

## **PENSIONS MIRED IN POLITICAL MINEFIELDS**

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### **Document Text**

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When Congress reconvenes in the fall, employers will be paying close attention.

For the sake of your retirement, you should, too.

Over the past decade, many companies have either under-funded their pension plans or abandoned them entirely. Fewer than half the pensions that existed in 1994 remain intact. The 29,000 plans that remain -- covering about 44 million Americans -- face a cumulative \$450 billion deficit, according to the Pension Benefit Guaranty Corp., a federal agency that insures private pensions.

Now congressional leaders have committed to reforming the country's private pension system, sparked in part by United Airlines' \$6.6 billion default this May to the PBGC. Thanks to United and other defaults, the PBGC has a \$23.3 billion funding gap -- and faces insolvency long before Social Security is projected to run out.

The goal couldn't be clearer, or more difficult: Shore up the financial integrity of the federal agency that backstops private pensions by raising insurance premiums and requiring stricter funding requirements, without causing more companies to drop their plans.

It's a political minefield that requires careful navigation.

"What Congress decides will shape whether people have [pension] plans in the future, and whether their kids will have one," said Lynn Dudley, vice president of retirement policy at the American Benefits Council, a business lobbying group.

In retooling federal pension legislation, one thorny issue involves the legality of a relatively new breed of retirement programs: cash-balance plans, which are hybrids between traditional defined-benefit pensions and more recently adopted defined-contribution plans, such as 401(k)s.

Because companies adopt hybrids primarily to save money, benefits at retirement are rarely as rich as they are under traditional pensions.

Particularly troubling to hybrid critics is how older workers fare when a traditional pension is converted into a hybrid. Because of differences in the pace at which benefits accumulate, switching late in a career from a traditional pension to a hybrid plan can deprive long-tenured workers of expected benefits when they don't have many working years left for their new accounts to earn a significant return.

For those who have been through the ordeal, the switch has often meant a setback for five or 10 years because they got no additional benefits until the cash-balance formula reached the amount they had already earned under the traditional plan, a phenomenon called "wear-away."

"What it boils down to is the elimination or dramatic curtailment of benefits," said Tom Moukawsher, a Hartford-based benefits lawyer with Moukawsher & Walsh who is representing employees in a class-action suit against CIGNA over its conversion to a cash-balance plan.

"People say cash-balance plans are good because they're portable. You always know what you have. You've got control. Yeah, but you only get half of what you used to get," Moukawsher said.

Hybrids are under a legal cloud because of concerns that they could discriminate against older workers. Conflicting court rulings have put the plans, which now cover about 8 million workers, in legal limbo.

In 2000, a federal court gave its blessings to the hybrid concept when it ruled that Onan Corp.'s plan was not inherently age discriminatory, but it left the conversion question unaddressed.

Three years later, a different federal judge from the same circuit ruled in a case against IBM Corp. that hybrid plans are inherently illegal, regardless of how the conversion is accomplished.

In that case, U.S. District Judge Patrick Murphy said Big Blue's \$40 billion hybrid plan violated federal regulations because younger employees would get more years to earn interest by the time they reached age 65 than their older colleagues would. IBM settled part of the claims but is appealing the decision.

The ruling sent a cloud of legal uncertainty through the private pension system that has had repercussions.

The pensions of companies that have already adopted hybrids -- such as Aetna, The Hartford and CIGNA -- are now legally suspect, pension experts say. And corporations hoping to cut costs by switching to hybrids -- such as Tribune Co., parent of The Courant -- have put their plans on hold until the legal issues are clarified.

The upshot: Companies looking to curtail legal liabilities or slash costs have more reason to simply discontinue their pension plans altogether. In that scenario, no employee earns further benefits.

"If you freeze the plan, it's even worse for older workers," said Ethan Kra, chief actuary of Mercer Human Resources Consulting. "Which is better: Giving people nothing or giving them half a loaf? I always thought half a loaf prevented you from starving. No loaf meant you starved."

To complicate matters, companies that sponsor hybrids, like those that sponsor traditional pensions, pay the PBGC for insuring their plan. Hybrids now account for about 25 percent of the insurer's premium revenue. When companies discontinue those plans -- as Hewlett-Packard did last month during a broad restructuring plan -- a significant source of much-needed revenue for the PBGC is eroded.

The overall picture of private pensions in the U.S. is of a system approaching extinction. In 2001, 34 firms with more than 1,000 employees terminated or froze their pension plans, according to consulting firm Watson Wyatt Worldwide. That number climbed steadily in 2002 to 39 firms, and in 2003 to 45.

Last year, after the decision against IBM's hybrid plan, the number of companies that froze or terminated their pensions accelerated sharply, to 71. Of those, 12 firms, or 17 percent, had a hybrid -- more than in the previous three years combined.

According to a recent survey by Hewitt Associates, of the companies that still provide traditional pensions, 27 percent say they will no longer offer them to new hires, while 18 percent plan to freeze pensions for all current participants, switching them over to plans such as 401(k)s instead.

The net effect for employees, pension experts say, is fewer guaranteed pensions and more investment risk -- in effect, even less retirement security.

In an effort to lend clarity to the issue, Congress has stepped in. Its actions will be watched closely in Connecticut and across the nation.

