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Cash-balance plans under fire

Court ruling against IBM could invalidate all such plans

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SAN FRANCISCO (CBS.MW) -- Companies may freeze or discontinue their pension benefits known as cash-balance plans due to a court ruling that could be used to find all such plans illegal, experts said.

Last week, a federal district court found IBM's cash-balance plan discriminated against older workers ([see full story](#)), and the court's reasoning could be applied to other such plans covering millions of workers, experts said. IBM has said it plans to appeal.

"The reasoning used in the ruling would probably invalidate every cash-balance ... plan in the country," said Eric Lofgren, director of the benefit-consulting group of Watson Wyatt Worldwide, a human-resources consulting firm.

Employers will now wait to see how IBM's appeal fares, Lofgren said. If the court's decision is not overturned, companies that now offer cash-balance plans will likely switch to defined-contribution plans, he said. Still, "the employer community in general seems very confident that IBM will win the appeal," he said.

Cash-balance plans are considered defined-benefit plans, but they also share traits with defined-contribution plans such as 401(k)s: The employer makes regular contributions, based on a percentage of salary, to an account in the worker's name, and usually guarantees a minimum level of interest on that account.

Unlike traditional defined-benefit plans which reward loyal workers with a spike in benefits near retirement, companies' contributions to a cash-balance plan rise steadily over time and are portable, making them more appealing to younger workers who don't plan to spend a career at one company.

Some companies, including IBM ([IBM: news, chart, profile](#)), came under fire in the 1990s when they converted from the traditional benefit to the cash-balance option, because the change meant older workers' expected benefits would decrease substantially.

Employees win

Employee-rights activists are hailing the ruling, by U.S. District Court Judge G. Patrick Murphy in the Southern District of Illinois, as a necessary means to protect older workers' benefits. And they hope the ruling will lead Congress to clarify the rules surrounding cash-balance plans.

"It was a huge victory for employees, not just of IBM, but employees throughout the country," said Karen Friedman, director of policy strategies at the Pension Rights Center.

"This is basically a wake-up call to employers that they can't cut back the benefits of their older employees simply to save money and that they have to be careful about what they're doing," she said.

Companies such as Motorola and Eastman Kodak have done a better job during conversions, because they've given employees the choice of continuing with a traditional defined-benefit plan or switching to the cash-balance plan, Friedman said. These companies "offered protections to older employees to make sure they don't lose benefits."

On a technicality

Still, experts said the court's ruling had nothing to do with the potentially adverse effects to older workers of converting to a cash-balance plan. That conversion process varies by company.

Instead, the judgment centered on how cash-balance plans' benefits are figured, and because most companies figure them the same way, the ruling has far-reaching implications.

Cash-balance plans fall under defined-benefit plan rules, and that means the future value of benefits is used to assess age discrimination, some experts said. Assessments of defined-contribution plans, in contrast, are based on the current value of benefits.

Thus, the judge found that the future value of benefits to, say, a 65-year-old would be less than the future value of benefits to a younger worker under a cash-balance plan. That's because, while an older worker may get a bigger slice of salary as a contribution, that money would have less time to accrue interest -- giving younger workers an unfair advantage, experts said.

Like others who are opposed to the age discrimination that's often found during conversions, Norman Stein, a law professor at the University of Alabama, sees the ruling against cash-balance plans as favorable to employees, though the technical basis of the court's finding doesn't necessarily address the plans' real problems.

"If you think of (cash-balance plans) as defined-contribution plans, you'd think they're not age discrimination," Stein said. But, the judge found "they violate an important technical requirement that all defined-benefit plans are required to satisfy," he said.

"What makes them bad is not what makes them illegal, and what makes them illegal is not necessarily what makes them bad," he said. "But because they're bad for most older employees, I don't think they should get a free pass. I think it should go back to Congress and Congress should decide what are good cash-balance plans and what are bad ones. That can happen if all cash-balance plans are illegal.

"They have caused tremendous, tremendous pain for older employees because these conversions have really hurt them," Stein added. "These really are age discriminatory, they really have hurt older employees, and for technical reason they also happen to be illegal."

But those in favor of cash-balance plans decry the logic of the judge's ruling. "The argument ... that because younger people have a longer time to accrue interest, it's age discriminatory, that's nonsense," said Mark Ugoretz, president of the ERISA Industry Committee, a trade association that represents major employers.

Under the ruling, Ugoretz said, "if you've got a savings account and your grandfather has a savings account, your grandfather's savings account would be considered age discriminatory because he has less time to accrue his benefit than you do. That's just silly."

Andrea Coombes is a reporter for CBS.MarketWatch.com in San Francisco.

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