Is Cross-Testing a Mistake? Cash Balance Plans, New Comparability Formulas, and the Incoherence of the Nondiscrimination Norm

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Is Cross-Testing a Mistake? Cash Balance Plans, New Comparability Formulas, and the Incoherence of the Nondiscrimination Norm

EDWARD A. ZELINSKY†

INTRODUCTION

The increasing tendency of large employers to convert their traditional defined benefit pension plans to the cash balance format has engendered substantial controversy, both within the qualified plan community and among the general public.¹ The rise of "new comparability" plans has yet to generate the same level of popular or political concern, perhaps because such plans have largely been embraced by smaller employers. However, among pension mavens, new comparability has occasioned strong supporters² and equally firm detractors.³

¹ Professor, Benjamin N. Cardozo School of Law, Yeshiva University, Room 519, 55 Fifth Avenue, New York, New York 10003, phone: 212-790-0277, fax: 212-790-0205, e-mail: Zelinsky@prodigy.net. I am indebted to many who reviewed and criticized drafts of this article: Professors James A. Wooten, Jonathan Barry Forman, Peter M. Van Zante, Norman Stein, and Bruce Wolk; Robert J. Michalski, EA, CPC, MSPA, Patrick J. Purcell, Alvin D. Lurie, Esq. Needless to say, many of this brotherhood of pension mavens disagree strongly with my analysis and conclusions; none agrees with everything I have to say. All were nevertheless gracious with their time and advice.


³ See, e.g., Brian Graff, Small Business Retirement Plans Will Terminate Due to Potential Treasury Changes to Qualified Plan
So far, these two controversies have largely remained isolated from one another. It is, however, the premise of this article that these two controversies raise a common underlying issue: the propriety of cross-testing, i.e., analyzing defined benefit arrangements as if they were defined contribution plans and vice versa.

The Treasury regulations on economic discrimination explicitly condone cross-testing. Indeed, it is difficult to conceive of either the cash balance controversy in its current form or the new comparability format without the Treasury's formal approval of cross-testing. Thus, at one level, the issue raised by the cash balance and new comparability approaches is whether the Treasury was correct to condone the cross-testing without which these "hybrid" approaches to retirement income would not have emerged.


4. It bears emphasis that the focus of the cross-testing regulations, and hence this article, is the Code's prohibition on economic discrimination (i.e., discrimination in favor of highly compensated employees), although I do discuss age discrimination infra Part IV.

5. The term "hybrid" plan is generally used to refer to qualified plans designed to utilize cross-testing by mixing the attributes of the defined benefit and defined contribution approaches. See DAN M. MCGILL ET AL., FUNDAMENTALS OF PRIVATE PENSIONS 297 (7th ed. 1996); see also PATRICK J. PURCELL, CONGRESSIONAL RESEARCH SERVICE, CRS REPORT FOR CONGRESS, PENSION COVERAGE AND PARTICIPATION: SUMMARY OF RECENT TRENDS 3 (2000) ("In recent years, many employers have converted their traditional pensions to
A principal contention of this article is that the Treasury was correct to embrace cross-testing, as the relevant concern should be the substance of the allocation of pension resources, rather than the form by which that allocation is achieved. Given as baselines the distribution of pension resources achievable through defined benefit arrangements, there is no persuasive basis for opposing hybrid plans (like new comparability arrangements) which, via cross-testing, achieve outcomes substantively similar to such baselines. In this area, substance—rather than form—should control and, in substance, cross-tested hybrid plans allocate pension resources in a fashion similar to conventional defined benefit and defined contribution plans.

Moreover, an exploration of the merits of cross-testing reveals a second stratum of concern, for that exploration discloses the theoretical and practical incoherence of the nondiscrimination mandate which cross-testing implements. As a theoretical matter, the nondiscrimination norm ignores the time value of money. The nondiscrimination norm consequently equates nominally identical benefits which, because they will be paid at different times, have significantly different present values. Likewise, the nondiscrimination norm equates markedly dissimilar contributions because, over different time frames to retirement, they will produce the same nominal benefits.

In practice, if participants are of widely varied ages, allocations of qualified plan resources proscribed by the nondiscrimination principle when made under the defined contribution format become acceptable when achieved via a defined benefit formula. Similarly, given employees of significantly different ages, plan allocations forbidden in the name of nondiscrimination when accomplished via the defined contribution motif are permitted when such allocations are formulated in defined benefit terms.

The nondiscrimination norm is particularly manipulable in the context of small plans and thus fails precisely when, in the terms advocated by its proponents, the norm is most needed to protect rank-and-file employees and the public fisc.

From this analysis, a number of corollaries flow: Cross-testing is not a mistake, but a textually plausible approach

*hybrid plans that have characteristics of both [defined benefit and defined contribution] plans.*) (emphasis in original).
to the nondiscrimination norm which imparts useful flexibility to the overly-complex and constricting qualified plan regime. Insofar as cross-testing exposes the theoretical and practical incoherence of the nondiscrimination norm, it is that norm, not cross-testing, which should be reassessed. Treasury Notice 2000-14 and the recently-adopted regulations aimed at cross-tested new comparability plans are analytically weak. The new regulations rest on shaky statutory grounds insofar as these regulations mandate double testing for new comparability arrangements, i.e., testing for nondiscrimination twice, once on the basis of projected benefits, a second time on the basis of contributions. In the final analysis, the nondiscrimination norm has outlived its usefulness and should be abolished or replaced by straightforward statutory requirements for minimum contributions and benefits.

The first section of this article sets the background by describing the cash balance and new comparability motifs as well as the concept of cross-testing upon which these hybrid motifs depend.

The second section explores critiques of cross-testing, in particular, the concerns raised in Treasury Notice 2000-14 and addressed in recently-adopted regulations pertaining to new comparability arrangements. An important focus of this section is a comparison of new comparability uses of cross-testing with “age-weighted” designs condoned in Notice 2000-14 and the new regulations. This section concludes that, as a matter of policy, cross-testing should be permitted. There is no reason for an allocation of pension resources acceptable under the defined benefit format to be rejected in the defined contribution setting. There is similarly no reason for an allocation permitted in the defined contribution context to be spurned under the defined benefit banner. In this context, substance should control over form; much of the opposition to new comparability methodologies is best understood as reflecting opposition to small plans and the legal rules which permit them.

The third section of this article argues that cross-testing reveals a deeper flaw in the qualified plan regime, the theoretical and practical incoherence of the nondiscrimination norm. Most dramatically, when covered workers are of significantly different ages, patterns of pension resources outlawed as discriminatory in the defined
benefit setting are condoned in the defined contribution context and vice versa. Among other themes in this section, I argue that the search for the limits of hybrid plans has been reinforced by the emergence of a defined contribution culture in which retirement arrangements are expected less in the traditional, defined benefit form and more in the individual account format. The advent of a defined contribution culture has led employers and their qualified plan advisors to develop plan designs in which defined benefit pensions are made to resemble defined contribution arrangements (hence, cash balance pensions) and in which defined contribution plans are structured to replicate the economic effects of defined benefit pensions (hence, age-weighted and new comparability plans). The resulting profusion of hybrid arrangements has highlighted the incoherence of the nondiscrimination norm.

While the principal focus of this article is nondiscrimination as to rank-and-file participants, a fourth section discusses age discrimination. In this section, I argue that the current debate about cash balance plans and age discrimination has largely been unproductive because, inter alia, the fundamental concept—nondiscrimination—is in this context incoherent, producing fundamentally different results if the issue is framed in terms of contributions than if the issue is posed in terms of ultimate benefits. I also note that, because there is no statutory authority for cross-testing as to age discrimination, some plans which, through cross-testing, avoid discriminating against non-highly compensated employees may nevertheless, under current law, be discriminating on the basis of age.

