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CREATIVE BUSINESS SOLUTIONS – FOR A CHANGE

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Pension Protection Act: Implications for Hybrid Plans

Background

In the mid-1980s, many employers were grumbling about the administrative burdens the government had placed on defined benefit (DB) pension plans. At the same time, for a variety of reasons, defined contribution (DC) plans, which give participants the ability to invest their retirement funds, seemed to be an increasingly attractive alternative to DB.

In an attempt to get key DC features (such as individual accounts) within a DB environment, employers began adopting so-called “hybrids,” such as cash balance and pension equity plans. In many instances, employers designed the conversions to preserve overall employee benefits. In a number of cases, though, hybrid plans were intentionally used to reduce accruals (especially early retirement subsidies), associated plan liabilities, and plan sponsor pension expense.

Legal Challenges

Over time, employees, the media, and the general public became aware of the “take-away” effect of many of these plan conversions. The Wall Street Journal even featured a front-page story on actuaries, “caught on tape” at a national meeting, touting cash balance as a creative way to slash employee pension benefits.

It’s no wonder that, before long, a number of class-action lawsuits were filed on behalf of plan participants, claiming, among other things, that hybrids violated age-discrimination protections. IBM’s plan, for example, was deemed discriminatory in a series of rulings – which had been consistently upheld until the recent reversal by the Seventh Circuit Court of Appeals. Other cases are still pending. PNC (currently in the Third Circuit Court) and Southern California Edison (Ninth) are among the more well-known class-action suits yet to be decided. Some practitioners believe these rulings may not necessarily concur with those of the Seventh Circuit Court.

Implications of the Pension Protection Act

In August 2006, President Bush signed the Pension Protection Act (PPA) into law. It declares that hybrid plans that go into effect after June 28, 2005 will be considered compliant with regulations if designed consistent with PPA provisions. But, and this is a key concern for many employers, the same protections are not extended to conversions made before June 29, 2005. If your hybrid plan took effect prior to that date, the status of your program, and all benefits accrued by participants, are not covered under the PPA. These plans are still subject to interpretation in court – and are therefore still vulnerable, both legally and financially.

Certainly, with the enactment of the PPA, converting to a cash balance or pension equity plan is a more viable option for employers. With the PPA-provided “safe harbor” for new plans, hybrids might now be viewed as a tailor-made solution to new pension funding pressures (also created by the Act). And there’s no question that, in certain business situations, hybrid plans work extremely well. In the original IBM case, for instance, the employer had been facing daunting, and seemingly intractable, financial pressures. For IBM, converting to cash balance was the most palatable way to “convert” pension dollars into other types of compensation – so the company could attract and retain people who fit its

new business model. Had IBM not been able to redirect spending in this way, it's doubtful the company would have been able to survive, let alone achieve its remarkable turnaround.

Still, in most instances, employers will find that hybrids, by their nature, are a "mixed bag." That's because DB and DC plans are inherently very different, and incompatible, approaches, completely opposite in the ways they accrue and deliver retirement benefits – and provide protection to participants. By jamming the "round peg" of DC into the "square hole" of DB, hybrids can't help but produce something that's pared-down.

Ultimately, hybrids saddle employers with the "worst of both [benefit] worlds." Plan sponsors still have to meet the complicated, and costly, administrative and financial management obligations of a DB plan – without being able to offer the substantial upside investment potential of DC.

What To Do About Your Retirement Plan

Whatever your circumstances, Strategic Planning Associates has the processes, resources, and tools to address your retirement plan issues or concerns. Using our proven multidisciplinary approach, we can help you analyze your data; align program priorities with overall organizational objectives; and, through extensive management interviews, employee focus groups, and surveys, build consensus on design – and momentum for change.

If your business situation calls for a hybrid approach, we can convert your pension to a cash balance or pension equity plan customized and framed to achieve your organization's objectives. As appropriate, we can also offer you alternative strategies that may be even more effective. Either way, you'll implement a program with provisions and features designed to meet your specific needs.

If you converted to a hybrid plan before June 29, 2005, you'll find that our services can be particularly valuable to you. That's because Strategic Planning Associates is the only firm in the industry with a suite of "exit" strategies – to secure, and even enhance, your pension benefits, while substantially reducing your vulnerability and risk.