Business In The Beltway

Pension Wars: The Fallout After IBM

Janet Novack, 04.16.03, 11:00 AM ET

It's not often you see protestors outside a Treasury-Internal Revenue Service hearing on proposed tax code regulations. But ever since disgruntled **IBM** employees brought the issue to public attention, the movement by major corporations to convert traditional defined-benefit plans to so-called cash-balance pension plans has been a lightning rod for workers'--and particularly baby boomers'--growing anxiety over their retirement incomes.

And so, last week, there were picketers outside and raw emotions inside at hearings on rules that would end a moratorium the U.S. Department of the Treasury imposed in 1999 on giving its blessings to cash-balance conversions. "White-collar workers are under assault,'' complained a long-time **Verizon Communications** (nyse: VZ - news - people) employee. Maybe so. But the problem isn't cash-balance plans per se. Rather, the devil is in the details of conversion.

The difficulty of this issue was demonstrated by the fact that some employers, as well as workers, were unhappy with the regulations proposed by a business-friendly Bush Administration. Currently, under the moratorium, companies are able to convert, but must do so without government guidance on whether their moves violate age-discrimination rules. The proposed rules say conversion, per se, isn't discriminatory, but set up specific tests pension plans must meet. The Coalition to Preserve the Defined Benefit System, a newly formed lobbying group of 57 companies, including R.J. Reynolds Tobacco (nyse: RJR - news - people), Caterpillar (nyse: CAT - news - people), Dow Chemical (nyse: DOW - news - people), Cooper Industries (nyse: CBE - news - people), Wells Fargo (nyse: WFC - news - people) and Electronic Data Systems (nyse: EDS - news - people), claims that more than two-thirds of existing plans at the biggest U.S. companies would flunk the new tests.

Cash-plan conversions weren't always controversial. **Bank of America** (nyse: BAC - news - people) did the first conversion in the 1980s and in the 1990s the conversion movement quietly picked up steam. By 1998, 24% of S&P 500 firms sponsoring defined-benefit plans had converted, according to a study by two Federal Reserve Board economists. Then, the Fed study observed, IBM made its move and cash-balance conversions were characterized "as an example of corporate greed; a way to reduce benefits generosity in a way employees did not fully understand.''

Like traditional pension plans, and unlike 401(k) plans, cash-balance plans are wholly funded by employers and insured by the federal Pension Benefit Guarantee. A retired worker can collect a monthly payment for life, although many do take their pensions in lump sums. The big difference between traditional and cash-balance plans lies in the way workers accrue benefits.

In a cash-balance plan, the company contributes a set amount of salary for each worker every year to a theoretical account for him (even though the money is actually managed in one big pot), and then credits his account with some guaranteed annual return--typically the yield on 30-year Treasuries. If a worker leaves before retirement, no matter his age, he can take the amount in his "account" with him and roll it into an Individual Retirement Account. So employees who jump from company to company or forsake a traditional job--say, to raise children or start a business--don't lose out. In that way, the plan functions like a 401(k) savings plan.

Sounds reasonable, right? In fact, it's a lot fairer than the funding formula in a traditional defined benefit plan, argues Urban Institute retirement and tax policy expert **Eugene Steuerle**. In traditional plans, benefits are calculated using a formula based on the worker's salary in his last three or five years of service and his years with the company. Those who spend 30 years at one company do extremely well, while job hoppers and women who leave the labor force to raise families are shortchanged. The Fed study concluded that the companies most likely to convert to cash balance in the 1990s were those in industries with mobile workers and labor shortages; in other words, they made the switch to better compete for mobile, young workers.

So cash-balance plans make business sense. But that's no comfort if you're a boomer who spent your early years jumping from job to job, accruing few pension benefits, and then settled into a long-term corporate job, expecting you'd finally get yours--only to find the rules were being changed midgame.

A new study by **Watson Wyatt** (nyse: WW - news - people) of 78 companies that converted to cash-balance plans contains some telling numbers. These companies cut their pension costs an average of just 1.8% and, overall, 80% of workers came out ahead. A typical 40-year-old leaving a firm after ten years would walk away with 2.4 times more benefits under the new plan as the old.

But a 60-year-old leaving after 30 years of service would end up with only 78% of the pension benefits he would have had under the old system. Moreover, among the 45% of companies studied that reduced costs, 87% of workers in their fifties were losers. (Those companies that didn't cut costs tended to offer older workers transition relief--for example, giving them the option of staying in the old plan.)

Eric P. Lofgren, global director of the benefits consulting group at Watson Wyatt, which is working for the new employers' coalition, says that in recent years (since the IBM blowup), nearly all converting employers have protected employees 50 and above who are within five years of retirement. Indeed, **FedEx** (nyse: FDX - news - people), which is now converting, is giving all current employees a choice of plans. But the employers' coalition doesn't want such protections mandated.

The employers' group is adamantly opposed, for example, to a proposal by Rep. **Bernie Sanders**, (I-Vt.) backed by the Communications Workers of America, AARP and AFL-CIO. It would require companies to give any worker who is age 40 or had been employed for ten years the choice of remaining in the old plan or opting for the new one. "The man is trying to kill defined-benefit plans," fumes Lofgren. If companies find conversion too onerous, he notes, they'll simply terminate their defined-benefit plans altogether. This is no idle threat. Less than a fourth of private-sector workers are still covered by defined-benefit plans today, down from 39% in 1975.

J. Mark Iwry, a Brookings Institution senior fellow who was a top Treasury pension official when the 1999 moratorium was imposed, laments that the issue has become so polarized. But he insists "there are ways to provide reasonable transition protection while allowing companies the flexibility to make changes.'' Ultimately, however, the Treasury may not be able to do that through regulations, and Congress may have to step in.

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