A final section summarizes the implications of this analysis. I conclude that the pension concept of nondiscrimination has outlived its usefulness and should be abolished. Even for those who favor a more paternalistic pension policy than I support, it makes sense to replace the complex and haphazard rule of nondiscrimination with simpler mandates for minimum contributions and benefits. I further conclude that cross-testing properly introduces a modicum of flexibility to the body of law which


7. To reiterate: this article principally addresses the notion of economic discrimination in favor of highly compensated employees, although I do discuss age discrimination infra Part IV.
overregulates qualified plans, and correctly focuses upon the substance of pension allocations rather than the form by which such allocations are implemented. Insofar as cross-testing exposes the hollowness of the non-discrimination norm, the appropriate response is not to kill the messenger, but to reassess the message.

I. CROSS-TESTING, CASH BALANCE PLANS, AND NEW COMPARABILITY ARRANGEMENTS

A. The Logic of Cross-Testing

A central and venerable feature of the statutory framework governing qualified plans is that “the contributions or benefits provided” by such plans may “not discriminate in favor of highly compensated employees.” By itself, this nondiscrimination mandate could be read as requiring defined contribution arrangements to avoid discrimination on the basis of the employer’s plan contributions and as compelling defined benefit pensions to avoid discrimination on the basis of ultimate benefits. There is a comforting symmetry to this construction of the statute: since defined contribution plans specify the employer’s input (rather than the employee’s ultimate entitlement), for such plans discrimination should be assessed in terms of the inputs promised by the plan. Conversely, since defined benefit arrangements specify their ultimate outputs (rather than the contributions needed to fund them), discrimination for such plans should be assessed in terms of such specified outputs.


9. I.R.C. § 415(b)(6) buttresses the statutory argument for cross-testing by authorizing the Treasury, for purposes of I.R.C. § 401(a)(4), to compute benefits under defined contribution plans and contributions under defined benefit arrangements. The Treasury invokes I.R.C. § 415(b)(6) to justify its proposed new comparability regulations—unconvincingly, I think. However, I.R.C. § 415(b)(6) provides textual confirmation for cross-testing: without such cross-testing, § 415(b)(6) serves no apparent purpose. See infra text accompanying notes 130-31.
However, the statutory terminology is sufficiently flexible that, as a textual matter, the statute can also plausibly be read as authorizing cross-testing, i.e., assessing defined contribution plans for forbidden discrimination in terms of the benefits ultimately yielded by such plans, rather than by the employers' contributions, and testing defined benefit plans for discrimination by looking at the employers' inputs, rather than at the plans' final outputs. That construction is today embodied in the Treasury regulations.

For defined contribution plans, the general methodology of the cross-testing regulations is to convert the contributions to the employee's individual account balance to a projected annual benefit commencing at retirement and to then compare each employee's incremental annual benefit, so determined, for the presence vel non of forbidden discrimination. As an initial approximation, such discrimination is assessed in terms of the proportionality vel non of projected annuity benefits to each employee's current salary.

Consider, for example, a two person defined contribution pension plan which covers the owner of a business and her secretary. Suppose further that the owner earns $100,000 annually and is fifty years old, that the secretary earns $30,000 annually and is thirty-five years old, and that, for the current year, the employer contributes $10,000 for the older owner and $883 for her younger employee. In defined contribution terms, this plan

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10. See generally Treas. Reg. § 1.401(a)(4)-8 (as amended in 2001) (discussing cross-testing); see also McGillett et al., supra note 5, at 85; Langbein & Wolk, supra note 8, at 314-17. A major point of contention in the cash balance controversy is that the pension provisions addressing age discrimination provide no textual support for cross-testing when the issue is age (rather than economic) discrimination. See infra notes 162-63 and accompanying text.


12. Three qualifications are in order, two of which will prove important as the analysis continues. First, the rules for social security integration relax the test of proportionality to account for the employer's Federal Insurance Contributions Act (FICA) contributions. Second, the nondiscrimination regulations provide an alternative to a strict rule of proportionality via "rate groups." See infra text accompanying notes 94-106. This approach to nondiscrimination becomes important in the context of new comparability plans. Third, of less practical importance, plans which provide contributions and benefits without regard to the participants' salaries (for example, $20 per week regardless of salary) are deemed nondiscriminatory.
discriminates since, assessing on the basis of the proportionality of each employee's respective contribution to her current salary, in this example the highly compensated owner\(^{13}\) receives a plan contribution of 10% of her current salary\(^{14}\) while her employee receives a contribution which is slightly less than 3% of the employee's current compensation.\(^{15}\) If defined contribution plans could only test for discrimination in terms of the proportionality of contributions to current compensation, this plan fails since the owner receives more than triple the percentage of her salary as a pension contribution than the equivalent percentage for her employee.

The result, however, is radically different under cross-testing, i.e., measuring this defined contribution arrangement for the projected benefits it will ultimately pay. Under that approach, contributions are converted into the deferred annuities each contribution finances. In such annuity terms,\(^{16}\) our hypothetical owner accrues an additional $4277\(^{17}\) of annual retirement income under the plan in the current year while her employee earns an additional $1284\(^{18}\) of projected annuity income starting at retirement. In annuity terms, both receive the same percentage benefit relative to their respective salaries: both

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13. For these purposes, I.R.C. § 414(q)(1)(A) defines an employee as highly compensated if she owns 5% or more of the employer; moreover, I.R.C. § 414(q)(1)(B) defines an employee as highly compensated if she earns more than $80,000 annually. See I.R.C. § 414(q)(1)(A)-(B) (1994). For 2001, this figure is inflation-adjusted to $85,000. See I.R.S. Notice 2000-66, 2000-52 I.R.B. 600. Thus under either definition the business owner earning $100,000 annually is deemed highly compensated.

14. \(\frac{10,000}{100,000} = 10\%\).

15. \(\frac{883}{30,000} = 2.9\%\).

16. In this and in the examples which follow, I have made several assumptions. In particular, I have assumed an interest rate of 8.5% and have assumed an annuity purchase rate of 7.94833, i.e., to purchase $1 of annuity income starting at age sixty-five costs $7.94833. Alternative assumptions would alter the numbers but not the implications of these examples.

17. The arithmetic is as follows: The fifty year old owner is fifteen years from normal retirement at age sixty-five. Over the remaining fifteen years of her working life, the $10,000 contributed currently will grow to $33,997. \(\frac{10,000 \times (1.085)^{15}}{7.94833} = 33,997\). That sum will, in turn, purchase $4277 in annual income when the owner retires. \(\frac{33,997}{7.94833} = 4277\).

18. The thirty-five year old employee is thirty years from normal retirement at age sixty-five. Over the remaining thirty years of her working life, the $883 contributed currently will grow to $10,206. \(883 \times (1.085)^{30} = 10,206\). That amount will, in turn, purchase $1284 of annual income when the employee retires at age sixty-five. \(\frac{10,206}{7.94833} = 1284\).
the employer and her employee, in this year, accrue, in annuity terms, a deferred annual income at retirement equal to 4.3% of current salary.19

This result—pension accruals which, in contribution terms, discriminate but which, in benefit terms, do not—reflects the differing ages of the two participants, the consequently longer term to retirement for the younger, less well paid employee, and the extra compounding of interest during the younger employee's longer period to retirement. Because the contribution for the thirty-five year old employee has fifteen more years to earn interest than does the contribution for her boss (who is closer to retirement), the younger employee's contribution will, dollar for dollar, ultimately purchase more annuity income for her at age sixty-five than will the contribution for her older employer.20

This example illuminates the two themes of this paper. First, cross-testing is a sensible construction of the statute; there is no reason to proscribe allocations of pension resources which are acceptable in defined benefit terms simply because such allocations are implemented through defined contribution arrangements. In this example, if the employer were to establish a defined benefit plan, rather than a defined contribution plan, the economic effect of the defined benefit motif would mimic the results of the defined contribution formula she actually embraced. There is no compelling reason to prohibit the same economic result when implemented via the defined contribution format; the relevant inquiry should be the substance of pension allocations, not their form.21

