefit plan as support for its conclusion, and where the defendant Plan does not dispute such definition); *Lyons v. Georgia-Pacific Corp. Salaried Employees Ret. Plan*, 221 F.3d 1235, 1238 (11th Cir. 2000) (making the statement without any cited support); *Berger v. Xerox Corp. Ret. Income Guar. Plan*, 338 F.3d 755, 757 (7th Cir. 2003) (making the statement without any cited support).

54. Under I.R.C. § 4980 (2002), if a defined benefit plan is terminated and any portion of the assets revert back to the employer in accordance with the plan document, then such reversion is subject to a 20% penalty tax if the replacement defined contribution plan satisfies the qualified replacement plan rules of § 4980(d)(2), otherwise, under § 4980(d)(1), reversions are subject to a 50% penalty tax. A defined benefit plan that is amended into another form of a defined benefit plan is not subject to such penalties. Therefore, plan sponsors are in a better position if the conversion from a traditional defined benefit plan into a cash balance plan design is considered merely an amendment into another form of defined benefit plan rather than as a termination of a defined benefit plan and the establishment of a replacement. However, in the conversions that are known to have occurred, 100% of the assets were transferred to the replacement plans and the employers received no reversions at all; thus, even if a cash balance plan is someday deemed a defined contribution plan rather than a defined benefit plan, there is no reversion that is subject to any penalty tax.

55. See *infra* Section II.B.19.

addition to the laundry list of requirements⁵⁶ that are applicable to all qualified plans, there are certain specific requirements that apply only to defined benefit plans. The following list represents some of the issues that an employer must be prepared to deal with if it establishes a cash balance plan (or must continue to deal with if it converts a traditional defined benefit plan into a cash balance plan). Although these required thresholds and limitations are not shown in any specific order of importance, the first five represent issues which have to date been litigated in cash balance plan programs, which will be discussed in further detail later in this article, and the remaining provisions represent potential issues that cash balance plan sponsors must be prepared to defend if litigated by participants or if challenged by the Departments of Treasury or Labor.

1. No participant's accrued benefit can be reduced on account of any increase in his age or service.⁵⁷
2. No participant's benefit accrual can be ceased, nor can the rate of an employee's benefit accrual be reduced, because of the attainment of any age.⁵⁸
3. The optional form of benefit, when expressed as a lump sum distribution, shall not be less than the present value of benefits calculated by using the applicable mortality table and applicable interest rate⁵⁹ if the plan allows for a lump sum distribution.
4. A participant's accrued benefit cannot be decreased by an amendment of the plan.⁶⁰
5. Benefits must accrue in accordance to one of three accrued benefit methods (the 3-percent method, the 133 1/3 percent rule, or the Fractional rule).⁶¹
6. If the plan is amended to provide a significant reduction in the rate of future benefit accrual, then in order for the amendment to be effective, the plan administrator must provide a notice to

56. All plans must comply with the applicable provisions of I.R.C. § 401(a)(1) through (34) (2002) to be tax-qualified. *See supra* note 2.

57. I.R.C. § 401(a)(7) (referencing I.R.C. § 411(b)(1)(G), and 29 U.S.C. § 1054(b)(1)(G)).

58. I.R.C. § 401(a)(7) (referencing I.R.C. § 411(b)(1)(H), and 29 U.S.C. § 1054(b)(1)(H)). Note that the ERISA provision uses the term "employee" instead of "participant" in the first clause about benefit accrual.

59. I.R.C. § 401(a)(11) (referencing I.R.C. § 417(e)). This is sometimes referred to as either the "GATT rate" or the "RPA rate," referencing the Act that added this provision to the Code: the Retirement Protection Act of 1994 ("RPA"), signed into law by President Clinton on December 8, 1994 as part of the General Agreement on Tariffs and Trade ("GATT") legislation, P.L. 103-465.

60. I.R.C. § 401(a)(7) (referencing I.R.C. § 411(d)(6), and 29 U.S.C. § 1054(g)(1)).

61. *Id.* (referencing I.R.C. § 411(b)(1)(A), (B), and (C), and 29 U.S.C. § 1054(b)(1)(A), (B), and (C)).

- each applicable individual describing the reduction.⁶²
7. If the participant dies before the annuity starting date and has a surviving spouse, then a qualified pre-retirement joint and survivor annuity shall be provided to the participant's surviving spouse; otherwise, if a participant is married on her annuity starting date, then the accrued benefit payable to the participant shall be provided in the form of a qualified joint and survivor annuity unless the spouse agrees, in writing, to waive all ERISA spousal rights, and to receive an optional form of benefit payment (such as a lump sum distribution).⁶³
 8. The annual benefit paid cannot be greater than \$160,000 (as adjusted) or, if less, 100% of the participant's average compensation.⁶⁴
 9. For each year that the plan is top-heavy, each participant who is a non-key employee must receive a minimum accrued benefit of at least 2% of his average compensation for high five years for each year of service (to a maximum of ten years).⁶⁵
 10. Required distributions for employees who have attained age 70 1/2 must comply with the defined benefit plan minimum distribution rules.⁶⁶
 11. In order to provide definitely determinable benefits, whenever the amount of any benefit is to be determined on the basis of actuarial assumptions, such assumptions must be specified in the plan in such a way that precludes employer discretion.⁶⁷
 12. On each day of the plan year, the plan must benefit at least fifty employees or, if less, 40% of all employees of the employer.⁶⁸
 13. If the plan is terminated and there are excess assets after all liabilities have been paid, then the employer will pay a 50% penalty tax on the amount reverted.⁶⁹ Additionally, if the plan is voluntarily terminated, it must comply with the standard

62. I.R.C. § 4980F(2002); 29 U.S.C. § 1054 (h).

63. I.R.C. § 401(a)(11) (referencing I.R.C. § 417, and 29 U.S.C. § 1055). In addition to the benefits themselves, certain notices describing these spousal rights are required to be delivered at various times.

64. I.R.C. § 401(a)(16) (referencing I.R.C. § 415(b)). Note that a participant must be credited with ten years of service in order to be entitled to the full annual benefit limitation.

65. I.R.C. § 401(a)(10)(B) (referencing I.R.C. § 416).

66. I.R.C. § 401(a)(9). Regulations describing the method for calculating the required minimum distributions from defined contribution plans have been published in final form, in Treas. Reg. § 1.401(a)(9)-1 through -5, and -7 through -9. However, the regulations describing the method for calculating the required minimum distributions from defined benefit plans have only been published in temporary form, in Treas. Reg. § 1.401(a)(9)-6T.

67. I.R.C. § 401(a)(25) (2002).

68. *Id.* § 401(a)(26). There is controversy over whether, as the IRS interprets this statutory provision, each individual needs "meaningful benefits" in the defined benefit plan to be counted in the number account.

69. I.R.C. § 4980 (2002).

- termination rules.⁷⁰
14. The lump sum distributions payable to the top twenty five paid employees might be restricted depending on the plan's funded status.⁷¹
 15. Other than through a qualified plan loan,⁷² no in-service distributions are allowed⁷³ while participants are still active employees with the sponsoring employer.
 16. All defined benefit plans are subject to the minimum funding rules,⁷⁴ where an enrolled actuary is required to perform an actuarial valuation on an annual basis⁷⁵ in order to determine the proper funding based on the current value of plan assets and the expected level and timing of plan liabilities. The minimum required contribution is due on a quarterly basis,⁷⁶ may include an additional contribution if the employer is large,⁷⁷ and is based on a chosen funding method that can only periodically be changed.⁷⁸
 17. Most defined benefit plans must pay premiums on an annual basis to fund the PBGC,⁷⁹ and the premiums are calculated based on a standard dollar amount per participant plus a variable dollar amount (based on the funded status of the plan) per participant.⁸⁰
 18. For those defined benefit plans subject to PBGC governance, certain reportable events⁸¹ must be disclosed to the PBGC so that potentially troubled plans are at least on the PBGC's short list of plans that they need to monitor.
 19. Although not required by the Code or ERISA, defined benefit plans maintained by publicly held corporations must show on their income statements a pension expense that can potentially affect the overall earnings-per-share of the corporate sponsor.⁸²

70. See *supra* note 33.

71. Treas. Reg. § 1.401(a)(4)-5(b).

72. I.R.C. § 72(p) (2002).

73. Treas. Reg. § 1.401-1(b) indicates that in-service distributions are allowed from profit sharing plans, but not from defined benefit or other pension plans.

74. I.R.C. § 412(b) (2002); 29 U.S.C. § 1082(b).

75. I.R.C. § 412(c)(9); 29 U.S.C. § 1082(c)(9).

76. I.R.C. § 412(m); 29 U.S.C. § 1082(e).

77. I.R.C. § 412(l); 29 U.S.C. § 1082(d). A plan is large if there are more than one-hundred participants.

78. I.R.C. § 412(c)(5)(A) and 29 U.S.C. § 1082(c)(5)(A).

79. 29 U.S.C. § 1321, which covers almost all defined benefit plans, but with exceptions under paragraph (b) for certain plans, such as those only covering substantial owners or for plans maintained by professional service employers with less than twenty-five employees at all times after September 2, 1974.

80. 29 U.S.C. § 1306.

81. 29 U.S.C. § 1343.

82. Requirements of the Financial Accounting Standards Board, Standards

C. How do benefits accrue in a Cash Balance Plan?

As previously discussed, there are several cash balance plan designs. For the remainder of this article, unless otherwise indicated, a reference to a cash balance plan will suggest a "common" cash balance plan design. In a common cash balance plan, there is generally a formula in the document that provides pension credit allocations (such as ten percent of pay) and interest credit allocations (such as the GATT § 417(e) rate in effect in the December of the prior plan year) into each individual's hypothetical account for each year of credited service. If viewed on a graph, the accruals are essentially level throughout the employee's career (although they might increase somewhat in later years as the salaries are generally highest in the final years before retirement). This differs from the accrual patterns of traditional defined benefit plans, where, if viewed on a graph, the least valuable accruals are generally earned in the early years and the most valuable accruals are generally earned in the final years before retirement. Therefore, all other things being equal, a traditional defined benefit plan is designed to provide the most valuable benefits to older and longer-serviced employees. Cash balance plans, on the other hand, are not necessarily designed to favor any group of employees. As will be discussed later in the article, however, there is the economic reality that since a younger employee's expected career span is longer than an older employee's expected span, then the result of the compounding of interest over a longer period of time tends to make identical cash balance plan credits more valuable to younger and lesser-serviced employees than they are to older employees.

The other major difference between the accrual patterns in a traditional defined benefit plan and in a cash balance plan is the effect of applying an accrual formula to average salaries as opposed to applying the formula to each year's respective salary. In many traditional defined benefit plans, the replacement formula stated in the plan document is applied to a rolling average salary, and, since most employees receive continual compensation raises, the benefit increases proportionally as the salaries increase. For example, if a defined benefit plan promises an employee 70% of her high three year average salary upon retirement, and assuming that Employee A is fully vested and accrued in her benefit, then at age sixty, when her high three year average salary is \$100,000, she will receive a retirement annuity of \$70,000 per year upon retirement (age sixty-five) for the rest of her life; but at age sixty-three, when her salaries have increased each year and her high three year average is now \$120,000, then her annual benefit starting at age sixty-five will have jumped to

\$84,000. This increase in accrued benefit is due solely to her increased average salary.

In most cash balance plans, however, pension credits are accrued on a year-by-year basis, so the credits earned in the earlier years when salaries are traditionally lower will be locked in, and will not roll up as the employee's salaries increase over the rest of her career. For example, if a cash balance plan promises an employee an annual allocation of 10% of her salary, then if Employee A's salary for 2003 is \$100,000, she will receive an allocation for 2003 of \$10,000. If her salary increases in 2004 to \$120,000, then her allocation for 2004 will be \$12,000. So, although the cash balance allocations will increase each year as salaries increase, the earlier allocations will not be increased to reflect later salaries.

