

Do Hybrid Plans Offer a Better Allocation of Risk And Are They a Feasible Way Forward?

2005 US-UK Dialogue on Pensions

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American Benefits Council

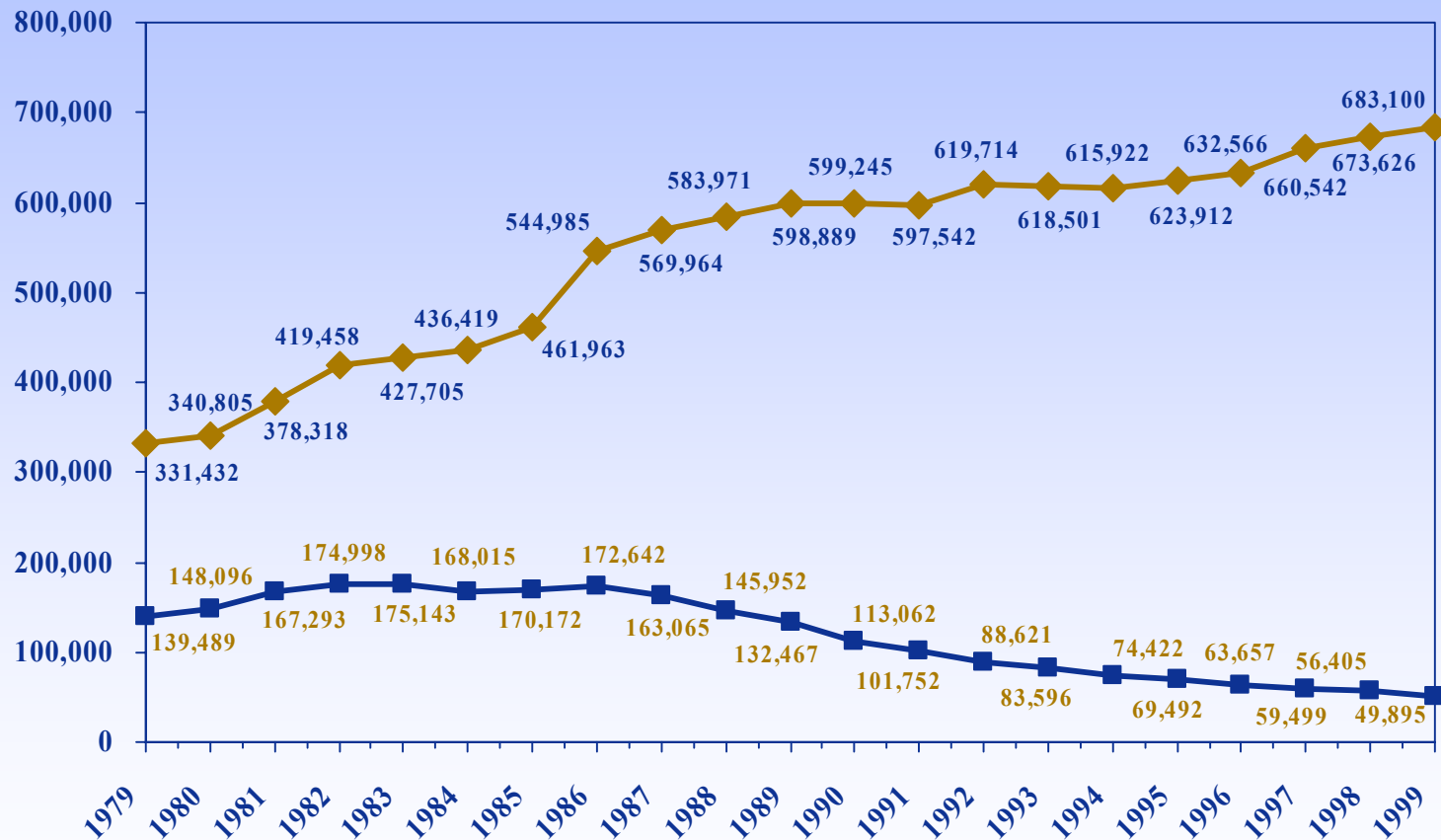
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Defined Benefit/Defined Contribution Trends

