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Commentary: Pensions That Discriminate against Older Workers

Kathi Cooper is something of a rarity in America these days. She has spent her entire career with a single company. For the past 24 years, Cooper has thrived at IBM, first in finance and planning and now working in internal controls. "I absolutely adore that company," she says.

Yet that didn't stop Cooper, 53, from taking IBM to court over changes it made to its traditional defined-benefit pension fund in 1995 and '99. She and thousands of other employees had tallied up their payouts under the newest plan, a so-called cash balance plan, and compared them with the old one. Younger workers with shorter tenure at Big Blue would make out better under the new plan, but to veterans like Cooper, the math didn't look right. And on July 31, Federal Judge G. Patrick Murphy of the Southern District of Illinois agreed. He concluded that the plan was indeed unfair, and in fact illegal.

Murphy's ruling, of course, is by no means the last word. IBM will appeal. At the same time, other courts in other cases have ruled in favor of companies with similar types of plans. But Murphy's decision points up something systemic and troubling about today's pension system. There is a basic mismatch between pension law and the way business really works. It has been decades since the dream of a worker was to stay put in one company for life. That's one reason why IBM and a legion of other big companies in recent years have replaced traditional pension plans with those that don't penalize workers who change jobs.

With those plans increasingly under attack by older employees, though, it's becoming clear that a company's best interests are not always going to intersect with those of all its workers. That's why Congress needs to step up with clear legislation that would reform federal pension laws for the first time in a generation. Until then, lawsuits and divergent court decisions will become the norm, leaving both workers and companies in a state of pension limbo. Worse, facing higher costs, companies threaten they might abandon cash balance pension plans altogether.

Congress will have its hands full. The issue is highly technical and politically charged, with huge stakes for two opposing groups pols can ill afford to antagonize: baby boomers nearing retirement and big corporations. Senate Finance Committee Chairman Charles E. Grassley says he is studying the court decisions, but is unlikely to act until the IBM appeal and that of another case against Xerox (XRX) Corp. are concluded. "We'll need to look at these decisions with an eye toward protecting older workers and ensuring that there are sufficient incentives for employers to maintain defined benefit plans," says Grassley.

So what would an ideal pension plan for workers in 2003 look like? It would be one that employers fund and at least partially guarantee, backed by the government. That would echo how old-style defined pension benefit plans work. But it would also incorporate the portability and simplicity that more modern cash balance plans aim for.

There's no reason why that can't be accomplished. But a lot of work remains to be done to iron out workable reforms. According to Murphy's ruling, today's cash balance plans break one of the key covenants of guaranteed pension plans: that they will never discriminate against older workers. Finding a way to structure them so they don't should be Congress's top priority in the debate.

Solving the problem is vital because hundreds of other employers have switched to IBM-style plans. According to benefit consultants Hewitt Associates, 30% of large employers have cash balance plans today. All told, 14% of U.S. employees are covered by them at employers ranging from Federated Department Stores (FD) and Verizon to Colgate-Palmolive (CL) and even Harvard University.

Without a solution, some worry that many companies will just suspend their plans. "These rulings increase significantly the cost of sponsoring pension plans and put the future of such plans in serious jeopardy," says Patricia M. Nazemetz, vice-president of human resources at Xerox. The day after the IBM decision, a court ruled that Xerox owes $300 million related to its own cash balance plan in a suit that revolved around the calculation of interest for departing workers, a different issue from the IBM case.

The crisis in cash balance plans also comes at a time when the entire retirement system is struggling. Social Security funding is an ever-present worry and a combination of low interest rates and poor stock market returns has left old-time corporate pension funds with too little cash to meet their coming obligations. Burdened by a number of recent plan failures -- including Enron's cash balance plan -- the federal Pension Benefit Guaranty Corp., which insures pension funds, is struggling. If companies were to abandon cash balance plans, which make up a good section of the PBGC's revenue base, that could spell further trouble for the agency's financial health.

The IRS is in the process of writing regulations for cash balance plans and may publish them before the end of this year. But employee activists argue that Murphy's decision proves existing law doesn't cover these plans and a new law is needed. "We need to create plans anew, authorized by Congress," says Karen Friedman, Director of Policy Strategies at the Pension Rights Center, "not created in the dark of the night and that don't fit the statutory framework of the pension law." Pension plans that are fair to both long-term older workers and more mobile younger ones should be the goal.

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