III. WHAT IS THE BIG CONTROVERSY OVER CASH BALANCE PLANS?

Although there are some issues with the general design of cash balance plans and whether they comply with the statutory provisions that apply specifically to defined benefit plans, most of the outrage, and in this author's opinion, misunderstanding, has centered around the conversion from a traditional defined benefit plan into a cash balance plan. "One of the hottest issues in the pension world today involves companies replacing their traditional pension plans with so-called cash balance plans."⁸³ When a traditional defined benefit plan is converted into a cash balance plan, the sponsoring employer must determine how the opening hypothetical cash balance accounts will be valued.⁸⁴ Cash balance plans are oftentimes viewed as being more beneficial to younger and lesser-serviced employees, so even if each participant's account balance on the first day after the conversion is equal to the present value of accrued benefits on the day before the conversion, there is a high probability that the level of benefits promised to an older and longer-serviced employee under the old plan design cannot be accumulated under the cash balance design with only a few years of allocations left until retirement. Therefore, the older and longer-serviced participants will generally lose out on some of the previously-promised benefits from the traditional plan that will not be available after the conversion into a cash balance plan.⁸⁵ Even if the employer tries to mitigate the loss of promised benefits to some of the older workers, unless it ensures that every single participant will not lose any promised

83. Jonathan Barry Forman & Amy Nixon, *Cash Balance Pension Plan Conversions*, 25 OKLA. CITY U. L. REV. 379, 380 (2000).

84. See generally *id.* (providing a complete discussion of conversions).

85. Accrued benefits can never be reduced due to a plan amendment, but promised benefits that have not yet been accrued can be reduced or eliminated. I.R.C. § 401(a)(7) (2002).

benefits under the new plan design, then there is always going to be a potential cut-off point where some older participants are not wholly protected. It is this group of employees caught in the middle that is the likely class of plaintiffs.

If the traditional defined benefit plan is terminated, then the plan pays out all accrued liabilities, and all future promised benefits are totally eliminated for all participants. If that employer establishes a brand new qualified retirement plan, then the new promised benefits are not affected by the accrued benefits from the now-terminated traditional defined benefit plan. The problem with conversions, rather than terminations, is that all of the accrued benefit rules for defined benefit plans will carry over into the new cash balance design, which then reasonably suggests that the future, not-yet-accrued benefits from the traditional defined benefit plan before the conversion, can affect the future benefit promises under the newly converted cash balance plan design.

There are several methods that can be used by employers to provide a smooth transition into the cash balance design, such as:⁸⁶ grandfathering the traditional defined benefit formula for certain older, longer-serviced participants; providing a one-time choice between the old and new formulas to certain grandfathered participants; providing an annual choice between the old and new formulas to certain grandfathered participants; providing the greater of the old or the new formula to certain grandfathered participants; providing the frozen benefits from the traditional plan (increased by salaries earned after the conversion) plus the cash balance benefits; providing greater cash balance plan credits to certain grandfathered participants; providing early retirement subsidies through the cash balance design that are lost after the conversion; or providing greater opening account balances for certain grandfathered participants that the cash balance plan would otherwise establish. To summarize, there are many options that are available to employers who *wish* to mitigate the effect of a cash balance plan conversion on certain older and longer-serviced participants. Such mitigation might reduce the possibility that an irate participant will sue the plan sponsor to recover future promised benefits that are lost in the conversion, and might be good public relations for the sponsoring employer. However, under the current statutory and regulatory framework, there is nothing that mandates *any* type of mitigation.

The following nine issues represent the controversies in cash

86. John Wendelin & Steve Pujol, *Cash Balance Pension Plans: Employer "Transition Benefit" Practices*, handout materials for the American Bar Association Joint Committee on Employee Benefits teleconference, "The Beat Goes On: New Cash Balance Cases That May Rock Things," (Aug. 26, 2003), available at <http://www.abanet.org/jceb/2003/t030826.html>.

balance plan conversions that have been litigated thus far. The classes of plaintiffs have generally been the “caught-in-the-middle” group.

A. *Wear-away*

As discussed, under ERISA § 204(g) and I.R.C. § 411(d)(6), no participant’s accrued benefit can ever be reduced due to a plan amendment.⁸⁷ This restriction applies to the conversion of a traditional defined benefit plan into a cash balance plan. If the employer does not mitigate the effect of lost future promised benefits, then the simple rule is that the participant’s hypothetical cash balance account can never be less than the present value of previously accrued benefits on the day before the conversion. The wear-away problem occurs when the method for determining the opening account balances for all participants produces opening accounts for some of the older workers that are less than their present values of previously accrued benefits. Such accounts will grow with annual cash balance and interest credits, but can never be less than the respective present value of previously accrued benefits. Therefore, it may take several years under the new cash balance formula for a participant’s cash balance account to exceed the preserved present value. It is only at that point in time that such a participant will reap any benefits from the cash balance conversion. In other words, it may take several years for the preserved present value to “wear away.”

To illustrate this point, assume an employer maintains a traditional defined benefit plan, which promises 1% of compensation for each year of service. Assume that Employee B, age sixty, has twenty years of service on December 31, 2002, when the plan is converted into a cash balance design, and assume further that the present value of his accrued benefit, based on the actuarial assumptions stated in the plan document, including a 5% interest rate, is \$150,000. Assume that the cash balance plan will provide an allocation of 10% of salary plus 5% interest credits, and the method of determining opening cash balance accounts, whatever it is, produces an opening balance of \$130,000 for Employee B. Employee B’s benefits from the plan, when communicated as a lump sum, must always be at least \$150,000, improved with interest. Therefore, on January 1, 2003, he is entitled to the greater of (i) \$150,000 or (ii) \$130,000. Assume that Employee B’s salary is \$100,000 for 2003. On December 31, 2003, he is entitled to the greater of (i) \$150,000 * 1.05 (which is \$157,500) or (ii) \$130,000 * 1.05 + \$10,000 (which is \$146,500). Assume that Employee B’s salary is \$110,000 for 2004. On December 31, 2004, he is entitled to the greater of (i) \$157,500 *

87. See *supra* note 60.

1.05 (which is \$165,375) or (ii) $\$146,500 * 1.05 + \$11,000$ (which is \$164,825). Assume that Employee B's salary is \$115,000 for 2005. On December 31, 2005, he is entitled to the greater of (i) \$165,375 * 1.05 (which is \$173,644) or (ii) $\$164,825 * 1.05 + \$11,500$ (which is \$184,566). Therefore, in this example, it would take Employee B three years until he actually accrues a benefit in the cash balance plan design, after the conversion, that will increase his preserved accrued benefits from the traditional defined benefit plan on the day before the conversion; however, note that in this example, Employee B would be sixty-three years old, and would have earned no benefit accruals between ages sixty and sixty-three, and even though his account from the cash balance plan design at age sixty-five will be more than his lump sum would have been at his age sixty-five if the Plan had merely been terminated on December 31, 2002, it will still be less than his lump sum would have been at his age sixty-five if the Plan had not been converted from the traditional defined benefit design.

The issue is whether cash balance plan conversions improperly reduce accrued benefits. See Sections IV.A.1 and IV.E.1 below.

B. Interest credits and the Whipsaw problem

While a participant is still employed, she is credited with cash balance credits and interest credits. However, there is a question as to whether the future interest credits constitute part of the accrued benefit. In other words, if a participant in a cash balance plan terminates employment at age fifty, then are the interest credits that would be added to her account over the next fifteen years (until normal retirement at age sixty-five) part of her accrued benefit, even if the participant takes a complete lump sum distribution at age fifty. One of the requirements of a distribution that is paid in a form other than as a life annuity, is that no portion of the accrued benefit may be forfeited.⁸⁸ Although many employers concede that future interest credits do constitute part of the accrued benefit that can never be reduced or taken away, there is still no affirmative statutory provision that requires it, and is only discussed in non-regulations guidance.⁸⁹

Also at issue is the calculation of the lump sum payable to a participant that so elects to receive a lump sum. In a traditional defined benefit plan, the document will express the promised retirement benefits in the form of an annuity starting at normal retirement age, and might provide a lump sum as an optional form of distribution. If a defined benefit plan offers a lump sum option, then the GATT § 417(e) rates must be used to calculate the

88. I.R.S. Notice 96-8, 1996-1 C.B. 359.

89. *Id.*

minimum lump sum that must be distributed at any point in time,⁹⁰ regardless of the plan's actuarial assumptions. Congress added the qualified joint and survivor annuity provisions, including this minimum lump sum distribution amount, in order to make it easier for working women to participate in pension plans, and to permit surviving spouses to share in participating workers' retirement benefits.⁹¹ Additionally, under ERISA § 203(a) and I.R.C. § 411(a)(2), the calculation of lump sum distributions and, likely, the opening account balances immediately following the conversion, cannot cause accrued benefits to be forfeited.

In a cash balance plan, however, interest credits are part of the benefit itself, not just a way to express mathematically equivalent benefit values at different points of time. The IRS issued a guidance⁹² that indicated that cash balance plans, as defined benefit plans, must also comply with the discounting rules of I.R.C. § 417(e). The problem is that if the sponsoring employer wants to provide interest credits until normal retirement with a guaranteed rate that is greater than the GATT § 417(e) applicable interest rate, and then discount to current age using the currently low GATT rates, then the minimum lump sum distribution that actually must be paid will be greater than the account balance. For example, if the employer wants to be benevolent and guarantee an 8% interest credit rate on the cash balance account, but if, according to the IRS, the plan is required to discount the distributions using a lower GATT interest rate, such as 5.48% for 2002, then the distribution will be greater than the hypothetical cash balance account since, mathematically, a lower discount rate will yield a higher present value. Assume Employee C is sixty-four years old, and has a cash balance account of \$100,000. If Employee C terminates employment and elects to receive a lump sum, then, under the IRS rules, the account balance must be projected to her age sixty-five at the Plan's interest crediting rate of 8% (i.e., $\$100,000 * 1.08$ (which is $\$108,000$)), but then discounted at the current GATT § 417(e) rate of 5.48% (i.e., $\$108,000 / 1.0548$ (which is $\$102,389$)). Therefore, in this case, if Employee C elected a lump sum distribution at age sixty-four, the Plan would be required to pay her \$102,389, even though the account based on the cash balance formula is only \$100,000.

90. *Id.* The applicable federal rates under I.R.C. § 417(e) are updated and published monthly. Many defined benefit plans, however, include procedures that set the GATT § 417(e) rate in effect in the month preceding the current plan year as the single rate that will be used to determine the minimum present values of accrued benefits for all lump sums that are distributed during the current plan year. *Id.*

91. David J. Guin, *The Retirement Equity Act of 1984: One Step Forward, Two Steps Back*, 37 ALA. L. REV. 163, 172 (1985).

92. I.R.S. Notice 96-8, 1996-1 C.B. 359.

This means that terminated participants taking lump sums will each receive more than their hypothetical cash balance accounts; thus, there will be an actuarial loss in the plan, which will require greater contributions from the employer to keep the plan properly funded for the remaining participants, who, will likely cause further actuarial losses when they terminate employment and receive their respected lump sum distributions. This phenomenon is referred to as whipsaw. Therefore, in order to avoid this whipsaw problem, employers are forced to credit interest using the lower guaranteed GATT rate rather than a higher rate. This practice avoids actuarial losses in the plan, but hurts participants who would have received greater interest credits if the cash balance plan did not need to comply with the minimum survivor annuity rules. In the above example, if the cash balance plan document indicated that interest would be credited at the current prevailing GATT § 417(e) rate rather than a locked-in rate of 8%, then Employee C's account would be improved and discounted at the same interest rate, resulting in a distribution equal to her hypothetical account balance of \$100,000.

The issue is whether the determination of a lump sum distribution must be the present value of the normal retirement benefits (expressed as an annuity). See sections IV.B.1, IV.C.1, IV.D.3, and IV.F.1 below.

C. Age discrimination – under ERISA

As previously discussed,⁹³ there are two provisions that prohibit age discrimination in a defined benefit plan's accrued benefits. However, these two separate provisions use two different terms, and the question is whether these terms "accrued benefit" and "rate of benefit accrual" mean the same thing. One argument is that they mean the same thing because, in order to calculate the rate of benefit accrual, the current year's accrued benefit must be compared to last year's accrued benefit. The other argument, however, is that since Congress chose to use two different terms in consecutive statutory provisions, then the terms intentionally have different definitions, and proving that the rate of accrual does not decrease because of age is independent of proving that accrued benefits do not decrease because of age. This latter argument is bolstered by two points: (1) the fact that there is a statutory definition of "accrued benefit" which is either expressed in the form of an annual benefit commencing at normal retirement age⁹⁴

93. See *supra* sections II.B.1 and 2 above.

94. I.R.C. § 411(a)(7)(A) (2002). This section of the Code defines the term "accrued benefit" for all purposes of I.R.C. § 411, with a reference to an exception to the general definition at § 411(c)(3), and ERISA §§ 3(23)(A) and 204(b)(1)(C). *Id.*

or is expressed as an actuarial equivalent of such amount,⁹⁵ but there is no statutory definition of “rate of benefit accruals;” and (2) the headings that contain the respective provisions are different⁹⁶ and that the provision for “rate of benefit accruals” ostensibly only applies to participants who are still employed beyond normal retirement age and are deferring the receipt of any plan benefits.