The top 10 central Connecticut companies, which face a collective \$6 billion shortfall in expected pension obligations, are quietly following the issue on the sidelines. Some say they will take their cue from Congress before making any decisions about the future of their pension plans.

Aetna, for example, switched its traditional pension to a cash-balance hybrid in 1999, and gave existing employees an eight-year period to make the transition. Those who retire during the eight years get the higher of the hybrid or an enhanced traditional pension, while new employees are automatically enrolled in the hybrid plan.

After 2007 -- if Aetna keeps the plan in place -- all retiree benefits will fall under the hybrid plan.

For the 28 percent of employees making the transition between now and 2007, pension account balances will start with the greater of the old and new formulas. But Aetna has not yet decided whether those employees will earn additional benefits immediately, or have to wait until the calculation under the new formula reaches the point at which the traditional pension left off.

"I don't think wear-away would be beneficial to employees, so that's something I'm trying to look at and manage appropriately. I can tell you it's going to be a challenge for us," said James Gould, head of compensation and benefits at Aetna.

Given a market environment in which many of Aetna's competitors don't offer a defined-benefit pension at all, "we have to manage it very carefully. Maybe the regulations will clarify a good direction for us," Gould said.

Even Connecticut firms that have never considered switching their plans say they are watching Congress closely, both for what it will say about hybrids and for stricter funding rules that could require them to immediately pour millions into their pension accounts, subject to the whims of the market.

"Companies are going to have ever more incentive to find an alternative to the traditional pension plan" if the new regulations make it difficult to predict how much they will have to plow into their pension funds each year, said Russell Jones, treasurer and chief investment officer of Bloomfield-based Kaman Corp.

"And you know you're not seeing new ones being put in place," Jones said.

Last month, the House and Senate each advanced competing reform bills. Both would clear the way for hybrids adopted in the future, as long as companies contribute at least as much to older workers' retirement accounts as they do to their younger colleagues with the same years of service and salary. Future hybrid plans will not be considered discriminatory merely because younger workers have more years for their interest credits to build.

The Senate version would go further. It addresses the most common problems that arise during the conversion process by prohibiting wear-away, and would require that employees over 40 with at least 15 years of service can choose between the old and the new plan. The House bill is silent on the conversion issue, prompting employee groups to call it a corporate giveaway that leaves hybrid plans' most egregious aspects untouched.

"This isn't a compromise. This is employers getting everything they ever wanted handed to them on a silver platter," said Eva Cantarella, a senior pension attorney for Michigan-based Hertz, Schram & Saretsky, who often represents employees in pension suits.

Yet to companies that have already switched to hybrids, neither proposal goes far enough. The focus on future plans still leaves the legal status of their plans unclear, and vulnerable to employee lawsuits.

"We think that the final legislation needs to be more explicit to protect companies that have already converted their traditional plans to hybrid plans," said Paul Zurawski, director of government affairs for Honeywell International Inc., which converted part of its \$12 billion traditional pension to a hybrid plan in 2000.

"If the provision doesn't pass, we will have to reconsider continuing with our plan. For our shareholders, who are the ultimate bosses, the question is whether or not we want to continue having this vulnerability," Zurawski said.

The loss of more pensions is the precise scenario all sides are trying to avoid.

"For the past several years now, [cash-balance hybrids have] been the only area where there's been any growth in defined-benefit plans. It's been the only bright light in a very gloomy arena," said James Klein, president of the American Benefits Council. "If the light is extinguished here, that's really a terrible thing for the pension system."

## TRADITIONAL VS. HYBRID

Benefits in traditional pensions usually are based on a combination of the number of years an employee has worked and his or her final average salary. The benefits grow at an accelerated pace toward the end of employees' careers.

But in hybrids, benefits generally accumulate the way 401(k) accounts do -- steadily. Hybrid benefits are based on a percentage of an employee's salary and earn interest each year. The interest rate can be tied to an index or fixed at a specified rate that employers can later change. The account balance determines the retirement benefit.

Benefits for hybrids and traditional pensions are funded by employers.

For employees who have worked a full career at one place, hybrid benefits are rarely as rich as traditional pensions. For job hoppers, hybrids often allow vested employees to take their accrued benefit immediately in a lump-sum payment or to roll it over into another retirement account. Compared with traditional pensions, hybrids can favor younger workers who have more years for their money to grow.

Both are protected -- up to a cap now set at \$45,614 a year -- by the Pension Benefit Guaranty Corp., a federal agency that insures defined-benefit pensions. Companies that sponsor hybrids, like those that sponsor traditional pensions, pay a premium to the PBGC for insuring the plan.

## SAFEGUARDING YOUR PENSION

Keep all documents, especially summary plan descriptions. They will be invaluable later if you have questions or disagreements about benefits.

Ask for the specific impact any change will have on you and your benefits.

Get the amount of your accrued benefit in writing. Because employers cannot cut benefits you have already earned, this will prove the minimum amount you are owed.

Remember that this is a voluntary system. Employers can freeze benefits at any time. Or, if your employer goes bankrupt, a federal insurer takes over and caps your benefits. The only money sure to stay under your control is your own. Consider funding a supplemental savings plan.

### [Illustration]

GRAPHIC: (B&W); Caption: Shortfalls in Big-Company Pension Plans Source: Regulatory Filings [LIBRARY NOTE: the text of this chart was not available electronically.]

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### **Abstract** (Document Summary)

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