

One Minute Memo™



Third Circuit Upholds Cash Balance Plan Design

On Tuesday, the Federal Court of Appeals for the Third Circuit affirmed dismissal of a class action against the PNC Financial Services Group, its cash balance pension plan, and its plan committee. *Register v. PNC Financial Services Group, Inc.*, Court of Appeals No. 05-5445 (3rd Cir., Jan. 30, 2007). The court rejected plan participants' claims that cash balance plans inherently discriminate against older workers because of age, and that the PNC plan violated ERISA's prohibition against "back-loading," *i.e.*, providing low rates of accrual in earlier years of employment and concentrating accrual of benefits in later years of employment.

The Third Circuit followed the Seventh Circuit's reasoning in *Cooper v. IBM Pers. Pension Plan*, 457 F.3d 636 (7th Cir. 2006), which held that cash balance plans do not inherently violate ERISA's anti-discrimination provisions. Two weeks earlier, the Supreme Court declined to hear an appeal in *Cooper*. 2007 WL 91579 (U.S. Jan. 16, 2007).

When PNC converted to a cash balance plan, it established a cash balance account for every participant. The new plan imputed a value to participants' "hypothetical" opening cash balance accounts in the form of annual "earnings or pay credits" and "interest credits." PNC also froze the early retirement benefits of the defined

benefit plan and gave participants the option of 1) receiving the accrued but frozen early retirement benefits or 2) receiving the benefit they would have accrued under the cash balance plan, whichever proved greater. If a participant elected to receive accrued early retirement benefits, his benefit remained frozen until his account balance under the new plan exceeded the accrued early retirement benefits.

Following *Cooper*, the Third Circuit recognized that cash balance plans define the benefit in terms of a stated account balance, rather than a stream of monthly payments for life to begin at retirement. Therefore, it found that the "accrual" of "benefit" expressly mentioned in ERISA referred to the credits deposited into the participant's cash balance account (inputs into the account), and not to an annuity when the account ends (outputs). Again following *Cooper*, the Third Circuit then observed that plaintiffs had not demonstrated that Congress intended to ignore the time value of money when it enacted ERISA's anti-discrimination provisions and thus to prohibit a plan under which an employee who remains in the plan for a longer period of time receives a proportionally greater benefit. The Third Circuit focused on the employer's input in order to uphold the plan design: "The circumstance that the same contribution in the form

of interest credits may result in a more valuable annuity for a younger employee is not discrimination in whole or in part based on age; rather it is the completely appropriate consequence of the application of an age-neutral principle to an accumulating account of the time value of money.”

The Third Circuit also rejected the participants’ claim that the cash balance plan’s design impermissibly backloaded benefit accruals because the plan froze the hypothetical benefits of those participants who chose to receive accrued early retirement benefits from the date of conversion until their hypothetical account balances exceeded the accrued early retirement benefit under the prior plan. The court found that PNC’s conversion to a cash balance plan simply did not implicate the objective of the anti-backloading provision of preventing a plan from being unfairly weighted against shorter-term employees.

In light of the decisions in *Cooper* and *Register* and the Supreme Court’s refusal to review the *Cooper* decision, most courts that have addressed the issue have found that cash balance plans do not inherently violate ERISA’s anti-discrimination or anti-backloading provisions. However, the issue remains unsettled within the Second Circuit, where the district courts have split in their views. The Second Circuit will probably soon address the issue and may create a split within the federal circuits if it declines to follow *Cooper* and *Register*.

If you have any questions concerning this One Minute Memo, please consult the Seyfarth Shaw LLP ERISA litigation or employee benefits counsel with whom you work or any ERISA litigation or employee benefits attorney on the website at www.seyfarth.com.

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