So, how does a cash balance plan prove compliance with both of these statutory provisions in the absence of any legally-binding guidance?⁹⁷ In pure economic terms, in a plan that provides a uniform cash balance credit of 10% of compensation, a younger employee and an older employee, each earning a salary of \$50,000, will receive the identical cash balance credit of \$5,000. However, due to the function of compounding interest over a longer period of time, a \$5,000 credit is more valuable to the younger employee. However, nothing in the statute discusses whether the impact of economic theorems affect a plan’s compliance with the accrued benefit and rate of benefit accrual rules.

The issue is whether a cash balance design violates the anti-age-discrimination rules of ERISA. See sections IV.D.1, IV.E.2, and IV.G.1 below.

D. Age discrimination – under ADEA

The general purpose of the Age Discrimination in Employment Act (“ADEA”)⁹⁸ is to prevent employment discrimination based upon age, and the protected class of employees are those who have attained age forty. The ADEA in many ways mirrors Title VII of the Civil Rights Act (“Title VII”)⁹⁹ as each shares the common notion of eliminating discrimination in the workplace. Title VII recognizes a couple theories of liability for employment discrimination cases, one being disparate impact. Disparate impact prohibits certain employment practices that have only a discriminatory effect upon employees. For a plaintiff to succeed under a disparate impact theory under Title VII, he must demonstrate that his employer uses neutral factors in its decision making process which disproportionately impacts a protected group. Stated another way, employment practices that

95. I.R.C. § 411(c)(3).

96. The heading of I.R.C. § 411(b)(1)(G) is “Accrued benefit may not decrease on account of increasing age or service” whereas the heading at I.R.C. § 411(b)(1)(H) is “Continued accrual beyond normal retirement age”.

97. See Reduction of Accruals and Allocations Because of the Attainment of any Age, Application, of Nondiscrimination Cross Testing Rules to Cash Balance Plans, 67 Fed. Reg. 76,123 (proposed Dec. 11, 2002). Treasury Regulations indicating how cash balance plans can comply with the rate of accrual requirements were published in proposed form in 2002, and, due to unexpected controversies, have not yet been published in final form.

98. 29 U.S.C. § 621, *et. seq.* (1996).

99. 42 U.S.C. § 2000e-2 (1991).

seem fair in form, but are actually discriminatory in operation, will violate Title VII. Due to the similarities between the ADEA and Title VII, however, it is unclear whether the ADEA also recognizes the disparate impact theories.¹⁰⁰ The United States Supreme Court has yet to decide on the issue and the appellate courts are currently split on an answer: the First, Seventh, and Tenth Circuits have affirmatively held that disparate impact claims are not available under the ADEA, which is seemingly the current trend, while the Second, Eighth, and Ninth Circuits continue to hold that such theories are available to plaintiffs.¹⁰¹

The issue is whether cash balance plan designs violate the anti-age-discrimination rules of ADEA. See sections IV.D.2 and IV.E.3 below.

E. Protection of Accrued Benefits

No accrued benefits in a defined benefit plan can be reduced due to a plan amendment.¹⁰² For this purpose, accrued benefits include early retirement benefits and benefit-type subsidies¹⁰³ and optional forms of benefits.¹⁰⁴ Therefore, when a traditional defined benefit plan is amended into a cash balance design, all early retirement benefits that a participant is entitled to on the day before the conversion must be available on the day after the conversion. However, some participants who are close to satisfying the requirements for early retirement benefits will never be able to grow into such benefits after the conversion. If the early retirement benefits and subsidies are not preserved after the conversion, then these participants might argue that the conversion violates these anti-cutback rules. The opposite argument is that if the plan were terminated, all participants who have not yet earned any early retirement benefits would lose out on such benefits, so why should an employer's choice to convert (which arguably impacts benefits for a few participants) be more problematic than an employer's choice to terminate the plan altogether (which absolutely impacts the benefits for all participants).

Here, the issue is whether the calculation of lump sum distributions, or the calculation of the opening account balances after the conversion, cause improper forfeitures. See sections

100. See generally Nathan Holmes, *The Age Discrimination In Employment Act Of 1967: Are Disparate Impact Claims Available?*, 69 U. CIN. L.REV. 299 (2000); Joshua A. Rodine, *Does the Cash Ever Balance After Conversion?: An Examination of Cash Balance Pension Plan Conversions and ADEA Claims*, 9 ELDER L.J. 285 (1991) (providing for a more comprehensive analysis of whether the ADEA recognizes disparate impact claims).

101. Holmes, *supra* note 100, at 311-18.

102. See, *supra* note 60.

103. I.R.C. § 411(d)(6)(B)(i); 29 U.S.C. § 1054(g)(2)(A).

104. I.R.C. § 411(d)(6)(B)(ii); 29 U.S.C. § 1054(g)(2)(B).

IV.B.2, IV.D.5, and IV.F.2 below.

F. Excessive Back-loading

One of the characteristics of a traditional defined benefit plan is the fact that the most valuable benefit accruals occur when a participant is close to retirement age. This is commonly referred to as back-loading. Although Congress acknowledged and accepted this back-loading phenomenon, they included provisions in the statute that limit the amount of back-loading. Congress provides three methods through which a defined benefit plan can prove that the accruals are not too back-loaded. Either the plan document provides that accruals will meet the 3-percent method,¹⁰⁵ the 133 1/3 percent rule¹⁰⁶ or the fractional rule.¹⁰⁷ Since the accrual patterns in a defined contribution plan are front-loaded (or at least ratably-loaded throughout an employee's career), defined contribution plans do not need to prove that they are not excessively back-loaded. Cash balance plans, by design, follow the accrual patterns of a defined contribution plan. However, cash balance plans, as a form of a defined benefit plan, must satisfy one of the three accrual methods, none of which were drafted to ensure that a front-loaded plan can prove non-excessive back-loading.¹⁰⁸

The issue is whether a cash balance plan can be designed to adequately comply with the anti-backloading accrual rules. See sections IV.B.3, IV.D.4, and IV.G.2 below.

G. Partial Termination

If a defined benefit plan ceases, or simply decreases, future benefit accruals under the plan, a partial termination shall be deemed to occur if, as a result of such cessation or decrease, a potential reversion to the employer, or employers, maintaining the plan (determined as of the date such cessation or decrease is adopted) is created or increased.¹⁰⁹ Upon a partial termination, which is determined based on facts and circumstances,¹¹⁰ all affected participants must be fully vested in their benefits accrued as of the date that a partial termination is deemed to have occurred.¹¹¹

The issue is whether a cash balance plan conversion might trigger a partial termination. See section IV.G.3 below.

105. I.R.C. § 411(b)(1)(A); 29 U.S.C. § 1054(b)(1)(A).

106. I.R.C. § 411(b)(1)(B); 29 U.S.C. § 1054(b)(1)(B).

107. I.R.C. § 411(b)(1)(C); 29 U.S.C. § 1054(b)(1)(C).

108. ERISA was enacted in 1974, and the first cash balance plans appeared in 1985. *Lyons*, 221 F.3d at 1238 n.2.

109. Treas. Reg. § 1.411(d)-2(b)(2).

110. *Id.* § 1.411(d)-2(b)(1).

111. I.R.C. § 411(d)(3).

H. Breach of Fiduciary Duty

The general rule is that the decision to amend a qualified plan is a settlor function¹¹² and only the implementation of the decision becomes a fiduciary function. However, the employer (wearing both hats as settlor and as plan fiduciary) needs to set the opening account balances after the conversion into a cash balance plan and, if it decides to mitigate some of the lost benefits for certain older and longer-serviced employees, then it needs to determine which group of participants will be protected, and how much protection to offer. The line between settlor function and fiduciary function is usually blurred, in contexts other than a conversion to a cash balance plan, and facts and circumstances will often dictate which hat the employer was wearing for any given decision.

The issue is whether there is a breach of fiduciary duty when the plan is converted. See section IV.A.2 below.

I. Reliance on a Determination Letter

Although retirement plans do not need to apply for a favorable determination letter from the IRS, many sponsoring employers voluntarily seek the IRS approval that the plan, in form, complies with the qualification rules. However, the determination letter seemingly only indicates that the plan will remain tax-qualified, but does not seem to protect the sponsoring employer from an ERISA civil action.

The issue is whether the IRS favorable determination letter saves the Plan from ERISA liability. See sections IV.B.4 and IV.C.2 below.

IV. HOW HAVE THE COURTS DECIDED ON THE ISSUES THAT ARE BEING LITIGATED?

As discussed, the major controversy over cash balance plans is the conversion from a traditional defined benefit plan into a cash balance plan design. Such was the genesis of the following cases, each involving a plaintiff or class of plaintiffs arguing that they lost promised benefits, and in some cases, accrued benefits, due to the conversion. Most of the cases hold that the employer did not violate the Code or ERISA by converting the respective plans at issue, and even if they did, that the designs were fine but that they need to pay slightly higher lump sum distributions. However, the most recent cases could be very problematic for all

112. *Lockheed Corp. v. Spink*, 517 U.S. 882, 890 (1996) (holding that employers are generally free under ERISA to amend a plan, and when they undertake those actions, they do not act as fiduciaries, but are analogous to the settlors of a trust).

cash balance plans, even those that are newly established and have never been the result of a conversion.

For purposes of this article, these cases are only summarized.¹¹³ Most cases that have subsequently been settled¹¹⁴ or which were unpublished¹¹⁵ will not be discussed here. The following are arranged in chronological order, and for each case, only the cash balance plan design issues are discussed, and the highest court's holding and rationale for each separate issue is discussed and represented as either in favor of the plaintiffs, in favor of the defendant plan, or not decided for procedural reasons. Each issue contains a summary of how the holding is relevant, and then there is an overall summary at the end of this section.

A. *Corcoran v. Bell Atlantic Corp.*¹¹⁶

The Third Circuit affirmed the holding of the district court in a table opinion, so the reasoning and holding of the district court needs to be reviewed. There were two amendments made to the Plan, a 1991 amendment that increased the age that participants could retire early with an unreduced service pension,¹¹⁷ and a 1995 amendment that converted the plan into a cash balance plan that used a specific published mortality table¹¹⁸ and interest rate¹¹⁹ to determine the opening accounts for all participants, and continued the increase in age for unreduced early retirement benefits that was instituted in the 1991 amendment. Only the issues for the 1995 amendment will be discussed here.

1. *The cash balance plan conversion did not improperly reduce accrued benefits (undecided)*: The plaintiffs claimed that the conversion to the cash balance plan violated ERISA § 204(g) and improperly reduced accrued benefits through a plan amendment

113. For a more comprehensive analysis, see Howard Shapiro et al., *Litigation Issues in Cash Balance Plans*, 2003 A.B.A. Jt. Comm. on Employee Benefits teleconference, *The Beat Goes On: New Cash Balance Cases That May Rock Things*, (Aug. 26, 2003), available at <http://www.abanet.org/jceb/2003/t030826.html>.

114. See, e.g., *Engers v. AT&T & AT&T Mgmt. Pension Plan*, No. 98-CV-3660, 2002 WL 32159586 (D. N.J. Oct. 17, 2002).

115. See, e.g., *Godinez v. CBS Corp.*, No. SA CV 01-28-GLT (ANX) 2002 WL 32155542 (C.D. Cal. May 20, 2002).

116. *Corcoran v. Bell Atl. Corp.*, No. Civ. A 97-510, 1997 WL 602859 (E.D. Pa. Sept. 23, 1997), *motion to amend denied*, 21 Employee Benefits Cas. 2369 (E.D. Pa. Oct. 29, 1997), and *aff'd* 159 F.3d 1350 (3d Cir. 1998) (table opinion).

117. *Id.* at *1. The age was incrementally increased: in 1994, the early retirement age increased to fifty-six, in 1996, the early retirement age increased to fifty-seven, and this pattern of a one year increase in age every two plan years continues (assumedly until the early retirement unreduced benefits are totally eliminated).