Second, as a practical and theoretical matter, the nondiscrimination norm is incoherent. In a defined contribution framework, this hypothetical plan discriminates since the older, better paid business owner receives a contribution which is a higher percentage of her

19. For the owner, $4277/$100,000 = 4.3%. For her employee, $1284/$30,000 = 4.3%.
20. For the younger employee, each dollar of today's contribution will become $1.45 of annual annuity income at retirement: $1284/$883 = $1.45. For her employer, each dollar of today's contribution will become forty-three cents of annual annuity income at retirement: $4277/$10,000 = $.43. This difference is attributable to the extra fifteen years during which the contribution for the younger employee will accrue investment earnings.
21. I construct a possible argument that, as a substantive matter, defined benefit-style allocations of pension resources should be confined to defined benefit plans, but find that argument unpersuasive. See infra Part II.F.
salary than does her lower compensated employee. However, in defined benefit terms, this plan does not discriminate since, converting contributions to deferred annuities, each employee earns an annuity which is the same percentage of her current salary. Discrimination thus proves to be an empty concept in this setting, leading to different conclusions depending upon the form in which the plan is cast.

On a theoretical level, the nondiscrimination norm is incoherent because it ignores the time value of money. Thus, the norm treats as equal benefits which are nominally the same but which, because they will be paid at different times, have different present values and are thus funded currently by different contributions. In our example, the norm equates a dollar of deferred income to commence for the business owner in fifteen years with a dollar to start for the secretary in thirty years—even though the discounted present values of those dollars are notably dissimilar.22

The analysis is essentially the same when a defined benefit plan is cross-tested. Suppose we alter the example so that the thirty-five year old is now the business owner earning $100,000 per year and the fifty year old is the secretary making $30,000 annually. Suppose further that the employer establishes a defined benefit plan under which the highly paid owner this year accrues $3000 in annual income starting at retirement while the secretary accrues in this year a deferred annuity at retirement of $263 per annum. In defined benefit terms, this plan discriminates as the business owner earns this year an annuity equal to 3% of her current year's salary23 while her secretary accrues an annuity equal to less than 1% of her current salary.24

However, converting these annuities into current contributions yields a different picture: looking to inputs rather than outputs, both the business owner25 and the

22. One dollar payable in thirty years has a present value of less than $.09. One dollar payable in fifteen years has a present value over three times greater, twenty-nine cents ($.29). 1/(1.085)^{30} = .0865183. 1/(1.085)^{15} = .2941399. Changing the interest rate assumption would alter the details, but not the thrust, of this example.
23. $3000/$100,000 = 3%.
24. $263/$30,000 = 0.87%.
25. To fund the $3000 deferred annuity earned by the business owner
secretary receive a contribution which is the same percentage (2%) of this year’s salary. Again, these results are explained by timing: Because the secretary is closer to retirement, it costs the employer more to fund a dollar of annuity income for her since the employer’s contribution has less time to accrue investment interest before payout. Thus, the secretary’s disproportionately small annuity appears more equitable when analyzed in contribution terms because, dollar for dollar, it is more costly (and more valuable) for the employer to provide an annuity for an older employee.

B. Cash Balance Plans and Cross-Testing

To the general public, the best known hybrid plan is the cash balance pension. The common characterization of the cash balance plan is that it is a defined benefit arrangement designed to look like a defined contribution pension. Unlike the traditional defined benefit arrangement, which promises the participant a deferred annuity based on his salary and service history, the cash balance format establishes for each participant a notional account balance. That theoretical account balance is each year credited with a hypothetical contribution based on the employee’s compensation (typically denoted “the pay credit”) and with hypothetical earnings (typically denoted “the interest credit”). When the participant leaves

requires a contribution of $2063, i.e., 2% of the owner’s current salary. The math, per the unit credit funding method, is as follows: To provide an annuity of $3000 at retirement requires $23,845 at age sixty-five. $3000 \times 7.94833 = 23,845. Discounting for the thirty years to retirement, to have this amount on hand at age sixty-five requires a contribution of $2063 today. $23,845/(1.085)^{30} = 2063. This contribution is 2% of the owner’s current salary. $2063/$100,000 = 2%.

26. To fund the $263 deferred annuity earned by the fifty year old secretary requires a contribution of $615, i.e., 2% of the secretary’s current salary. The math, per the unit credit funding method, is as follows: To provide an annuity of $263 at retirement requires $2090 at age sixty-five. $263 \times 7.94833 = 2090. Discounting for the fifteen years to retirement, to have this amount on hand at age sixty-five requires a contribution of $615 today. $2090/(1.085)^{15} = 615. This contribution is 2% of the secretary’s current salary. $615/$30,000 = 2%.

27. Since there is no authority for cross-testing as to age discrimination, this plan does not pass muster under the current statutes governing pension age discrimination. See infra Part IV.

28. See generally Zelinsky, Cash Balance Controversy, supra note 1 (discussing the cash balance plan).
employment, his interest in the plan equals the amount in this theoretical account balance; the benefit specified in this defined benefit arrangement.

The notional nature of the cash balance participant’s theoretical account balance contrasts with the participant’s economic interest in the financial performance of his individual account in a true defined contribution plan. In a true defined contribution plan, the participant garners his account’s superior investment performance and suffers from investment losses since his pension entitlement is the amount to which his account grows or falls. Because it is a defined contribution arrangement, there is no specified benefit underwritten by the plan or the employer.

In contrast, in the cash balance setting, the employee receives precisely the amount in his theoretical account balance. If plan resources are greater than this theoretical amount, that excess is retained by the plan since the plan, once it pays the defined benefit formulated as a notional account balance, has no further obligation to the employee. Similarly, if cash balance plan resources are less than the amount of the participant’s notional account balance, the employer, having assumed a defined benefit commitment, must contribute to the plan enough to remedy the deficiency.

Public debate about cash balance plans has largely focused on the conversion of existing defined benefit pensions from a traditional, annuity-promising format to the pseudo-defined contribution motif and the resulting disappointment of some employees’ expectations that they would continue to earn pension benefits under the traditional format. However, for purposes of this article, the significance of the cash balance approach is that it would have been less widely embraced had the Treasury not explicitly approved cross-testing.

In particular, the Treasury Regulations, as part of their safe harbor for cash balance arrangements, declare a cash balance plan nondiscriminatory as to rank-and-file employees if, inter alia, the plan’s theoretical individual account allocations satisfy defined contribution standards.

29. For that reason, defined contribution arrangements are also denoted as individual account plans. See ERISA § 3(34), 29 U.S.C. § 1002(34) (1994).

30. It bears emphasis that the regulations address the requirement of I.R.C. § 401(a)(4) that benefits or contributions not discriminate in favor of highly-compensated employees, but are silent on the question of age discrimination.
for nondiscrimination, i.e., if the plan’s “hypothetical allocations for all employees in the plan for all plan years . . . are the same percentage of plan year compensation or the same dollar amount.” Thus, in the case discussed earlier of the thirty-five year old business owner earning $100,000 yearly and her fifty year old secretary making $30,000 annually, a cash balance plan under which the pay credit for each employee is 2% of salary (or any other constant percentage) qualifies as nondiscriminatory even though, in annuity terms, the younger, higher paid business owner does substantially better as a percentage of current compensation than does her secretary. While not all cash balance plans utilize the regulations’ cross-testing safe harbor by providing a uniform pay credit for all employees, many, perhaps most, do.

An important issue in the current controversy over cash balance plans is whether such plans—permitted by the regulations to cross-test for discrimination as to highly-compensated employees—may test for age discrimination via cross-testing. My analysis is that cross-testing for age discrimination is sensible as a matter of policy, but that the relevant statutes are insufficiently flexible to be construed as permitting cross-testing for age discrimination. Others disagree.