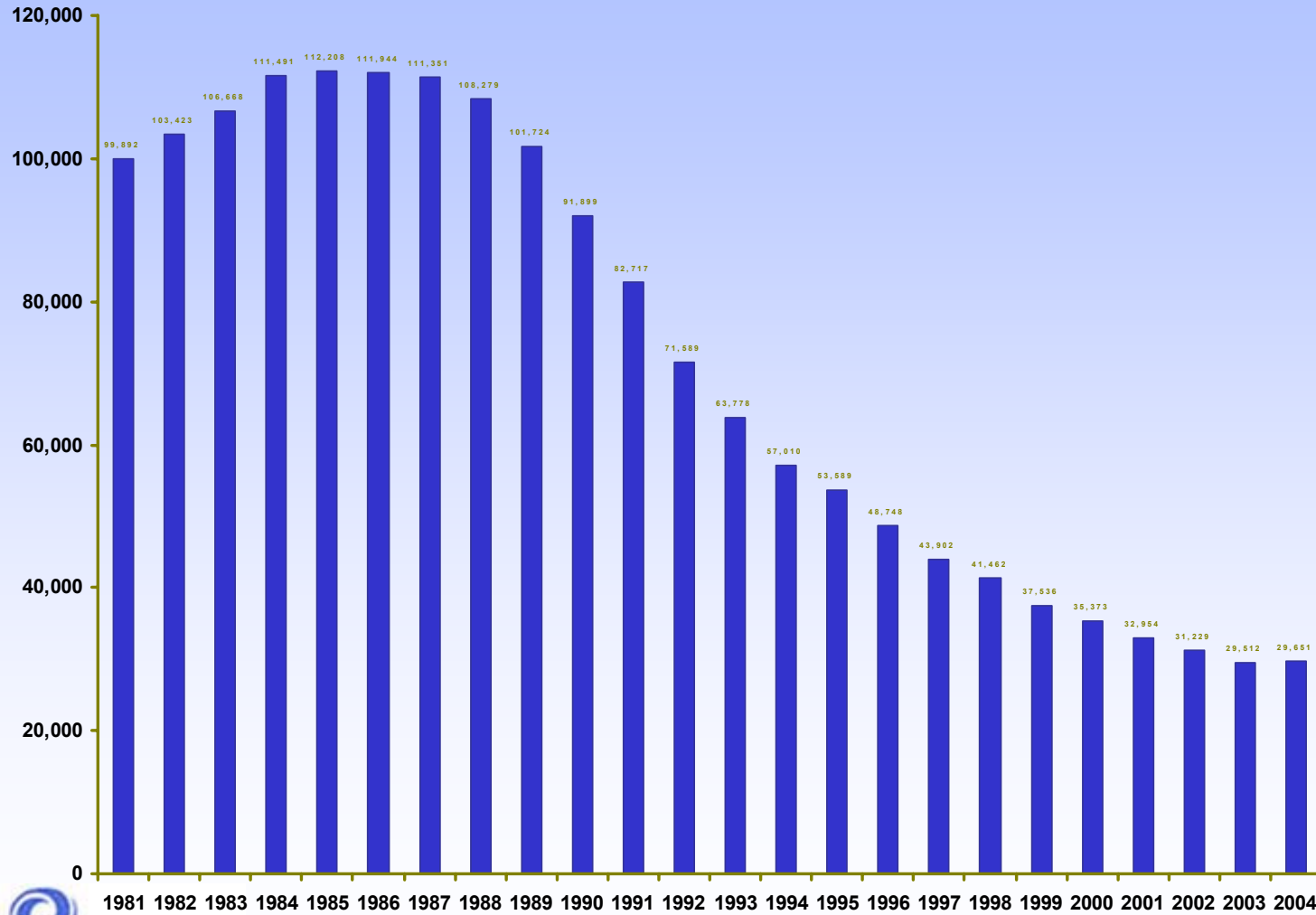
Number of Pension Plans, by Type of Plan, 1979-1999



- ◆- defined contribution plans
- defined benefit plans

Decline of the Defined Benefit System

Source: PBGC Pension Insurance Data Book 2003 and 2004 Annual Report



What is a Hybrid Plan?