118. *Id.* The unisex pension 1984 (UP84) mortality factor table was used without any setback. *Id.*

119. *Id.* The PBGC discount rate from September 1995. *Id.*

because the manner used in determining the opening account balances and the continued utilization of the phase out of the early retirement unreduced benefits had the effect of reducing the "cash-out" value of the plan.¹²⁰ The court looked at an earlier Third Circuit decision, the Senate Report accompanying the Retirement Equity Act of 1984, and IRS Revenue rulings¹²¹ and concluded that "the only accrued benefits which [ERISA] § 204(g) protects are those based on years of service already rendered at the time of the amendment."¹²² The Plaintiffs argued, however, that the plan used certain mortality and interest assumptions before the conversion and that the 1995 amendment substituted less favorable factors that resulted in an impermissible reduction of accrued benefits.¹²³ The court acknowledged that under IRS guidance,¹²⁴ it must look at facts and circumstances to make certain that the employer is not abusing a loop hole in the law by implementing a pattern of repeated plan amendments that breaks down a permanent benefit into a series of window benefits that can be eliminated at any time.¹²⁵ Therefore, instead of granting the Plan's motion to dismiss, the court permitted discovery to continue and gave both parties an additional thirty days to provide the facts and circumstances that would resolve this issue.¹²⁶ Since the motion to amend was eventually denied and since the affirmation by the Court of Appeals was simply a tabled decision,¹²⁷ it seems that under these facts, the Plaintiffs were not able to prove that the selection of assumptions used to determine opening account balances after the conversion violated ERISA § 204(g).

Therefore, in the Third Circuit, courts will look at the facts and circumstances to determine whether the selection of actuarial assumptions used to determine opening cash balance account values, if they differ from the original assumptions, violate the anti-cutback accrued benefit rules of ERISA § 204(g).

2. *There was no breach of fiduciary duty when the plan was converted:* The class of plaintiffs argued that the use of a certain mortality table and certain interest assumptions to determine the opening cash balance accounts immediately after the conversion constituted a breach in fiduciary duty.¹²⁸ The court held that "the act of amending a pension plan does not trigger ERISA's fiduciary

120. *Id.* at *2.

121. *Id.* at *2-6.

122. *Corcoran*, 1997 WL 602859, at *5.

123. *Id.* at *6.

124. *Id.* at *7 (citing Rev. Rul. 92-66, 1992-2 C.B. 92, 94, and Treas. Reg. § 1.411(d)-4, Q&A 1(c)(1)).

125. *Id.* at *8.

126. *Id.*

127. *See supra* note 116.

128. *Corcoran*, 1997 WL at *2.

duties.”¹²⁹ Thus, the Plan’s motion to dismiss for this count was granted.¹³⁰

Therefore, in the Third Circuit, there is no actionable breach of fiduciary under ERISA for the selection of actuarial equivalents used to determine opening account balances in the cash balance plan immediately after the conversion.

*B. Esden v. Retirement Plan of First National Bank of Boston*¹³¹

The Second Circuit Court of Appeals reversed the district court’s holding, and remanded back to the district court for further proceedings to calculate class damages. The plan was converted into a cash balance plan in 1989, and subsequently received two favorable determination letters from the IRS indicating that the IRS believed that the Plan document was in compliance with the qualification rules of I.R.C. § 401(a).¹³² The interest credits to the cash balance accounts until distribution are based on a floating rate tied into Treasury Bill rates, but never greater than 10.0% or less than 5.5%.¹³³ However, once a participant elects to receive an immediate distribution of his or her account balance, then the account is credited with interest at 4% until retirement to determine the normal retirement annuity benefit, and then is discounted at the minimum rate of 5.5% since the actual plan rate is variable.¹³⁴

1. *The determination of a lump sum distribution must be the present value of the normal retirement benefits:* The Plaintiff (individually and on behalf of a similarly situated class) contends that when she was paid her cash balance account, it was less than the required distribution¹³⁵ (under the requirements of ERISA §§ 203(e) and 205(g)(3) and I.R.C. §§ 411(a)(11) and 417(e)(3)).¹³⁶ The defendant countered that the court should rely on the Plan’s favorable determination letter issued by the IRS, and argued for the first time on appeal that the Treasury Regulations published under I.R.C. §§ 411 and 417 are unreasonable.¹³⁷ The district court granted the Plan’s motion for summary judgment, indicating that deference to Notice 96-8 would allow “[t]he participant. . . [to] receive a windfall, and the account balance could no longer be said to reflect an accurate projection of plan benefits as they accrue [in

129. *Id.* at *9 (citing *Lockheed Corp.*, 517 U.S. at 116).

130. *Id.* at *10.

131. 182 F.R.D. 432 (D. Vt. 1998), *motion to alter or amend the judgment denied*, 5 F.Supp.2d (D. Vt. 1998) (unpublished), *rev’d* 229 F.3d 154 (2d Cir. 2000), *cert. denied* 531 U.S. 1061 (2001).

132. *Esden*, 229 F. 3d at 159.

133. *Id.* at 160.

134. *Id.* at 161.

135. *Id.* at 162.

136. *Id.* at 168.

137. *Id.* at 162.

the cash balance plan].”¹³⁸ However, the appellate court reversed, indicating that: first, the normal retirement benefit in a defined benefit plan must be expressed as an annuity commencing at normal retirement age;¹³⁹ and second, if the distribution will be in the form of a lump sum, then the Plan must determine the lump sum in accordance with I.R.C. §§ 411(a)(11) and 417(e)(3).¹⁴⁰ The court determined that Notice 96-8 should be given deference because it “represents the fair and considered judgment of the IRS,”¹⁴¹ and, even without regard to the Notice, the court would reach the same result “on the basis of the governing statutes and regulations.”¹⁴² To sum this up, the court stated that a “defined benefit plan, including one adopting a cash balance format, need not offer a lump-sum distribution as an optional form of benefit, but when it does so provide, that distribution must be the actuarial equivalent of the accrued benefit valued according to the statutory methodology.”¹⁴³ Thus, the appellate court remanded the case back to the district court for further proceedings to calculate class damages, and with instructions for the lower court to “determine the proper projection rate for the calculation of damages, provided only that in no event may the projection rate be less than the minimum 5.5% guaranteed under the terms of the plan.”¹⁴⁴

Therefore, in the Second Circuit, cash balance plans must comply with Notice 96-8 when they determine minimum lump sums for distributions, even if such minimum exceeds the hypothetical account balances communicated in the plan.

2. *The calculation of the lump sum distribution caused improper forfeitures:* The court further held that by “making part of her benefit conditional on the form of payment chosen[,] the Plan made that benefit forfeitable, in violation of ERISA § 203(a); I.R.C. § 411(a)(2) and Treas. Reg. § 1.411(a)-4T.”¹⁴⁵ The court based its holding on the portion of Notice 96-8 that describes cash balance plans with interest credits that are tied to a variable index (such as the Bank of Boston Plan at issue): first, “the plan must prescribe a method for determining the rate at which future interest credits will be applied to project the participant’s accrued benefit as of normal retirement age;”¹⁴⁶ and second, “in determining the amount of an employee’s accrued benefit, a forfeiture . . . will result if the value of future interest credits is

138. *Esdén*, 182 F.R.D. at 438.

139. *Esdén*, 229 F.3d at 162.

140. *Id.* at 164-65.

141. *Id.* at 168.

142. *Id.* at 172.

143. *Id.* at 173 (internal citation omitted).

144. *Id.* at 177.

145. *Esdén*, 229 F.3d at 168.

146. *Id.* at 166.

projected using a rate that *understates the value of those credits or if the plan by its terms reduces the interest rate or rate of return used for projecting future interest credits.*¹⁴⁷ Under these facts, the court found that the Plan complied with the first requirement under Notice 96-8,¹⁴⁸ but failed to meet the second requirement, indicating that “by fixing the future interest credits at 4.0% for the purpose of the projections . . . the Plan conditions the right to receive the additional 1.5% interest on the form of distribution that the participant elects.”¹⁴⁹ Thus, the court held that the portion of the lump sum that should have been paid to the Plaintiff based on the additional 1.5% crediting rate was improperly forfeited, in violation of ERISA § 203(a).

Therefore, in the Second Circuit, if a cash balance plan provides interest credits that are tied into a variable index, then the relevant portions of Notice 96-8 must be complied with to prevent an improper forfeiture.

3. *Cash balance plans must meet the anti-backloading accrual rules (undecided):* Although it appears that the Plaintiffs did not argue the point, through dicta, the court opined that the Plan could only satisfy the 133 1/3% accrual rule (under I.R.C. § 411(b)(1)(B) and ERISA § 204(b)(1)(B)) if it used the 5.5% crediting rate instead of the 4.0% rate that was actually used.¹⁵⁰

Therefore, in the Second Circuit, cash balance plans will likely need to prove compliance with the accrual rules if questioned by the Plaintiffs.

4. *The IRS favorable determination letter does not save the Plan from ERISA liability:* The court held that “the Plan’s reliance on determination letters cannot shield it from liability in a suit brought by a plan participant for violations of ERISA.”¹⁵¹

Therefore, in the Second Circuit, although favorable determination letters might ensure the tax qualified status of a retirement plan, it in no way affects the ERISA rights provided to participants of a cash balance plan.

C. *Lyons v. Georgia-Pacific Corp. Salaried Employees Retirement Plan*¹⁵²

The Eleventh Circuit Court of Appeals reversed the district court’s holding, and remanded back to the district court for further proceedings to calculate class damages, which is still ongoing. The

147. *Id.* at 167.

148. *Id.* at 166.

149. *Id.* at 167.

150. *Id.* at 167 n.18.

151. *Esdén*, 229 F.3d at 176.

152. 66 F. Supp. 2d 1328 (N.D. Ga. 1999), *rev’d* 221 F.3d 1235 (11th Cir. 2000), *cert. denied* 532 U.S. 967 (2001), *remanded to* 196 F. Supp. 2d 1260 (N.D. Ga. 2002).

plan was converted into a cash balance plan before the Plaintiff became a participant due to a merger of his employer into Georgia-Pacific.¹⁵³ The Plan had received two favorable determination letters from the IRS indicating that the IRS believed that the Plan document was in compliance with the qualification rules of I.R.C. § 401(a).¹⁵⁴ The interest credits to the cash balance accounts until distribution are based on the PBGC twelve-month "immediate" annuity interest rate for the preceding year plus 0.75%.¹⁵⁵ However, once a participant elects to receive an immediate distribution of his or her account balance, the value of the cash balance account will be distributed.¹⁵⁶

1. *The determination of a lump sum distribution must be the present value of the normal retirement benefits:* The Plaintiff (individually, since procedurally, the class certification of other potential plaintiffs is at issue) contends that when he was paid his cash balance account, it was less than the required distribution under the requirements of ERISA § 203(e)(2)¹⁵⁷ (and I.R.C. §§ 411(a)(11) and 417(e)(3)). The defendant Plan countered that the court should rely on the Plan's favorable determination letter issued by the IRS,¹⁵⁸ and argued that the Treasury Regulations published under I.R.C. § 411 are unreasonable.¹⁵⁹ The district court granted the Plan's motion for summary judgment, indicating that "the portion of Treas. Reg. § 1.411(a)-11 at issue in this case [is] an unreasonable construction of the congressional mandate set forth in ERISA § 203(e)."¹⁶⁰ However, the Court of Appeals reversed, countering that "[b]ecause Congress has not spoken directly to the precise issue, because the legislative history is ambiguous, and because Treasury Regulation 1.411(a)-11 is not unreasonable, at least insofar as it applies to the specific type of plan in this case, Treasury Regulation 1.411(a)-11 is due to be upheld."¹⁶¹ The court determined that "Treasury Regulation § 1.417(e)-1, which was in effect at the time of the distribution, unequivocally states that '[t]he present value of any optional form of benefit cannot be less than the present value of the normal retirement benefit determined in accordance with this paragraph'"¹⁶² and that "Treasury Regulations 1.411(a)-11, which was issued in 1988, requires the lump sum distributions under the Plan be calculated by determining what would have been the

153. *Lyons*, 221 F.3d at 1239.

154. *Id.* at 1240.

155. *Id.* at 1238.

156. *Id.* at 1238-39.

157. *Id.* at 1240.

158. *Id.* at 1252.

159. *Lyons*, 221 F.3d at 1248.

160. *Lyons*, 66 F. Supp. 2d at 1336.

161. *Lyons*, 221 F.3d at 1249.