C. New Comparability Plans and Cross-Testing

In several respects, new comparability plans differ from cash balance arrangements: while cash balance

32. See supra text accompanying notes 22-27.
33. Some cash balance plans provide for a pay credit which increases as an employee cohorts get older, for example, a 3% pay credit for employees in their thirties, a 4% pay credit for employees in their forties, etc. This kind of formula falls outside the regulatory safe harbor for cash balance plans since no uniform percentage applies to all employees. In addition, another variant of cash balance methodology, the pension equity plan, determines account balances in a fashion which may fall outside the nondiscrimination safe harbor.
34. See Zelinsky, Cash Balance Controversy, supra note 1, at 733-48; Zelinsky, Cash Balance Controversy Revisited, supra note 1.
arrangements are defined benefit plans designed to look like defined contribution pensions, new comparability arrangements are defined contribution plans designed to be tested for discrimination in defined benefit terms. Cash balance plans have largely been embraced by large employers; new comparability is essentially a small employer phenomenon. However, both new comparability and cash balance plans are best understood in the context of the regulations’ approval of cross-testing.

One version of the new comparability approach is known as “superintegration.” Generally, defined contribution plans may integrate with social security, i.e., a plan may provide for less employer contributions with respect to the portion of each employee’s salary which is below the social security wage base and which is thus covered by social security. The rationale for integration is that the employer makes two pension contributions for compensation covered by social security, the contribution to the employer’s plan plus the employer’s Federal Insurance Contributions Act (FICA) payment. Hence, the employer can—consistent with the nondiscrimination norm—contribute less to its qualified plan for social security covered compensation because the employer pays FICA on that amount. However, the lower contribution rate is limited to the employee compensation subject to social security coverage. To the extent employees earn compensation above the social security level, they must all receive the same percentage contribution on that noncovered compensation. In simplest terms, when social


37. Because these plans have emerged relatively recently, the terminology in this area has yet to be standardized. Some use the term “new comparability” to refer only to category-based arrangements. See infra text accompanying note 50 (discussing categorization approach). My preference is to use the term “new comparability” to refer to both such class-based plans and to superintegrated arrangements and to contrast these with the kind of single formula, “age-weighted” plans condoned in Notice 2000-14 and the recently-adopted Treasury regulations. See I.R.S. Notice 2000-14, 2000-10 I.R.B. 737.

38. See LANGBEIN & WOLK, supra note 8, at 318-22.

security coverage ends, higher employer-contribution rates begin.

Superintegration formulas deliberately flout these rules by establishing higher salary thresholds for larger ("integrated") contribution levels. Thus, higher plan contribution rates do not start when social security coverage ends but at some greater threshold. The result is an allocation of resources which flunks nondiscrimination standards in defined contribution terms (because it provides lower contribution rates on salary exceeding the social security coverage level) but which passes muster when cross-tested by defined benefit criteria (by converting employer contributions into projected annuity benefits).

To illustrate, consider a two-physician medical practice, with a fifty-five year old doctor anxious to begin serious retirement savings and a thirty-one year old physician with a growing family, more interested in current income than in pension coverage. Suppose the older physician earns $150,000 per year, the younger doctor earns $100,000 annually, and the practice has one other employee, a thirty-one year old nurse who earns $30,000 per year. A conventional integrated defined contribution pension plan for this practice would provide both an employer contribution of 5.7% of each employee's first $80,400 of salary (the amount of salary covered by social security contributions) and an employer contribution of 11.4% for each employee's compensation in excess of $80,400 (such excess being excluded from social security coverage). The result of this formula is shown in Table 1.

To continue this hypothetical, neither doctor is happy with this possibility, as the older doctor wants greater retirement savings while the younger doctor, pressed for current income, wants less. Under a superintegrated formula, the employer could contribute 2.823% of each employee's first $100,000 of compensation and 54.354% of each employee's compensation in excess of $100,000, as illustrated in Table 2.

40. In this example, I use the 2001 social security coverage level ($80,400) and the statutory integration rate (5.7%). Using these assumptions, the integration formula of I.R.C. § 401(l)(2) permits as nondiscriminatory a defined contribution formula under which the employer contributes 5.7% for the first $80,400 of an employee's salary and double that amount (11.4%) for salary in excess of $80,400.
Table 1

<table>
<thead>
<tr>
<th>Employee</th>
<th>Annual Salary</th>
<th>Pension Contribution</th>
</tr>
</thead>
<tbody>
<tr>
<td>55 year old physician</td>
<td>$150,000</td>
<td>$12,517(^{41})</td>
</tr>
<tr>
<td>31 year old physician</td>
<td>$100,000</td>
<td>$6,817(^{42})</td>
</tr>
<tr>
<td>31 year old nurse</td>
<td>$30,000</td>
<td>$1,710(^{43})</td>
</tr>
</tbody>
</table>

Table 2

<table>
<thead>
<tr>
<th>Employee</th>
<th>Annual Salary</th>
<th>Pension Contribution</th>
</tr>
</thead>
<tbody>
<tr>
<td>55 year old physician</td>
<td>$150,000</td>
<td>$30,000(^{44})</td>
</tr>
<tr>
<td>31 year old physician</td>
<td>$100,000</td>
<td>$2,823(^{45})</td>
</tr>
<tr>
<td>31 year old nurse</td>
<td>$30,000</td>
<td>$847(^{46})</td>
</tr>
</tbody>
</table>

In defined contribution terms, this formula discriminates as the highest paid employee (the fifty-five year old doctor) receives a pension contribution which, as a percentage of salary (20%) is roughly seven times the comparable percentage (2.8%) for the nurse. However, cross-tested for anticipated benefits, as shown in Table 3 below, this superintegrated plan passes muster because the projected annuity each employee earns during this year is

\[
\text{($80,400 \times 0.057) + ($69,600 \times 0.114) = $4582.80 + $7934.40 = $12,517.20.}
\]

\[
\text{($80,400 \times 0.057) + ($19,600 \times 0.114) = $4582.80 + $2234.40 = $6817.20.}
\]

\[
\text{($30,000 \times 0.057 = $1710. Since the nurse has no income in excess of the social security base ($80,400), the nurse has no income subject to the higher contribution rate of 11.4%.}
\]

\[
\text{($100,000 \times 0.02823 + ($50,000 \times 0.54354) = $2823 + $27,177 = $30,000.}
\]


\[
\text{$100,000 \times 0.02823 = $2823. Since this physician has no income in excess of $100,000, he has no income subject to the higher contribution level, 54.354%.}
\]

If the younger physician is neither an officer nor an owner of the employer, he must receive a slightly larger contribution, $3000. See I.R.C. § 416(i)(1) (1994 & Supp. II 1996) (defining key employees); see also I.R.C. § 416(c)(2)(A) (1994) (requiring 3% minimum contribution for non-key employees). In the interests of simplicity, I have ignored this qualification which does not affect the substance of the example. On the top-heavy rules of I.R.C. § 416, see U.S. GEN. ACCT. OFF, PRIVATE PENSIONS, "TOP-HEAVY" RULES FOR OWNER-DOMINATED PLANS (2000).

\[
\text{$50,000 \times 0.02823 = $847. Since the nurse has no income in excess of $100,000, the nurse has no income subject to the higher contribution level, 54.354%. Technically, under § 416, the nurse’s contribution must be rounded up to $900. See I.R.C. § 416(i)(1) (1994 & Supp. II 1996) (defining key employees); id. § 416(c)(2)(A) (1994) (requiring 3% minimum contribution for non-key employees). In the interests of simplicity, I have ignored this qualification which does not affect the substance of the example.}\\
\]
the same percentage of the employee’s compensation (5.69%).