- Defined Benefit plan with Defined Contribution features
- “Cash Balance”: Employers provide annual “pay credits” to a hypothetical account and “interest credits” on the account
- “Pension Equity Plan”: Employers provide credits for each year of service and the credits are multiplied by employees’ final pay to produce a lump sum



Features of Hybrid Plans

- Transparency: notional account balance
- Steady benefit accrual over worker's employment years
- Portable: lump sum benefit
- Employer-funded like other DB plans
- PBGC guaranteed benefit

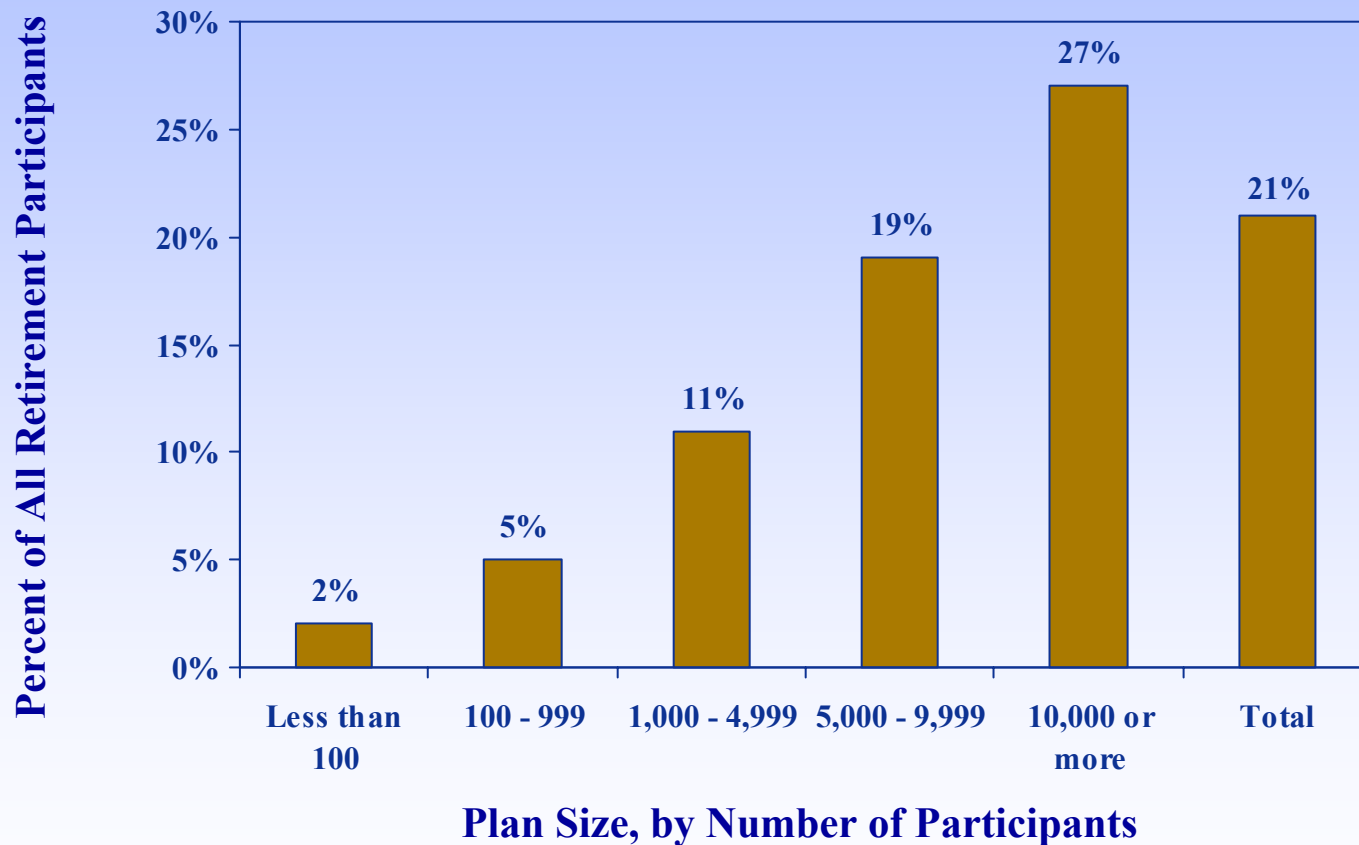


Hybrid Plans

- 1,500 plans
- 8½ million participants
- 25% of PBGC premium revenue



Estimated Number of Hybrid Plan Participants as a Percentage of Total Participants, by Plan Size



Why Employers and Employees Like Hybrid Plans?