162. *Id.* at 1251.

normal retirement benefit had the participant not elected to take an early lump sum distribution, and then discounting that amount to [a] present value using the PBGC rate prescribed in ERISA § 203(e).¹⁶³ Thus, the appellate court remanded the case back to the district court for further proceedings consistent with this opinion.¹⁶⁴ On remand, the district court agreed that the cash balance accounts should be credited with the Plan's stated crediting rate until age sixty-five, but denied granting either party's summary judgment motions and determined that evidence will need to be presented by both sides to determine the actual discount rate to use under I.R.C. § 417(e)(3) and the Court of Appeals opinion, and would further need to argue whether the discount can include pre-retirement mortality (an issue that was not decided in the Appellate opinion).¹⁶⁵

Therefore, in the Eleventh Circuit, cash balance plans must comply with Treasury Regulations under I.R.C. §§ 411 and 417 and Notice 96-8 when they determine minimum lump sums for distributions, even if such minimum exceeds the hypothetical account balances communicated in the plan.

2. *The IRS favorable determination letter does not save the Plan from ERISA liability:* The court relied on the amicus brief filed by the IRS and held that since the determination letter itself "does not specifically address the issue at hand, the IRS letter is not owed any deference."¹⁶⁶ Further, "the IRS determination letter is due no deference because it evidences no investigation or legal analysis of the facts by the IRS."¹⁶⁷

Therefore, in the Eleventh Circuit, although favorable determination letters might ensure the tax qualified status of a retirement plan, it in no way protects the Plan from liability to participants.

D. *Eaton v. Onan Corp.*¹⁶⁸

The district court granted the Plan's motion for summary judgment on two counts, but denied summary judgment for three other counts. The employer originally maintained a defined benefit plan and a profit sharing plan that collectively constituted a "floor-offset" arrangement, and in 1989, the defined benefit plan

163. *Id.* at 1252.

164. *Id.* at 1254.

165. *Lyons*, 196 F. Supp. 2d at 1273. According to Eva Cantarella, plaintiff's attorney, the settlement discussions are still ongoing, but are close to being finalized (comments made on April 1, 2004 at a meeting of the ERISA Litigation Subcommittee of the Chicago Bar Association Employee Benefits Committee).

166. *Lyons*, 221 F.3d at 1252.

167. *Id.*

168. 117 F. Supp. 2d 812 (S.D. Ind. 2000).

was converted to a cash balance plan.¹⁶⁹ Under the cash balance plan design, if a participant elects an annuity form of distribution, then he or she will be entitled to the greater of (i) the actuarial equivalent of the cash balance account, (ii) a defined "minimum annuity," or (iii) a defined "grandfathered annuity;" however, if the participant elects a lump sum distribution, then he or she is just entitled to the account balance without regard to a minimum or grandfathered benefit.¹⁷⁰ The facts indicate that the employer made reasonable attempts to properly communicate the cash balance design to the plan participants,¹⁷¹ and tried to get a favorable determination letter from the IRS which was not granted but which was ultimately forwarded to the IRS national office for review.¹⁷²

1. *The cash balance plan design does not violate the anti-age-discrimination rules of ERISA:* The class of plaintiffs argued that in order to determine that the rate of benefit accruals do not decrease on account of age, in violation of ERISA § 204(b)(1)(H), the Plan must first convert the cash balanced accounts into annuities.¹⁷³ The court determined that for two separate reasons, as a matter of law, a Plan may use cash balance accounts expressed as annuities to determine rate of accruals, but nothing in ERISA, its legislative history, or its associated public policy concerns require it.¹⁷⁴ The two reasons were: first, because of the heading of the statute, the requirement of a comparison of rates of benefit accruals "were intended to ensure that employees who choose to work past the age of normal retirement continue to accrue benefits, albeit with some important restrictions;"¹⁷⁵ and, second, even if the provision does apply to participants who have not yet attained normal retirement age, the "court does not believe those statutes *require* that the rate of benefit accrual be measured *solely* in terms of [a] change in value of an annuity payable at normal retirement age."¹⁷⁶ Thus, the court granted the Plan's motion for summary judgment.

Therefore, even though this case was subsequently settled, it seems that in the Southern District of Indiana, as a matter of law, cash balance plans do not inherently violate the age discrimination provisions of ERISA. However, as discussed at IV.G.1 below, another district court in the same Seventh Circuit issued a totally opposite opinion.¹⁷⁷ Therefore, until settled by the Seventh

169. *Eaton*, 117 F. Supp. 2d at 819.

170. *Id.* at 820-21.

171. *Id.* at 821.

172. *Id.*

173. *Id.* at 823.

174. *Eaton*, 117 F. Supp. 2d at 834.

175. *Id.* at 826.

176. *Id.*

177. See *infra* notes 223-241 and accompanying text.

Circuit, this crucial issue is left unresolved.

2. *The cash balance plan design does not violate the anti-age-discrimination rules of the ADEA:* The plaintiffs argued that the cash balance design, which includes a minimum and grandfathered annuity if a participant elects to receive an annuity, but which omits such minimum and grandfathered benefit amounts if the same participant elects to receive a lump sum distribution, violated the Age Discrimination in Employment Act.¹⁷⁸ However, to prove this contention, the plaintiffs needed to use the “disparate impact” theory of liability, and the court reminded them that the “Seventh Circuit has clearly held that disparate impact claims are not recognizable under the ADEA.”¹⁷⁹ Thus, the court granted the Plan’s motion for summary judgment because plaintiffs have failed to establish a claim for disparate treatment under the ADEA (the recognized argument under the ADEA in the Seventh Circuit).¹⁸⁰

Therefore, in the Seventh Circuit, plaintiffs must prove disparate treatment under the ADEA and cannot prove their ADEA age discrimination claim after the conversion to a cash balance plan under the theory of disparate impact.

3. *The determination of a lump sum distribution must be the present value of the normal retirement benefits (unresolved):* The plaintiffs further claimed that the Plan did not properly value the lump sum distributions because they did not include the grandfathered benefits.¹⁸¹ The defendants countered that minimum lump sum distribution rules under I.R.C. § 417(e) only apply to involuntary “automatic cash-outs” of a defined benefit plan and not to lump sum distributions that are voluntarily elected.¹⁸² Since the Eleventh and Second Circuits had just held, in *Lyons v. Georgia Pacific* and in *Esden v. Bank of Boston*, respectively, that I.R.C. § 417(e) applies to all lump sum distributions, regardless of whether it is voluntary or involuntary, then this court would not go against the trend.¹⁸³ Thus, the court could not grant summary judgment for either party, and it instructed the parties to develop an orderly resolution of this issue.¹⁸⁴

Therefore, even though this case was subsequently settled, it seems that in the Southern District of Indiana, the minimum lump sum calculations under I.R.C. § 417(e) apply to all lump sum distributions from all defined benefit plans (including cash balance plans), regardless of whether they are voluntary elections or

178. *Eaton*, 117 F. Supp. 2d at 835.

179. *Id.* at 837.

180. *Id.*

181. *Id.* at 840.

182. *Id.* at 842.

183. *Eaton*, 117 F. Supp. 2d at 842.

184. *Id.* at 843.

involuntary cash outs.

4. *Cash balance plans must meet the anti-backloading accrual rules (undecided)*: The plaintiffs further argued that the Plan failed to meet any of the three required benefit accrual rules for defined benefit plans; specifically, the Plan did not meet the 133 1/3% rule.¹⁸⁵ The court indicated that the IRS Key District found that the Plan failed to meet any of the benefit accrual rules, and that there was a pending Tax Court case brought by another Onan Corp. employee.¹⁸⁶ Thus, the court could not grant summary judgment for either party, and this issue will require further exploration before it can be decided.¹⁸⁷

Therefore, in the Southern District of Indiana, the issue of whether cash balance plans, by design, can satisfy any of the three benefit accrual rules that prevent excessive back-loading, is undecided and will probably be decided on a facts and circumstances basis in future cases rather than as a matter of law.

5. *The calculation of opening cash balance accounts cannot cause improper forfeitures (undecided)*: The final relevant claim that the plaintiffs argued before the court was that the Plan improperly used different interest rates that produced understated opening account balances and overstated profit sharing plan offsets, in violation of ERISA § 203(a).¹⁸⁸ The Plan countered that the use of different interest rates is not unreasonable as a matter of law.¹⁸⁹ Thus, the court could not grant summary judgment for either party, and the court finds that there is a material issue of fact that ultimately needs to be resolved.¹⁹⁰

Therefore, in the Southern District of Indiana, the issue of whether actuarial equivalents are reasonable in a cash balance plan, will probably be decided on a facts and circumstances basis in future cases rather than as a matter of law.

*E. Campbell v. BankBoston, NA*¹⁹¹

The First Circuit Court of Appeals affirmed the district court's granting of the Plan's motion for summary judgment. The plan was converted into a cash balance plan in 1989 and was then amended in 1997.¹⁹² After the conversion, the plan contained a "Benefit Safeguard Minimum Benefit," which provided that benefits under the previous plan design would continue to accrue for certain long-term employees,¹⁹³ but the subsequent 1997

185. *Id.*

186. *Id.* at 844.

187. *Id.* at 845.

188. *Eaton*, 117 F. Supp. 2d at 846.

189. *Id.*

190. *Id.*

191. 206 F. Supp. 2d 70 (D. Mass. 2002), *aff'd* 327 F.3d 1 (1st Cir. 2003).

192. *Campbell*, 327 F.3d at 3.

193. *Id.* at 2.

amendment eliminated the further accrual of benefits under the old plan design and froze all grandfathered benefits as of December 31, 1996.¹⁹⁴ There was a separate plan at issue, a separation pay plan,¹⁹⁵ which will not be discussed here.

1. *The cash balance plan conversion did not improperly reduce accrued benefits:* The individual plaintiff was one of the long-serviced employees that was grandfathered after the 1989 conversion, and argued that the reduction in benefit amount after the 1997 amendment to the cash balance plan (i.e., the elimination of future benefit accruals) constituted a forfeiture of accrued benefits in violation of ERISA § 204(g) (and I.R.C. § 411(d)(6)(A)).¹⁹⁶ The court determined that the ERISA anti-cutback provision only protected “accrued benefits” and that the 1997 amendment properly protected the benefits accrued as of that date.¹⁹⁷ Thus, the court affirmed the district court, and held that “no accrued benefits were reduced; only expected benefits were reduced, which BankBoston could, under the law, modify or eliminate.”¹⁹⁸

Therefore, in the First Circuit, a cash balance plan can be amended to eliminate future promised benefits, as long as the benefits accrued as of the date of plan amendment are not reduced.

2. *The cash balance plan design did not violate the anti-age-discrimination rules of ERISA (undecided):* The plaintiff argued that the “cash balance plan violates the anti-discrimination provisions of ERISA.”¹⁹⁹ The court determined that, procedurally, the plaintiff did not raise the issue at the lower court, because in the complaint, only violations of the age discrimination provisions of ADEA were raised but not the age discrimination provisions of ERISA.²⁰⁰ Thus, the issue was not decided by the Court of Appeals. However, since the court felt that this issue may be raised by a plaintiff through future litigation, it “briefly describe[d] the controversy”²⁰¹ and indicated that the IRS has issued proposed regulations in December 2002 describing how cash balance plans can comply with the anti-discrimination rules of ERISA.²⁰² The court further opined that “the ERISA age discrimination provision may not even apply to workers younger than the age of normal retirement.”²⁰³

194. *Id.*

195. *Id.* at 4-5.

196. *Id.* at 8.

197. *Campbell*, 327 F.3d at 8.

198. *Id.*

199. *Id.* at 9.

200. *Id.*

201. *Id.*

202. *Id.* at 10.

203. *Campbell*, 327 F.3d at 10.

Therefore, in the First Circuit, although the court did not hold that as a matter of law cash balance plans do not inherently violate the age discrimination provisions of ERISA, the court questioned whether the rules apply to participants who have not yet attained retirement age and opined that the proposed Treasury Regulations should at least be afforded some deference. However, as discussed below at IV.G.1, a district court in the Seventh Circuit issued a totally opposite opinion.

3. *The cash balance plan design did not violate the anti-age-discrimination rules of the ADEA (undecided)*: The plaintiff argued that the cash balance design, after conversion, violated the ADEA because the employer “knew that the decrease in pension benefits as a result of the conversion to the cash balance plan would be particularly adverse to older workers.”²⁰⁴ The court determined that, procedurally, this claim was barred because the charge was originally filed with the EEOC “beyond the limitations period.”²⁰⁵ Thus, the issue was not decided by the Court of Appeals; however, the court questioned whether the First Circuit would accept a “disparate impact” claim under the ADEA if a plaintiff who is not barred by the statute of limitations should argue it in future litigation.²⁰⁶

Therefore, in the First Circuit, plaintiffs must prove disparate treatment under the ADEA and probably cannot prove their ADEA age discrimination claim after the conversion to a cash balance plan under the theory of disparate impact.