Table 3

<table>
<thead>
<tr>
<th>employee</th>
<th>annual salary</th>
<th>projected annuity</th>
</tr>
</thead>
<tbody>
<tr>
<td>55 year old physician</td>
<td>$150,000</td>
<td>$8534</td>
</tr>
<tr>
<td>31 year old physician</td>
<td>$100,000</td>
<td>$5689</td>
</tr>
<tr>
<td>31 year old nurse</td>
<td>$30,000</td>
<td>$1707</td>
</tr>
</tbody>
</table>

Proponents of new comparability formulas argue that this outcome is acceptable since it merely replicates, through a defined contribution arrangement, a pattern of pension resources deemed nondiscriminatory when achieved through defined benefit methodology—an argument I find convincing since I see no reason for the form, rather than the substance, of pension allocations to be of controlling significance.

Similar results could be obtained under a categorization approach, i.e., by dividing all present and future employees into three classes: for example, physicians age forty years and older, all younger physicians, and all other personnel. Under this categorization version of new comparability, members of the class of older doctors (for now, a class of one) would each receive plan contributions of 20% of current salary, the younger physicians (also currently a category of one) would receive contributions of 2.823% of compensation, and the residual category of all other employees (for now, just the nurse) would also receive plan contributions of 2.823% of current salary. This approach produces the same allocations as the superintegrated design and, like that design, discriminates in defined contribution terms as the fifty-five year old highly compensated doctor receives a plan

47. In ten years (when this physician is ready to retire at age sixty-five), the physician’s contribution of $30,000 will grow to $67,830 which, at a purchase rate of 7.94833, will purchase $8534 of annual annuity income starting at retirement. ($30,000) x (1.085)^{10} = $67,830. $67,830/7.94833 = $8534.

48. In thirty-four years (when this physician is ready to retire at age sixty-five), the physician’s contribution of $2823 will have grown to $45,219 which, at a purchase rate of 7.94833, will purchase $5689 of annual annuity income starting at retirement. ($2823) x (1.085)^{34} = $45,219. $45,219/7.94833 = $5689.

49. In thirty-four years (when the nurse is ready to retire at age sixty-five), the nurse’s contribution of $847 will grow to $13,567 which, at a purchase rate of 7.94833, will purchase $1707 of annual annuity income starting at retirement. ($847) x (1.085)^{34} = $13,567. $13,567/7.94833 = $1707.
allocation of 20% of his salary while the nurse receives a plan allocation of only 2.823% of current compensation. On the other hand, as we have seen, these allocations, when cross-tested for projected annuities, pass muster in defined benefit terms.\footnote{50}{See supra notes 47-49 and accompanying text.}

II. THE PROPRIETY OF CROSS-TESTING

A. The Arguments for Cross-Testing

The normative argument for cross-testing is straightforward: the form through which qualified plan allocations are achieved should not matter. As long as a particular allotment of qualified plan resources is nondiscriminatory in either defined contribution or defined benefit terms, it is not relevant whether that allotment is implemented through defined contribution or defined benefit methodology.\footnote{51}{The fashion in which Professors Langbein and Wolk pose the issue suggests the alternative connotations which can be attached to it. See LANGBEIN & WOLK, supra note 8, at 317 (“Why should economically equivalent benefits be discriminatory if provided through a defined contribution plan, but nondiscriminatory if provided through a defined benefit plan?”).}

The pragmatic argument for cross-testing is that, absent cross-testing, employers, particularly small employers, will not sponsor qualified plans or will sponsor plans which are suboptimal. Consider again, in this context, the choices confronting the older, highly compensated physician under a conventional defined contribution plan.\footnote{52}{See supra text accompanying notes 40-45.}

That plan leaves the physician dissatisfied since he would like to save more for his retirement. That plan also leaves the younger doctor dissatisfied since he would like to save less. Considering the legal, accounting, and administrative costs of the plan, the older physician could well conclude that the conventional defined contribution plan, if that is his only alternative,\footnote{53}{Implicit in this argument is the unavailability of a true defined benefit plan. The factors deterring the physician from establishing a defined benefit plan are discussed infra text accompanying notes 153-59.} is not worth the candle. The result would be no qualified plan.\footnote{54}{The underlying premise of at least some cross-testing opponents is that the doctor's failure to establish a qualified plan is a good thing or, at least, nothing about which to be troubled. See infra Part II.E.}
The analysis in the cash balance setting, while somewhat different, leads to similar conclusions. It is not likely that a large employer, dissatisfied with its traditional defined benefit pension plan, will terminate that plan and eschew all pension coverage. Rather, if that employer does not have the cash balance alternative, the realistic choice will be the status quo of the traditional plan, the termination of that plan and its replacement with a true defined contribution arrangement such as a 401(k) plan, or the embrace of such devices as stock options, stock appreciation rights and nonqualified deferred compensation.

Many commentators believe that the defined benefit format, since it shifts investment risk to the employer, is for many employees economically desirable in comparison with defined contribution arrangements under which investment risk (and reward) belong to the employees. From this perspective, the cash balance alternative permits those employers who would otherwise exit the defined benefit regime to remain within it. Insofar as cross-testing facilitates cash balance arrangements, such cross-testing improves employees' retirement security by keeping alive employers' commitment to provide employees with defined benefits—rather than moving to the defined contribution and nonqualified alternatives.

B. Notice 2000-14

To date, the most important critique of cross-testing is Notice 2000-14, in which the Treasury expresses its misgivings about new comparability plans, misgivings subsequently reflected in amendments to the Treasury regulations. Although Notice 2000-14 is brief, four themes emerge from it. First, Notice 2000-14 distinguishes between good and bad cross-testing formulas. As an example of the former, Notice 2000-14 condones a defined contribution plan with a single track, "age-weighted" methodology under which all employees (regardless of compensation levels) accrue larger amounts as they get older or acquire greater

55. I am one of these. See also Alvin D. Lurie, Cash Balance Plans: Enigma Variations, 85 TAX NOTES 503, 510 (1999).
57. See infra Part II.D.
seniority. In contrast, the Notice criticizes the kind of classification formulas discussed earlier and indicts superintegration designs as well.

Second, the Notice defines the problem with these new comparability devices as the fact that "by plan design, non-highly compensated employees never have an opportunity to earn the higher allocation rates as they work additional years for the employer and grow older." Thus, in our example of a new comparability categorization arrangement, the Treasury's stated concern is that the nurse is permanently consigned to a residual employee classification receiving a plan contribution of 2.8% of current salary and can never move into the older physician class (receiving a 20% allocation)—unlike the young physician who will age as a matter of course and thus some day graduate to the more favorable classification.

Third, the Notice opines that plans of this sort cannot "be reconciled with the basic purpose of the nondiscrimination rules as applied to defined contribution plans." Finally, the Treasury raises the issue of conversion: when existing defined contribution plans are converted to new comparability formulas, rank-and-file employees typically see their allocation rates go down as a percentage of salary while highly compensated participants see their rates go up.

I find these arguments unconvincing. Notice 2000-14 never confronts the underlying issue of substance and form: why is an allocation of pension resources which is permitted in a defined benefit setting impermissible when implemented through a defined contribution arrangement? The drafters of Notice 2000-14 elide this question when they suggest that cross-tested new comparability plans fail "the basic purpose of the nondiscrimination rules as applied to defined contribution plans." This, however, assumes away the basic inquiry, i.e., whether defined contribution arrangements must be scrutinized in defined contribution terms.

Indeed, the Notice never informs us what the purpose of the nondiscrimination provisions might be or what aspect of that purpose is uniquely applied to defined contribution

58. See infra Part II.C.
59. See supra text accompanying note 50.
60. See supra notes 44-49 and accompanying text.
61. See supra text accompanying note 50.
arrangements. Perhaps the drafters of Notice 2000-14 view as self-evident "the basic purpose of the nondiscrimination rules as applied to defined contribution plans." If so, I disagree.