- Reasons employers convert to hybrids
 - Employee appreciation (96%)
 - Ease of communication (93%)

(Watson Wyatt)

- Transparent, portable, deliver benefits more equitably to short, medium and longer-service employees

(Federal Reserve)

- Women rank portability as top pension priority

(Center for Policy Alternatives)



Hybrid Plan Myths & Facts

Myth: Employers convert to “save money”

Fact: Plan costs increase average 2.2% following conversions

- Excluding companies in “severe financial distress” plan costs rose by 5.9%

(Watson Wyatt)

Myth: Hybrids are only good for younger workers

Fact: 74% of cash balance plans and 87% of pension equity plans provide pay credits that increase with age or service

(Mellon Financial and Watson Wyatt)



Hybrid Plan Myths & Facts

Myth: Workers lose earned benefits

Fact: ERISA Section 204(g) and Internal Revenue Code Section 411(d)(6) protect all benefits that employees have earned



How Do Workers Fare Under a Hybrid Plan?

- 80% of participants build higher retirement benefits under a hybrid plan than traditional plan of equal cost
 - Traditional plans give disproportionate benefits to long-service employees
 - Employers changing jobs three times during career will, on average, earn 17% greater benefits in a hybrid plan
- (Watson Wyatt)
- But there is an “expectation”



Challenges to Hybrid Plans

- Claims that the design is age discriminatory
- Claims that the design is legitimate, but that conversions are age discriminatory
- Critics may accept basic legitimacy on design, but not until there is a “deal” on conversions



Legislative Status

- Congress prevented Treasury Department from issuing guidance
- Bush Administration proposed legislation
 - Plans are legitimate
 - 5-year delay provision
 - Dramatic new concept in benefits policy
- Hybrid issue connected with funding reform



A Feasible Way Forward?

- Hybrid plans: last hope for DB plans
- Legal limbo
- Retroactive relief
- Plan sponsors beginning to freeze plans
- Need to resolve the concept of “expectation”



For More Information

We're on the Web at
www.americanbenefitscouncil.org



The screenshot shows the American Benefits Council website. At the top left is the logo and name "AMERICAN BENEFITS COUNCIL". Below it is a navigation menu with links: About the Council, Issues, News Room, Publications, Capitol Connection, Speakers Bureau, Committee Materials, Calendar, Political Action Comm., Am. Benefits Institute, Links, Search, Contact Us, and Home. The main content area is titled "What's New" and features three articles:

- Council Comments on United Airlines Pension Development**
November 5: As is being widely reported, United Airlines announced on November 4 that it will apparently ask the Federal Bankruptcy Court for permission to terminate its four pension plans. Aside from the obvious impact on United's employees and their families, the announcement could also have far-reaching implications for the Pension Benefits Guaranty Corporation and the broader employer-sponsored pension system.
When United Airlines first hinted at their intentions on August 19, American Benefits Council President Jim Klein issued a public statement: "My words then carry the same weight now," Klein said today. "This announcement is deeply troubling, because it reflects the uncertainty and precariousness that goes along with retirement plan sponsorship today."
For further comment on this matter, contact [Deanna Johnson, Esq.](mailto:Deanna.Johnson@abc.org), APR, Council director, communications, or [Jason Hammacilla](mailto:Jason.Hammacilla@abc.org), Council communications associate, at 202-289-6700.
- Council President comments on elections' impact on benefits policy**
November 3: American Benefits Council President James A. Klein has released a statement on the impact of the 2006 election results.
For further comment, contact [Deanna Johnson, Esq.](mailto:Deanna.Johnson@abc.org), APR, Council director, communications, or [Jason Hammacilla](mailto:Jason.Hammacilla@abc.org), Council communications associate, at 202-289-6700.
- Council Submits Comment Letter to Treasury, IRS on Deferred Compensation**
November 2: Following the President's October 22 signing of [the Tax Job Act](http://www.irs.gov), the Internal Revenue Service (IRS) now has until December 21 to issue guidance relating to the deferred compensation provisions included in the bill. The Council has now submitted comments to the U.S. Treasury Department and IRS regarding areas of interest that must be addressed during the transition period to the new law.

Other sections visible include "Benefits Byte" with a date of November 18, 2004, and "Make Your Voice Heard" with a section titled "Ask Treasury to Support Notification of 'Use It or Lose It' Rule".

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