F. *Berger v. Xerox*²⁰⁷

The Seventh Circuit Court of Appeals affirmed the district court’s series of decisions granting of the Plan’s motion for summary judgment. Xerox originally maintained two plans that, collectively, created a “‘floor-offset’ arrangement” (a profit sharing plan and a pension plan called the Retirement Income Guarantee Plan (“RIGP”)).²⁰⁸ In 1990, the profit sharing plan was terminated and the assets were transferred into the RIPG and, for each participant, were segregated into “Transitional Retirement

204. *Id.* at 9.

205. *Id.*

206. *Id.* at 10 n.9.

207. *Berger v. Xerox Ret. Income Guar. Plan*, 231 F. Supp. 2d 804 (S.D. Ill. 2002), *aff’d and modified*, 338 F.3d 755 (7th Cir. 2003). The original case was *Berger v. Nazametz & Xerox Corporation Retirement Income Guarantee Plan*, No. 00-CV-0584-DRH, 2001 WL 936322 (S.D. Ill. June 26, 2001), with a subsequent motion to reconsider at 157 F. Supp. 2d 998 (S.D. Ill. 2001), and then a granting in part of plaintiff’s motion for summary judgment, 2002 WL 1774744 (S.D. Ill. July 22, 2002). Subsequently, Nazametz was dropped as a defendant since she was never the Plan Administrator at any time relevant to this action.

208. *Nazametz*, 157 F. Supp. 2d at 1001-02.

Account”²⁰⁹ (“TRA”). At the same time, the original defined benefit design of the RIGP was converted into a cash balance design, and the opening account balances for all participants, referred to as “Cash Balance Retirement Accounts” (“CBRA”), were equal to the opening amount in their TRAs (so that, “[f]or participants who did not have a PSP benefit, the CBRA opening balance was zero, and there was no TRA.”)²¹⁰ After the transfer, this single plan still acted as a floor-offset arrangement, but was governed under I.R.C. § 414(k) (and ERISA § 3(35)(A) and (B)) because it had certain defined contribution attributes (i.e., the TRAs) and certain defined benefit attributes (i.e., the CBRAs).²¹¹ Then, the single plan was amended further in 1998 to include an enhanced benefit, called a “RIGP Plus” benefit, for certain older and longer-serviced employees.²¹² The terms of the general cash balance plan design provided a 5% of compensation accrual and interest credits equal to “the effective average yield for one-year Treasury bills measured as of the first business day of each month of the prior year, plus one percent;”²¹³ however, when a participant elects a lump sum distribution, the projection will be made at “the PBGC rate(s) plus a mortality factor.”²¹⁴ Since the single plan is still a floor-offset, the CBRA will be entirely disregarded if a participant’s TRA exceeds his or her CBRA.²¹⁵

1. *The determination of a lump sum distribution must be the present value of the normal retirement benefits:* The class of plaintiffs argued that the amount they received, after electing lump sum distributions, was not the actuarial equivalent of what they would have received either as an annuity or a lump sum had they waited until age 65 (under the requirements of ERISA § 204(c)(3)²¹⁶ (and I.R.C. §§ 411(c)(3)). The defendant countered that since “the employee’s entitlement to future interest credits terminates when he takes a distribution, which he can do at any time after his entitlement to a pension vests, the only benefit that he accrues is . . . the hypothetical cash balance on that date; and so that is his lump sum entitlement.”²¹⁷ However, the court determined that the cash balance plan is indeed a defined benefit plan, and it “triggers the congressional policy of requiring that a lump-sum distribution of pension benefits equal the value of the benefits if the employee decides to wait until the normal

209. *Id.* at 1002.

210. *Id.*

211. *Id.* at 1003.

212. *Id.* at 1004.

213. *Id.* at 1002.

214. *Nazametz*, 157 F. Supp. 2d at 1008.

215. *Id.* at 1008 n.10.

216. *Berger*, 338 F.3d at 759.

217. *Id.* at 761.

retirement age and take them then in the form of a pension.”²¹⁸ The court then decreed, in a scathing manner, that the participants “are, in short, being invited to sell their pension entitlement back to the company cheap, and that is a sale that ERISA prohibits.”²¹⁹ Thus, the court affirmed the district court’s finding in favor of the plaintiff’s motion for summary judgment on this issue. The court further affirmed the district court’s prohibition against the Plan’s use of a pre-retirement mortality assumption, and even called the Plan’s argument in favor of the discount as “unfathomable.”²²⁰

Therefore, in the Seventh Circuit, cash balance plans must convert hypothetical accounts into annuities payable at retirement before determining the minimum lump sum payable to participants who elect to receive lump sum distributions before retirement age.

2. *The calculation of the lump sum distribution caused improper forfeitures:* The court determined that Notice 96-8 must be complied with, and further held that the “plan conditions the employee’s right to future interest credits on the form of the distribution that he elects to take (pension at age sixty-five rather than lump sum now), which is precisely what the law forbids.”²²¹ The Plan had argued that its cash balance plan is not the same as the plan described in Notice 96-8 and is instead a hybrid cash balance plan, but the court disagreed, and in another villifying attack on the defendant plan, stated that “for ‘hybrid’ read ‘unlawful’.”²²²

Therefore, in the Seventh Circuit, if a cash balance plan provides interest credits that are tied into a variable index, then the relevant portions of Notice 96-8 must be complied with to prevent an improper forfeiture, and if the plan provides a pre-retirement death benefit, then the plan may not use a pre-retirement mortality discount factor.

G. *Cooper v. IBM Personal Pension Plan*²²³

The district court granted the plaintiff’s motion for summary judgment on two major counts, but denied summary judgment for two other counts. The plan was amended in 1995 to provide a pension equity formula (which is a type of cash balance plan), with a pension credit formula based on points credited, and which

218. *Id.* Note that the Court of Appeals decision is lacking legal support or reference to any of the lower court’s opinions for this conclusion, but support can be found at *Nazametz*, 157 F. Supp. 2d at 1008.

219. *Berger*, 338 F.3d at 762.

220. *Id.* at 764.

221. *Id.* at 763 (agreeing with the Second Circuit’s decision in *Esden*).

222. *Id.* at 762-63.

223. 274 F. Supp. 2d 1010 (S.D. Ill. 2003).

provided certain base points for the participant's age in the determination year (to a maximum of 425 base points) and extra points if the participant's five year average salary exceeds the Social Security taxable wage base (limited to seventy-five excess points).²²⁴ Then, in 1999, this plan was converted to a common cash balance design, where, each month, a participant's Personal Pension Account accumulates pay credits of 5% of pay and interest credits at a rate that is one point higher than the rate of return on one year treasury securities.²²⁵ Since the plaintiff class contends that both types of cash balance formulas are age-discriminatory, each type of plan design will be discussed below.

1. *The cash balance plan design violates the anti-age-discrimination rules of ERISA:* There are two statutory provisions that seek to prevent discrimination in defined benefit plans based on age: first, the prohibition from reducing an accrued benefit on account of increasing age under ERISA § 204(b)(1)(G) and I.R.C. § 411(b)(1)(G); and second, the prohibition from ceasing an employee's benefit accrual or reducing the rate of an employee's benefit accrual because of the attainment of any age under ERISA § 204(b)(1)(H) and I.R.C. § 411(b)(1)(H).

Regarding the first provision, the Plaintiffs argue only that the Pension Credit Formula violates the rules.²²⁶ There is a lack of cited legal authority in the opinion; the court seems to make its conclusion based solely on a hypothetical scenario where some potential participants might be discriminated under the PCF.²²⁷ Although the Plan argues that the court should only look at actual participants, and insists that "no specific employee has actually suffered a reduction in his or her benefit,"²²⁸ the court rejected their argument, holding that the statute "relates to damages as opposed to liability and because Congress has conferred statutory standing to all 'participants' in an ERISA plan."²²⁹ Thus, the court granted the Plaintiff's motion for summary judgment on this issue.²³⁰

Regarding the second provision, the Plaintiffs argued that both the Pension Credit Formula and the Personal Pension Account designs violate the rules.²³¹ Since ERISA is not clear in the statute, the court needs to make an analysis as to whether the terms "accrued benefit" and "rate of benefit accruals" have the same meaning.²³² The court dismissed the Plan's argument that

224. *Id.* at 1012.

225. *Id.* at 1012-13.

226. *Id.* at 1013.

227. *Id.* at 1014-15.

228. *Id.* at 1015.

229. *Cooper*, 274 F. Supp. 2d at 1015.

230. *Id.* at 1022.

231. *Id.* at 1015, 1020.

232. *Id.* at 1016.

Congress intentionally used two different terms to mean two different things,²³³ and held that the “answer is simple [and that] Congress chose to be grammatically correct.”²³⁴ Thus, the court held that the Pension Credit Formula (i.e., the pension equity formula) violated the statute and granted the Plaintiff’s motion for summary judgment. The court continued its analysis in regards to the Personal Pension Account, and discounted the Plan’s argument that the affect of the time value of money has no relevance in the analysis, holding that the “CBF violates the literal terms of ERISA § 204(b)(1)(H).”²³⁵ Thus, the court also held that the Personal Pension Account (i.e., the cash balance formula) violated the statute and granted the Plaintiff’s motion for summary judgment. It is interesting that even though the court held against the Plan, it commented that “there *may* be policy reasons why Congress should specifically authorize [cash balance plans] in the context of defined benefit plans. But the narrow question is whether the 1999 Plan comports with the *literal and unambiguous* provisions of ERISA § 204(b)(1)(H), and it does not.”²³⁶

Therefore, in the Southern District of Illinois, as a matter of law, cash balance plans do inherently violate the age discrimination provisions of ERISA; however, as discussed above, the *Eaton v. Onan Corp.* case, previously decided by another district court in the same Seventh Circuit, issued a totally opposite opinion. Even though *Eaton* has been settled, its logic remains valid. Therefore, until settled by the Court of Appeals for the Seventh Circuit, this most crucial issue is now left unresolved.

2. *Cash balance plans must meet the anti-backloading accrual rules (undecided)*: The Plaintiffs further argued that the Pension Credit Formula failed to meet any of the three required benefit accrual rules for defined benefit plans.²³⁷ The court rejected the Plan’s description of how it passed the fractional rule test.²³⁸ Thus, the court could not grant summary judgment for either party, and there is a triable issue of fact regarding the back-loading claim.²³⁹

Therefore, in the Southern District of Illinois, the issue of whether cash balance plans, by design, can satisfy any of the three benefit accrual rules that prevent excessive back-loading, is

233. *Id.*

234. *Id.*

235. *Cooper*, 274 F. Supp. 2d at 1021.

236. *Id.* at 1022 (emphasis added). Note that the court earlier stated that “ERISA does not explicitly answer this question,” but then seemingly ignored such statement and indicated that it understood the literal and unambiguous language of this provision. *Id.* at 1015.

237. *Id.* at 1016.

238. *Id.* at 1017.

239. *Id.* at 1023.

undecided and will probably be decided on a facts and circumstances basis in future cases rather than as a matter of law.

3. *Cash balance plan conversions might trigger a partial termination (undecided)*: The Plaintiffs further argued that the conversion to the Personal Pension Account design might have caused a partial plan termination (under I.R.C. § 411(d)(3)) because (1) the amendment resulted in a decrease in future benefit accruals and (2) such decrease increased the potential for a reversion.²⁴⁰ The court could not grant summary judgment for either party, and there is a triable issue of fact regarding the partial termination claim.²⁴¹

Therefore, in the Southern District of Illinois, the issue of whether a cash balance plan conversion will trigger a partial termination, is undecided and will probably be decided on a facts and circumstances basis in future cases rather than as a matter of law.

H. Summary of cash balance plan litigation to date

1. *Does a cash balance plan conversion improperly reduce accrued benefits? (Wear-away, section III.A. above)*: The Third Circuit (*Corcoran*) ultimately held in favor of the Plan based on facts and circumstances; and, the First Circuit (*Campbell*) held in favor of the Plan.