The qualified plan rules are conventionally thought to embody an expensive tax expenditure which can only be justified if retirement benefits are channeled to rank-and-file employees. I dissent from the premise that qualified plan law constitutes a tax expenditure, concluding that the Code provisions governing qualified pension and profit sharing arrangements are consistent with normative tax principles for measuring income. But even accepting the premise that qualified plan law constitutes a tax expenditure and even viewing the nondiscrimination norm as a means of using that expenditure to guarantee retirement benefits for non-highly compensated personnel, the question of substance and form remains: Why must the purpose of the qualified plan tax expenditure be measured against defined contribution plans solely in contribution terms and not in terms of projected benefits? Why does it not satisfy the purposes of the nondiscrimination norm when an individual account arrangement emulates an outcome deemed nondiscriminatory when achieved via defined benefit methodology? The drafters of Notice 2000-14 may have answers to these questions. If so, they have not disclosed them.

This leaves us with the basic conundrum: Notice 2000-14 excoriates new comparability plans for achieving, via cross-testing, allocations of pension resources deemed nondiscriminatory when accomplished through defined benefit devices. Why should the form by which pension allocations are implemented matter?

The Notice's observations about the categorization approach are, at first blush, more convincing. It is true that,

when employees are classified along new comparability lines, the rank-and-file participants (in our example, the nurse) have no realistic possibility of reaching the category receiving greater contributions\(^\text{64}\) (in our example, older physicians). On a second look, however, matters are less clear.

Under the superintegrated approach, there is no formal barrier to the nurse's eventual receipt of enough compensation to trigger the higher contribution rate. In our superintegration example, a nurse earning in excess of $100,000\(^6\) will receive the same contribution on such excess as the older physician. Thus, the Notice's critique of classifications unattainable by rank-and-file participants is, at least formally, inapplicable to superintegrated plans, which plans, however, Notice 2000-14 lumps together with new comparability classification arrangements.

The logical retort is that, as a substantive matter, the nurse is unlikely ever to earn more than $100,000 and, if he did, the plan could then well be amended to elevate the salary threshold for greater contributions, thereby depriving the nurse of the larger contributions. Thus, in substance, the nurse, under superintegration, has no more practical likelihood of reaching the compensation level which triggers greater contribution rates than of going to medical school and becoming a senior physician of the practice, eligible for greater contributions under the new comparability classification approach.

The problem with this retort is that it proves too much, since it applies with equal force to a conventional defined benefit plan.\(^6\) The nurse is never likely to earn the same salary as the physician and is thus never likely to accrue, in the defined benefit context, pension resources like the physician's. In theory, the nurse may remain employed long enough that the economics of conventional defined benefit plans favoring older employees start to favor the nurse. However, given current patterns of employee mobility,\(^7\)

64. While the nurse could theoretically go to medical school, that is a slim reed on which to base a defense of this new comparability plan.
65. See supra text accompanying notes 44-49.
66. See id.
67. Those looking at historical data tend to discount reports of increased worker mobility while those looking at contemporary data generally confirm the perception of an increasingly mobile workforce. See Zelinsky, Cash Balance Controversy, supra note 1, at 709; see also Employee Retention Growing Problem
there is at best a small possibility that the thirty-one year old nurse will remain with this employer long enough to accrue benefits at older ages.

In sum, the ultimate sin of category-based cross-testing is its candor in disclosing the economic reality that the nurse will not earn benefits like the older physician. Economically equivalent results occur under defined benefit formulas which produce minimal current contributions for the younger nurse and which are unlikely to yield significant benefits for the nurse in the future in light of the likelihood that the nurse will change jobs or that the employer will cease to exist upon the physician's retirement. This brings us again to the central question: is there a reason to condemn defined contribution allocations of pension resources which are in substance economically equivalent to those allocations achieved via defined benefit plans?

Moreover, this line of thought exposes further analytical weakness in Notice 2000-14 which lumps together new comparability categorization plans and superintegrated arrangements without explaining why they should be treated the same. The Notice's critique of category-based plans—rank-and-file employees will not graduate to the more favorable categories—does not, as a formal matter, apply to superintegrated plans, under which, in theory, any employee can earn the amount needed to trigger greater contribution rates. If the rationale for linking category and superintegrated plans is that in practice they produce economically equivalent results, we again confront the reality that defined benefit plans produce such results also. Why, then, condemn in the name of economic substance defined contribution arrangements which mimic defined benefit plans?

In complaining about the conversion of conventional defined contribution plans to new comparability formats, Notice 2000-14 echoes concerns raised in the cash balance

For Employers, SHRM Survey Finds, BNA PENSION & BENEFITS DAILY, July 7, 2000. Even those skeptical of the argument that mobility is increasing in the work place must doubt that the thirty-one year old nurse in this example will remain in his present position long enough to accrue significant benefits under a defined benefit arrangement. See, e.g., Martin A. Corry, AARP Criticizes New Comparability Plans, TAX NOTES TODAY, July 6, 2000, at 2000 TNT 130-59 (referring to the "mobile workforce and the turnover often experienced by small firms").
context. In that context also, a major complaint has been that older employees, on the verge of accruing substantial retirement and early retirement benefits, are deprived by cash balance conversions of their expectation that they would earn such benefits.68

And the analysis of conversions and disappointed expectations is the same in the new comparability context:69 As a matter of law, an employee has a right to benefits accrued to date under existing pension formulas; an employee has no right to any particular pension formula going forward.70 As a matter of psychology, employees' sense of betrayal when pension formulas change is widespread and deeply-held. Employers interested in reasonable relationships with their workforces are well-advised to acknowledge that psychological reality. It is, however, one thing to say that enlightened employers ought to recognize the reality of employees' psychological expectations in the pension status quo; it is another to say that there is (or should be) a legal basis for those expectations.

C. "Good" Cross-Testing: Age-Weighted Formulas

The most provocative pronouncement of Notice 2000-14 (mirrored in the new regulations71) is the asserted distinction between good and bad cross-testing.72 Under Notice 2000-14, good cross-testing occurs when a single set of contribution rates is available to all employees as they age and acquire greater seniority. Notice 2000-14 thus condones defined contribution plans typically denoted as "age-weighted," plans which, without superintergration or categorization of employees, mimic defined benefit results by increasing contributions as employees age. However, Notice 2000-14's approval is conditioned upon all employees having the chance to earn along a single age-based track the same higher contribution rates as the employees grow older.

68. Zelinsky, Cash Balance Controversy, supra note 1, at 695-704.
69. Id. at 754-57.
70. An important qualification is that, in a collective bargaining context, an employer may not be able to change pension plans unilaterally.
71. See infra notes 122-26 and accompanying text.
72. This assertion is also reflected in the new regulations which distinguish between age-weighted defined contribution plans (i.e., good cross-testing) and new comparability formulas (i.e., bad cross-testing). See infra Part II.D.
Notice 2000-14's distinction between good and bad cross-testing ultimately proves unpersuasive. An initial observation is that in some, perhaps many, cases a single track age-weighted formula, condoned by Notice 2000-14, can produce the same results as the new comparability designs attacked in Notice 2000-14. Returning to the three participant example (a fifty-five year old physician and two thirty-one year olds, a physician and a nurse), suppose that the employer's defined contribution plan, like most age-weighted formulas, uses a years-to-retirement factor which increases each year as the participant ages. Suppose in particular that the employer under its defined contribution plan contributes for each employee a percentage of salary determined by multiplying 45.22% times a years-to-retirement factor increasing each year as the employee gets older. The result of this age-weighted approach for the current year is precisely the same as the outcome under either the superintegrated or new comparability classification alternative, as shown in Table 4.