2. *Must the determination of a lump sum distribution be the present value of the normal retirement benefits? (Whipsaw, the treatment of future interest credits as accrued benefits, and the need to comply with Notice 96-8, section III.B. above)*: The Second Circuit (*Esdén*) held in favor of the Plaintiffs; the Eleventh Circuit (*Lyons*) held in favor of the Plaintiff; and the Seventh Circuit (*Berger*) held in favor of the Plaintiff (since *Berger* was decided after the Southern District of Indiana decided on *Eaton*, its logic is rendered irrelevant).

3. *Does the cash balance plan design violate the anti-age-discrimination rules of ERISA? (ERISA age discrimination, section III.C. above)*: The Southern District of Indiana (*Eaton*) held in favor of the Plan (even though the case has subsequently settled); the First Circuit (*Campbell*) did not decide because of procedural reasons (but opined that it would probably hold in favor of the Plan); and the Southern District of Illinois (*Cooper*) held in favor of the Plaintiff.

4. *Does the cash balance plan design violate the anti-age-discrimination rules of ADEA? (ADEA age discrimination, section III.D. above)*: The Southern District of Indiana (*Eaton*) held in favor of the Plan, because the Seventh Circuit does not accept

240. *Id.* at 1022.

241. *Id.*

disparate impact theories; and the First Circuit (*Campbell*) did not decide because of procedural reasons (but opined that the First Circuit would probably not accept disparate impact theories).

5. *Does the calculation of lump sum distributions, or the calculation of opening cash balance accounts, cause improper forfeitures? (Protection of accrued benefits, section III.E. above):* The Second Circuit (*Esdén*) held in favor of the Plaintiffs; and the Seventh Circuit (*Berger*) held in favor of the Plaintiffs (since the *Berger* case was decided after the Southern District of Indiana decided on *Eaton*, its logic is rendered irrelevant).

6. *Must cash balance plans meet the anti-backloading accrual rules? (Excessive Back Loading, section III.F. above):* The Second Circuit (*Esdén*) was undecided because it could not grant summary judgment for either party (but indicated through dicta that the Plan would have failed to prove compliance); and the Seventh Circuit (*Berger*) was undecided because it could not grant summary judgment for either party (since the *Berger* case was decided after the Southern District of Indiana decided on *Eaton*, its logic is rendered irrelevant).

7. *Does a cash balance plan conversion trigger a partial termination? (Excessive Back Loading, section III.G. above):* The Southern District of Illinois (*Cooper*) was undecided because it could not grant summary judgment for either party.

8. *Is there a breach of fiduciary duty when a plan is converted into a cash balance plan? (Breach of Fiduciary Duty, section III.H. above):* The Third Circuit (*Corcoran*) held in favor of the Plan.

9. *Does an IRS favorable determination letter save the plan from ERISA liability? (Reliance on a Determination Letter, section III.I. above):* The Second Circuit (*Esdén*) held in favor of the Plaintiff; and the Eleventh Circuit (*Lyons*) held in favor of the Plaintiff.

V. HOW DOES THE GOVERNMENT TREAT CASH BALANCE PLANS?

The executive branch of government, through its various regulatory agencies, seems to support cash balance plan designs, or, at the very least, acknowledge their importance in the retirement plan universe. However, in the legislative branch, there are some voices that seem to oppose cash balance plans. The various view points will be summarized.

A. What is the Department of Treasury's position?

The Department of Treasury ("DOT") seems to accept cash balance plans through published guidance: (1) Notice 96-8,²⁴² which explains how cash balance plans can be designed to avoid the anti-backloading accrual rules, explains how lump sum

242. I.R.S. Notice 96-8, 1996-1 C.B. 359.

distributions need to be calculated, and asks for public comments for future cash balance plan guidance; (2) preambles to 1991 and 1993 regulations under I.R.C. § 401(a)(4);²⁴³ and recently proposed regulations under I.R.C. § 411(b)(1)(G) and (H),²⁴⁴ which give CB plans special rules to pass the rate of benefit accrual rules. Additionally, the IRS has routinely issued favorable determination letters for new cash balance plans (although there is a moratorium on determination letters for cash balance plan conversions).²⁴⁵ Therefore, although they are trying to mold how cash balance plans can comply with the qualification rules, there seems to be affirmative support for the cash balance plan design by the DOT.

B. *What is the Department of Labor's position?*

The Department of Labor ("DOL") has yet to come out with an official position regarding cash balance plans. It does however acknowledge and provide information on them, which would ostensibly seem to shed a positive viewpoint on them. The DOL has posted on their website under the Employee Benefits Security Administration section some frequently asked questions ("FAQs") for cash balance plans.²⁴⁶ Additionally, the form 5500 allows a defined benefit plan to indicate that it has cash balance plan features.²⁴⁷ Therefore, the DOL certainly views cash balance designs as acceptable under the current statutory framework.

C. *What is the Pension Benefit Guaranty Corporation's position?*

The Pension Benefit Guaranty Corporation ("PBGC") undoubtedly accepts cash balance plans as defined benefit plans. Like the other agencies, however, there are no specific statements

243. Treas. Dec. Int. Rev. 8359 (1991). This regulation indicated a safe harbor for cash balance plans in the final nondiscrimination regulations. *Id.* After the 1991 final regulations were rescinded and reissued in final form in 1993, the preamble, T.D. 8485 (1993) indicated that Treasury would need to further review cash balance plan designs.

244. REG-209500-86; REG-164464-02 (Dec. 11, 2002).

245. Colleen T. Congel, *Cash Balance Plans: IRS Instructs EP Personnel to Identify, Refer all Conversion Cases for Technical Advice*, BNA PENSION AND BENEFITS DAILY, Sept. 17, 1999.

246. U.S. Department of Labor, Frequently Asked Questions about Cash Balance Pension Plans, at http://www.dol.gov/ebsa/FAQs/faq_consumer_cashbalanceplans.html (last visited Oct. 1, 2003).

247. The reporting requirements of ERISA §§ 104 and 4065, and I.R.C. § 6058, are satisfied when employee benefit plans file a Form 5500, *Annual Report/Return of Employee Benefit Plan*, with the Department of Labor. The plan characteristics are entered in line 10 of the form, and characteristic code 1C is used for cash balance plans, which according to the instructions, is a plan, whatever it is called, that "rather than or in addition to expressing the accrued benefit as a benefit commencing at normal retirement age, defines benefits for each employee in terms more common to a defined contribution plan, such as a single sum distribution amount."

of the legal rationale for such plans, only general sweeping statements. On the PBGC website, there are copies of remarks, public information publications, and PBGC regulations that all accept cash balance plans as defined benefit plans, properly under the purview of the PBGC.²⁴⁸ In fact, the PBGC published a request for comments²⁴⁹ on how the PBGC can value the liabilities of a cash balance plan²⁵⁰ that uses a variable index (such as using the GATT § 417(e) rate, which changes each year). In the request for public comments, the PBGC indicated that they need input on how to administer the termination of cash balance plans since Congress only anticipated terminations of traditional defined benefit plans when ERISA was enacted in 1974.

D. What is the Equal Employment Opportunity Commission's position?

In September 1999, the Equal Employment Opportunity Commission ("EEOC") created a national team of experts to analyze the ramifications of cash balance plans upon older workers. In announcing the National Cash Balance Pension Team, EEOC Chairwoman Ida L. Castro stated that:

Whether or not Cash Balance Pension Plans discriminate against employees covered by the ADEA is a question that I am determined to explore fully. The complexity of the issue, which partly stems from the variety of ways these pension plans evolve and are formulated, necessitates our drawing upon the best expertise within EEOC to make determinations about their compliance with provisions of the ADEA.²⁵¹

Furthermore, the team is instructed to collaborate with various groups such as the Departments of Treasury and Labor, as well as gather feedback from employers, employees, labor groups and civil rights groups.²⁵²

248. <http://www.pbgc.gov> (last visited on Oct. 4, 2003).

249. Title IV Aspects of Cash Balance Plans with Variable Indices, 65 Fed. Reg. 41610-12 (July 6, 2000).

250. 29 U.S.C. § 1104.

251. Press Release, Equal Employment Opportunity Commission (Sept. 20, 1999) available at <http://www.eeoc.gov/press/9-20-99.html>. Under Title III of ERISA, as amended through executive orders, the only government agencies with authority to regulate the provisions of ERISA are the Departments of Labor and Treasury. However, since there are alleged age discrimination issues with the Age Discrimination in Employment Act, then the EEOC, which has authority to regulate the provisions of the ADEA, can potentially affect the viability of the cash balance plan design.

252. Search of the EEOC website on October 1, 2003 and March 4, 2004 indicate no reporting of any activity by this team, and only shows the news release establishing the team.

E. What is the Financial Accounting Standards Board's position?

The Financial Accounting Standards Board ("FASB") has recently decided to add a limited scope project to its agenda that will address the issue of cash balance plans.²⁵³ Presently, there is not any accounting guidance for how public companies are supposed to report their cash balance plan obligations and costs on their income statements and balance sheets. FASB is hoping that the result of this project will actually help define a cash balance plan.²⁵⁴

F. What is the Congressional position?

Bills have been introduced to protect employees in conversions and which would render the proposed Treasury Regulations inapplicable. The main piece of legislation to protect employees in a cash balance plan conversion is the Pension Benefits Protection Act of 2003 introduced in both the House of Representatives²⁵⁵ and in the Senate.²⁵⁶ There are two general components of the Pension Benefits Protection Act of 2003 that regard cash balance plans. The first is the requirement that companies that convert to a cash balance plan must allow workers who are at least forty years old or have at least ten years of service to be given the choice of remaining in their current defined benefit plan design. As stated by Bernie Sanders, Representative of Vermont, "the employees cannot be forced into an inferior plan when a company makes a promise to its employees regarding their pension benefits, it must not be able to pull the rug out from under its employees by cutting their pension benefits in midstream."²⁵⁷ The second component of the proposed legislation will eliminate the Bush Administration's proposed cash balance pension plan Treasury Regulations, which are viewed as allowing discrimination against older employees. Most likely these bills will never pass due to the Bush Administration's strong position on the matter; and former White House Press Secretary Ari Fleischer has even labeled the idea that cash balance plans hurt older workers as "not valid."²⁵⁸ Additionally, referring to the

253. Financial Accounting Standards Board, *FASB Adds Project on Measurement of "Cash-Balance" Defined Pension Plan Obligations* at http://www.fasb.org/pensions_9-25-03.shtml (last visited Mar. 4, 2004).

254. *Id.*

255. Pension Benefit Protection Act of 2003, H.R. 1677, 108th Cong. (2003)

256. Pension Benefit Protection Act of 2003, S. 825, 108th Cong. (2003).

257. Statement of Congressman Sanders on Apr. 8, 2003 regarding: The Pension Benefits Protection Act *available at* <http://bernie.house.gov/statements/20030408190049.asp> (last visited Mar. 4, 2004).

258. White House Press Briefing, Ari Fleischer, White House Press Secretary in Washington, D.C. (Dec. 10, 2002) *available at* <http://www.whitehouse.gov/news/releases/>

Treasury Department's proposed regulations, Fleischer stated, "under these rules, the plan must be age neutral before the conversion, age neutral after the conversion, [and] age neutral in the process of the conversion."²⁵⁹ The latest action taken by Congress was the amendment by the House to an appropriations bill²⁶⁰ that would prohibit the Treasury from using funds to assist in the overturning of a recent district court case that held that all cash balance plans, by design, violate the age discrimination rules of ERISA.²⁶¹

VI. IS THE CASH BALANCE PLAN PART OF THE DEFINED BENEFIT PLAN RENAISSANCE?

Up to this point, there has been a lot of negative press and, in the author's opinion, misunderstandings and confusion over cash balance plans. However, a string of recent legislative amendments and agency guidance, all indicate that public policy favors the renaissance and revitalization of the use of defined benefit plans in a company's overall retirement program. The author suggests that the future defined benefit plan universe will be comprised mostly by cash balance or other hybrid designs, and unless Congress steps in and allows cash balance plan designs to be accepted, and even encouraged, under their own statutory definition and rules, then there will likely be a total defined benefit extinction rather than a renaissance. The current issues being litigated have been discussed; and if there is a combination of statutory and regulatory changes that solve the issues and allow cash balance plan designs to easily comply with all existing qualified plan rules, and any potential provisions relating only to cash balance plans, then the future of cash balance plans should be quite beneficial for many employers and employees alike.

2002/12/20021210-11.html (last visited Mar. 4, 2004).