<table>
<thead>
<tr>
<th>employee</th>
<th>annual salary</th>
<th>pension contribution</th>
</tr>
</thead>
<tbody>
<tr>
<td>55 year old physician</td>
<td>$150,000</td>
<td>$30,000</td>
</tr>
<tr>
<td>31 year old physician</td>
<td>$100,000</td>
<td>$2823</td>
</tr>
<tr>
<td>31 year old nurse</td>
<td>$30,000</td>
<td>$847</td>
</tr>
</tbody>
</table>

Why is this an acceptable outcome under Notice 2000-14 when accomplished by a single track, age-weighted formula but is not an acceptable result when implemented under either the superintegrated or categorization method? According to the Notice, the flaw of the categorization approach (which, in this case, achieves the same allocation currently as the age-weighted design) is that it never grants the nurse the same allocation rate as the physicians. In contrast, under the age-weighted formula, as the nurse gets older, his years-to-retirement factor will grow just like the

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73. $150,000 \times 0.4522 \times 0.442885 = \$30,000.  
74. $100,000 \times 0.4522 \times 0.062429 = \$2823.  
75. $30,000 \times 0.4522 \times 0.062429 = \$847.  

I.R.C. § 416 increases this contribution to $3000 if the younger physician is neither an officer nor an owner of the employer. See I.R.C. § 416 (1994 & Supp. II 1996). This qualification does not change the substance of this example.

76. $30,000 \times 0.4522 \times 0.062429 = \$847.  
77. Under I.R.C. § 416, this contribution in practice must be rounded up to $900. See I.R.C. § 416 (1994 & Supp. II 1996). This qualification does not change the substance of this example.
When the nurse is age fifty-five, the nurse’s years-to-retirement factor will be precisely the same as the factor used currently by the older doctor at age fifty-five. Thus, in the year the nurse turns fifty-five, assuming the nurse is still earning $30,000 annually,\textsuperscript{6} the nurse will receive a contribution of $6000.\textsuperscript{7} This contribution will represent the same 20% of current compensation as the senior physician received at age fifty-five. Consequently, an age-weighted cross-tested allocation is, according to the Treasury, acceptable today because the formula has a single track which, in this example, will in the future work to the nurse’s benefit as he gets older.

How realistic is the prospect that, under this age-weighted plan, the thirty-one year old nurse really will in twenty-four years earn the same contribution rate as does the fifty-five year old physician today? Not very. In this example, there is a strong possibility that, when the physician now age fifty-five reaches normal retirement age in ten years, he will close the practice and terminate the plan—if he doesn’t do so sooner. In that case the nurse, as he ages those ten years, will, under the age-weighted approach condensed in Notice 2000-14, receive increasing contributions each year—but he will never reach the age-based contribution rates of the senior physician. Indeed, as the nurse ages, so does the physician, so that the plan’s highest years-to-retirement factor proves to be a moving target for the nurse: As the factor increases for the nurse, it also increases for the doctor.

Moreover, given current patterns of employee mobility, it is unlikely that the nurse will in fact remain with the employer for the ten years until the doctor retires, let alone the twenty-four years until the nurse’s fifty-fifth birthday. In short, the prospect that the nurse will, under this age-weighted formula, accrue contributions at older ages in emulation of the senior physician, while possible in theory, is not great in practice, given the likelihood of the plan terminating and of the nurse switching jobs.

In this context, the tension between form and substance recurs. If single track, age-weighted plans are acceptable because in form rank-and-file employees may remain in employment as they grow older and thus theoretically

\textsuperscript{6} This is an oversimplification which is heuristically useful in this context.

\textsuperscript{7} $30,000 \times .4522 \times .442285 = $6000. \frac{6000}{30,000} = 20\%.$
receive the plan’s higher contribution rates as they age, the same formalistic defense applies to superintegrated plans since, in theory, all employees may in the future see their earnings rise to the level necessary to trigger higher contribution rates under superintegrated arrangements. If, on the other hand, the Treasury’s objection to new comparability plans is premised on economic substance—rank-and-file employees will in practice receive little under categorized or superintegrated arrangements—the same is true under the age-weighted formulas approved in Notice 2000-14, to say nothing of conventional defined benefit plans, neither of which is criticized in Notice 2000-14.

The Treasury’s distinction between new comparability and age-weighted formulas appears stronger if this example is changed to add to the staff a fifty-five year old nurse who, like his younger colleague, earns $30,000. In that case, the allocation under either the superintegrated or the new comparability categorization approaches is illustrated in Table 5.

Table 5

<table>
<thead>
<tr>
<th>Employee</th>
<th>Annual Salary</th>
<th>Pension Contribution</th>
</tr>
</thead>
<tbody>
<tr>
<td>55 year old physician</td>
<td>$150,000</td>
<td>$30,000(^{78})</td>
</tr>
<tr>
<td>31 year old physician</td>
<td>$100,000</td>
<td>$2823(^{79})</td>
</tr>
<tr>
<td>55 year old nurse</td>
<td>$30,000</td>
<td>$847(^{80})</td>
</tr>
<tr>
<td>31 year old nurse</td>
<td>$30,000</td>
<td>$847(^{81})</td>
</tr>
</tbody>
</table>

However, under the age-weighted formula, the fifty-five year old nurse does much better. Table 6 shows that the contribution the older nurse receives under the age-weighted formula condoned by Notice 2000-14 ($6000) is substantially larger than his contribution under new comparability methodologies ($847).

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78. Under the categorization method, $150,000 \times 20\% = $30,000. Under the superintegrated approach, \((100,000 \times .02823) + (50,000 \times .54354) = 2823 + 27,177 = $30,000.\)

79. Under the categorization method, $100,000 \times .02823 = $2823. Under the superintegrated approach, \((100,000 \times .02823) = 2823.\)

80. Under the categorization method, $30,000 \times .02823 = $847. Under the superintegrated approach, \((30,000 \times .02823) = 847.\)

81. Under the categorization method, $30,000 \times .02823 = $847. Under the superintegrated approach, \((30,000 \times .02823) = 847.\)
Moreover, in this example, the new comparability approach cannot be defended via defined benefit equivalence since the equivalent defined benefit plan would not pass muster under the nondiscrimination norm. When we project each employee’s new comparability contribution into an anticipated annuity benefit, the older nurse’s annuity is a disproportionately small percentage of his current compensation, as shown in Table 7.

Table 7

<table>
<thead>
<tr>
<th>employee</th>
<th>annual salary</th>
<th>annuity</th>
<th>projected annuity as % of salary</th>
</tr>
</thead>
<tbody>
<tr>
<td>55 year old physician</td>
<td>$150,000</td>
<td>$853456</td>
<td>5.69%57</td>
</tr>
<tr>
<td>31 year old physician</td>
<td>$100,000</td>
<td>$568958</td>
<td>5.69%59</td>
</tr>
<tr>
<td>55 year old nurse</td>
<td>$30,000</td>
<td>$24150</td>
<td>0.80%91</td>
</tr>
<tr>
<td>31 year old nurse</td>
<td>$30,000</td>
<td>$170792</td>
<td>5.69%93</td>
</tr>
</tbody>
</table>

In defined benefit terms, this new comparability plan flunks the nondiscrimination test since the non-highly compensated nurse age fifty-five has only ten years to retirement. Consequently, his new comparability contribution ($847) has relatively little time for investment growth and will thus not ripen into a retirement annuity.