259. *Id.*

260. Amendment A025 to House Bill H.R. 2989, *The Transportation, Treasury, and Independent Agencies Appropriation Act of 2004*, 108th Cong., 1st Sess., introduced Sept. 9, 2003 by Rep. Sanders. However, Congress asked the Secretary of Treasury to propose legislation, and in the President's budget proposal released on February 2, 2004, legislation was proposed with three basic goals: (1) to clarify the legality of cash balance plans; (2) to assure fairness to older workers after a conversion with a transition period of protection (such as five years); And (3) to remove the cap on market interest rate credits (which, in mitigating the whipsaw problem, would likely render certain aspects of Notice 96-8 irrelevant). The press release is available at <http://www.ustreas.gov/press/releases/js1132.htm> (last visited Apr. 1, 2004).

261. CCH Inc., Pension and Benefits News, Pension and Benefits News, Sept. 17, 2003.

A. *How has the media viewed cash balance plans so far?*

Among other things, many overfunded defined benefit plans were being converted in the 1990's, and the results of the conversions boosted their financial statements and their earnings per share. As mentioned earlier, the accounting changes that FASB is looking into could change how future conversions are reported on the financial statements. The most likely event is that if new accounting rules are created, these rules will cause companies to report higher pension liabilities on their books. "Some companies' pension obligations stood to increase about 20% if changes were adopted. An increase in pension obligations can indirectly reduce profit."²⁶² Other problems are that "a sharp increase in pension liabilities could also disrupt a company's ability to borrow money. Furthermore, as this stuff gets onto balance sheets, it starts triggering certain things. A company's creditors can call in the debt, or change the provisions so the company suddenly has to pay a higher interest rate."²⁶³ Such a result could cause a sharp decline in companies' willingness to convert their traditional defined benefit plans into cash balance plans. Aside from the negative attention paid to the improvements to a company's financial status after a conversion, there has also been a lot of negative press about the alleged age discrimination violations of the conversions.²⁶⁴

B. *What is the defined benefit plan renaissance?*

This article is proposing that there is a defined benefit renaissance underway, or at the very least, the factors are in place to help foster such a revitalization of such plans. This necessarily means that defined benefit plans used to be the favored plan, that there was a period of decline, and that there should currently be a growing number of defined benefit plans. Arguably, traditional defined benefit plans that were converted into cash balance plans rather than being terminated bolster the number of current defined benefit plans. In addition, many new cash balance plans have been established by employers that were not, at the time of adoption, sponsoring defined benefit plans. Therefore, if cash balance plans are not wholly accepted as good plans, and if there continues to be litigation, bad press and Congressional doubt as to the design itself, then there will likely be an extinction of all

262. Mary Williams Walsh, *Changes Discussed in Accounting for Pension Fund Obligations*, N.Y. TIMES, Sept. 25, 2003, at C1.

263. *Id.*

264. For a good sampling of the negative press, especially since *Cooper v. IBM* was decided, go to the ERISA Blog section of the website for the Law Offices of B. Janell Grenier, Esq. at <http://www.benefitscounsel.com/erisaarchive/000430.html> (last visited Mar. 4, 2004).

defined benefit plans rather than a rejuvenation. First, we need to see how traditional defined benefit plans fit into the picture when ERISA was first enacted.

ERISA was enacted in 1974, in a vastly different business environment. The defined benefit plan was the predominant plan, as indicated by the following two observations:

ERISA was a product of its time. It was based on the assumption that defined benefit plans would be the mainstay of the pension system. It emphasized replacement ratios rather than account balances, as a measure of pension adequacy. The long-term viability of such plans, which contain an inherent age bias, was not questioned, even though the baby boom was just then entering adulthood and the demographic significance of such a large cohort was well recognized. Nor did ERISA's proponents consider how plans should evolve if life expectancies increased and the demand for labor changed.²⁶⁵

ERISA was forged 30 years ago, addressing the issues that seemed of paramount importance in the early 1970s. Reacting in significant part to the collapse of Studebaker and the ensuing financial ruin brought to the thousands of the company's employees and retirees, ERISA sought to create a comprehensive framework that would ensure that future employers would be forced to live up to their pension promises. . . . These rules, although they applied in differing degrees to all retirement plans, were most closely attuned to the defined benefit plan structure, the dominant plan of the era, and the one covering the greatest number of employees.²⁶⁶

So, the defined benefit plan seems to have been the main type of qualified plan at the time Congress enacted ERISA.²⁶⁷ However, statistics demonstrate that for various reasons, they have lost favor with employers and employees alike.²⁶⁸ But the promotion of defined benefit pension plans is on the upswing. In 1998, the PBGC indicated that they are turning their attention to the first part of their mission statement: "to encourage the continuation and maintenance of voluntary private pensions for the benefit of their participants."²⁶⁹ Former President Clinton's

265. Pamela Perun & C. Eugene Steuerle, *ERISA at 50: A New Model for the Private Pension System*, Occasional Paper Number 4 for the Retirement Project of the Urban Institute at 2 (Mar. 2000) available at http://www.urban.org/uploadPDF/retire_4.pdf (last visited Mar. 4, 2004).

266. Scott Macey & Gretchen Young, *The Future of Employee Benefits: A Call for Reform*, 15 *BENEFITS LAW JOURNAL* 5, 7-8 (2002).

267. Douglas Fore, *Do We have a Retirement Crisis in America?*, TIAA-CRED Institute Research Dialogue, 2003.

268. For statistics, see Department of Labor's Bureau of Labor Statistics, *Employee Participation in Defined Benefit and Defined Contribution Plans, 1985-2000*, available at <http://www.bls.gov/opub/cw/c/cm20030325tb01.htm> (last visited Mar. 4, 2004).

269. Nell Hennessy, Deputy Executive Director and Chief Negotiator of the PBGC, Remarks at the Meeting of the WEB Network of Benefits Professionals

and Vice President Gore's "interest in defined benefit plans is simply indicative of the interest we are beginning to see from other Baby Boomers as we get closer to traditional retirement ages."²⁷⁰ In her concluding remarks, Ms. Hennessy stated:

as benefits professionals, you are well aware of the important role that a defined benefit plan plays in a well-rounded employee benefits package. Hopefully we can work together to educate workers and employers so that, over the next ten to fifteen years, we can make meaningful pensions a reality for more American workers.²⁷¹

Many accounts in 401(k) plans and other defined contribution plans have eroded in the last few years due to the current economic environment.²⁷² That, in conjunction with the following statutory changes favorable to defined benefit plans, set the stage for a defined benefit plan renaissance over the next few years.

1. Effective in 2000, the combined plan limitations have been repealed.²⁷³ Before repeal, if an employer maintained both a defined benefit and a defined contribution plan, and an employee participated in both, then he or she was barred from receiving the maximum benefit from the defined benefit plan and the maximum allocation in the defined contribution plan, assuming compensation was high enough to warrant this level of contributions. Due to the method of calculating the combined plan limits, many affected participants received the maximum defined contribution allocation and thus received a reduced benefit from the defined benefit plans. After the repeal, such participants can now receive the maximum benefit from the defined benefit plan as well.
2. Effective in 1997, Congress eliminated the penalty tax on excess distributions.²⁷⁴ Before the repeal, participants in a defined benefit plan would pay a 15% penalty tax if they died and their remaining benefits in the defined benefit plan were "excessive." This proved to be a disincentive for participants to accumulate large benefits in a qualified plan. After the repeal, no participant needs to be concerned with "excessive" accumulations upon death.
3. Effective in 2002, the maximum limit on benefits from defined

(Feb. 19, 1998), available at <http://www.pbgc.gov/news/speeches/web.htm> (last visited Mar. 4, 2004).

270. *Id.*

271. *Id.*

272. William Bernstein, *Riding for a Fall: The 401(k) is Likely to Turn out to be a Defined-Chaos Retirement Plan*, BARRON'S, Nov. 26, 2001.

273. I.R.C. § 415(e) (1994), repealed by the Small Business Job Protection Act of 1996.

274. I.R.C. § 4980A (1994), temporarily repealed by the Small Business Job Protection Act of 1996, then permanently repealed by the Taxpayer Relief Act of 1997.

benefit plans is increased to \$160,000 per year payable at age sixty-two.²⁷⁵ Before the amendment, the maximum limit was \$90,000 (as adjusted) per year payable at the participant's social security retirement age (sixty-five, sixty-six, or sixty-seven, depending on year of birth). After the amendment, participants in a defined benefit plan can receive greater benefits (as long as the employer can properly fund for them).

4. Finally, the IRS over the years has clarified the nondiscrimination rules that apply to defined benefit plans, especially with the addition of the cross-testing rules as part of the 1993 final regulations.²⁷⁶

C. Why is a cash balance plan design integral to fuel the renaissance?

Cash balance plans meet the needs of employers with mobile work forces. Through a cash balance plan, employers can offer significant benefits to employees that are only there for a short period of time. As they leave, their cash balance accounts are portable, and can easily be rolled over into an IRA or transferred into another qualified plan. Because of the cross-testing provisions, the deferral opportunity is flexible. Additionally, if the employer is a partnership, then the allocation of the plan contribution among the partners can simply be his or her allocation for the year, plus or minus the proportionate cost for non-partner participants and a proportionate share of gains or losses.

Statistically, cash balance plans are quite prominent²⁷⁷: 40% of all defined benefit plan assets are in cash balance plan trusts; 25% of all defined benefit plan participants are in cash balance plans; 33% of the Fortune 100 companies sponsor cash balance plans; and 19% of the 1000 largest U.S. companies sponsor cash balance plans. Additionally, over 300 defined benefit plans have been converted into cash balance plans, but are awaiting IRS determination letters.²⁷⁸ All in all, public policy demands that Congress and the executive agencies find solutions that encourage employers to establish new cash balance plans or convert their existing defined benefit plans into cash balance plans. As noted by a former Benefits Tax Counsel at the Department of Treasury,

275. I.R.C. § 415(b), as amended by the Economic Growth and Tax Relief Reconciliation Act of 2001.

276. Treas. Reg. § 1.40(a)(4)-8 (2000).

277. See Stephen Taub, *Cash-Balance Plans Hang in the Balance*, Aug. 5, 2003, available at <http://www.cfo.com/article/1,5309.10351//A/776/00.html> (last visited Mar. 4, 2004).

278. See Rep. Bernie Sanders, member of Congress, letter to Arthur Levitt, Jr., Chairman of the Securities Exchange Commission, dated January 6, 2000, available at <http://www.house.gov/bernie/publications/letters/2001-01-06-sec-ibm.html> (discussing the IBM conversion and its affect on shareholders).

[t]he overall defined benefit system would benefit considerably from a resolution of the cash balance controversy that would settle the law governing those plans in a reasonable way. . . . I believed Congress could resolve the cash balance controversy in a manner that reasonably protects older workers from the adverse effects of a conversion while allowing employers reasonable flexibility to change their plans.²⁷⁹

VII. CONCLUSION

Tax qualified retirement plans fall into two categories: defined benefit plans and defined contribution plans. For various reasons, defined benefit plans have, over the years, become less favorable for employers than defined contribution plans. Some of the reasons include higher annual administrative costs, rigid funding requirements during economic down turns, and the perceived lack of understanding of defined benefit promises by younger and shorter-serviced employees. However, during this same general period, Congress has amended ERISA and The Code to make defined benefit plans more attractive. Some examples are the elimination of the combined plan limits and the increased dollar limit that can be paid from a plan. These statutory changes, as well as the depressed economy that makes defined contribution plans (especially 401(k) plans) less attractive, are some of the basic reasons that a defined benefit plan renaissance is set to begin.

Since there are a substantial number of existing cash balance plans, whether through conversion or not, the cash balance design itself is responsible for at least the defined benefit plan preservation, if not for the renaissance. However, for cash balance plans to help foster the renaissance that is suggested, all of the ambiguity over their designs must be resolved. This author hopes that either Congress will amend ERISA and the Code to provide a definition and a statutory framework from which cash balance plans can comply with the qualified plan rules, or they should adopt the legislative proposals suggested by the Department of Treasury. Otherwise, the one class of qualified plans that provides pension security, i.e. defined benefit plans, will fade into the history books.

279. Safeguarding America's Retirement Security: An Examination of Defined Benefit Pension Plans and the Pension Benefits Guaranty Corporation, Committee on Government Affairs, Subcommittee on Financial management, the Budget, and Information Security, 108th Cong. (2003) (statement of Mark Iwry, Senior Fellow, The Brookings Institute).