82. $150,000 \times .4522 \times .442285 = $30,000.
83. $100,000 \times .4522 \times .062429 = $2823.
84. $30,000 \times .4522 \times .442285 = $6000.
85. $30,000 \times .4522 \times .062429 = $847.
86. See supra note 47.
87. $8534/150,000 = 5.69%.
88. See supra note 48.
89. $5689/100,000 = 5.69%.
90. In ten years (when this nurse is ready to retire at age sixty-five), the nurse’s contribution of $847 will have grown to $1915 which, at a purchase rate of $7.94833, will purchase $241 of annual annuity income starting at retirement. ($847 \times (1.085)^{10} = $1915. $1915/7.94833 = $241.
91. $241/30,000 = 0.80%.
92. See supra note 48.
93. $1707/30,000 = 5.69%.
comparable to that earned by the other participants in the plan who either have more years of investment growth before retirement (the thirty-one year old nurse and physician) or receive a substantially larger contribution as a percentage of salary (the fifty-five year old physician).

However, by adding two more thirty-one year old nurses to this hypothetical workforce, the new comparability formula passes muster in defined benefit terms despite the small annuity accrued by the older nurse. Consider now a six participant plan with the addition of two more thirty-one year old nurses. This example is illustrated in Table 8.

Table 8

<table>
<thead>
<tr>
<th>employee</th>
<th>annual salary</th>
<th>annuity</th>
<th>projected annuity as % of salary</th>
</tr>
</thead>
<tbody>
<tr>
<td>55 year old physician</td>
<td>$150,000</td>
<td>$8534(^{94})</td>
<td>5.69%(^{95})</td>
</tr>
<tr>
<td>31 year old physician</td>
<td>$100,000</td>
<td>$5689(^{96})</td>
<td>5.69%(^{97})</td>
</tr>
<tr>
<td>55 year old nurse</td>
<td>$30,000</td>
<td>$241(^{98})</td>
<td>0.80%(^{99})</td>
</tr>
<tr>
<td>31 year old nurse A</td>
<td>$30,000</td>
<td>$1707(^{100})</td>
<td>5.69%(^{101})</td>
</tr>
<tr>
<td>31 year old nurse B</td>
<td>$30,000</td>
<td>$1707(^{102})</td>
<td>5.69%(^{103})</td>
</tr>
<tr>
<td>31 year old nurse C</td>
<td>$30,000</td>
<td>$1707(^{104})</td>
<td>5.69%(^{105})</td>
</tr>
</tbody>
</table>

In this example, the new comparability plan, translated into its defined benefit equivalent, is deemed nondiscriminatory under the rate group methodology of the Treasury Regulations\(^{106}\) since nurses A, B, and C, who represent three of the employer's four rank-and-file

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94. See supra note 47.
95. See supra note 87.
96. See supra note 48.
97. $5689/$100,000 = 5.69%.
98. In ten years (when this nurse is ready to retire at age sixty-five), the nurse's contribution of $847 will have grown to $1915 which, at a purchase rate of 7.94833, will purchase $241 of annual annuity income starting at retirement. ($847) x (1.085)^{10} = $1915. $1915/7.94833 = $241.
99. $241/$30,000 = 0.80%.
100. See supra note 49.
101. See supra note 93.
102. See supra note 49.
103. See supra note 93.
104. See supra note 49.
105. See supra note 93.
106. See Treas. Reg. §§ 1.401(a)(4)-2(c)(3), 1.401(a)(4)-3(c) (as amended in 1993); see also McGill et al., supra note 5, at 79-83; Langbein & Wolk, supra note 8, at 304-11.
employees, accrue annuity benefits which, as a percentage of current compensation, reach the same annuity to salary ratio (5.69%) as do the projected annuity benefits earned by the two physicians. In this example, there are two rate groups: one for the older physician and one for the younger physician. Each such group consists of the two physicians and the three (younger) nurses with the same projected annuity rate (5.69% of salary). Since the three thirty-one year old nurses constitute more than 70% of the overall non-highly compensated group (the four nurses), this plan is nondiscriminatory under the rate group methodology. In this example, the minimal contribution to the older nurse under new comparability methodologies complies with the nondiscrimination norm because a group of younger nurses (comprising more than 70% of the practice's non-highly compensated employees) earn significant benefits in annuity terms.

To summarize, Notice 2000-14's distinction between good and bad cross-testing is not convincing. First, a single track, age-weighted formula of the sort condoned by the Notice can in many cases produce the same results as the new comparability methodologies the Notice attacks. Second, the Notice's defense of good cross-testing—under "good" formulas, rank-and-file participants can theoretically earn in the future at the same higher contribution rates available to highly compensated employees—is unpersuasive since, in practice, younger employees are unlikely to participate in plans long enough to earn these higher rates. Finally, the "bad" results achieved by the new comparability methodologies, when converted into their defined benefit equivalents, can pass muster in defined benefit terms. This, again, brings us back to the central issue unaddressed in Notice 2000-14: Why should an allocation of pension resources considered nondiscriminatory in defined benefit terms be verboten when implemented via a defined contribution plan?

D. The New Amendments to the Cross-Testing Regulations: The Enigma of Double Testing

On June 29, 2001, the Treasury adopted amendments to the cross-testing regulations to restrict new
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comparability formulas. Not surprisingly, the new amendments reflect many of the same concerns as Notice 2000-14. Also not surprisingly, the new amendments embody the same analytical limitations as Notice 2000-14. Central to these amendments is the double testing of hybrid defined contribution plans like new comparability arrangements: after proving nondiscriminatory on the basis of their projected benefits, under the new regulations, such hybrid plans must also satisfy additional rules as to their contributions. The logical and statutory bases for this double testing are weak.

Echoing Notice 2000-14, the Treasury's preamble to the regulations' amendments questions "whether new comparability and similar plans are consistent with the basic purpose of the nondiscrimination rules under § 401(a)(4)." Also like Notice 2000-14, the Treasury's preamble never tells us what that purpose might be or why it might be bad for defined contribution plans to mirror the distribution patterns of defined benefit arrangements.

To limit new comparability arrangements, the new amendments introduce three new concepts to the regulations governing the cross-testing of individual account arrangements: "broadly available allocation rates," "smoothly increasing schedule of allocation rates," and "minimum allocation gateway."

Under the amendments, a defined contribution formula has "broadly available allocation rates" if, for the current year, each contribution rate under the plan is available to a group of employees satisfying the coverage requirements of I.R.C. § 410(b). Thus, in our earlier example, the 20% contribution rate for the older physician is not broadly available within the meaning of the amendments since that rate applies to only a single, highly-compensated employee.


111. Such compliance must be measured without resort to the average benefit percentage test of I.R.C. § 410(b)(2) (1994).

112. See supra notes 47-50 and accompanying text.
and to no non-highly compensated employees.\textsuperscript{113} And, for these purposes, it is irrelevant that, in defined benefit terms, the older physician's higher contribution is equivalent to the contribution for the lower paid nurse.\textsuperscript{114}

If an allocation rate is broadly available, the inquiry under the amendments ends. If, however, an allocation rate is not broadly available (as will often be the case under new comparability methodologies), the plan must comply with the minimum allocation gateway. To pass this gateway, each non-highly compensated employee in the plan must receive contributions equal to the greater of 5% of the employee's compensation or one-third of the highly compensated employee's contribution rate.\textsuperscript{115} Thus, to continue the example, the employer, under the amendments, either must abandon the new comparability plan (because the 20% rate is not broadly available) or must increase the nurse's contribution to 5% of his salary (to pass the minimum allocation gateway).\textsuperscript{116} These rules effectively mandate for the nurse a higher contribution which, in defined benefit terms, gives the nurse a benefit proportionately greater relative to his salary than the projected benefit for the older physician.\textsuperscript{117}

\textsuperscript{113} The older doctor is one of two highly-compensated employees, the other being the younger physician. No non-highly compensated employees benefit from the higher allocation rate. Hence, that rate flunks as too narrowly available since the percentage of highly-compensated employees benefiting from that rate (50%) is impermissibly greater than the percentage of non-highly compensated employees benefiting from that rate (0%). See Treas. Reg. § 1.401(a)(4)-8(b)(1)(viii), ex.3, 66 Fed. Reg. 34,535, 34,543 (June 29, 2001).

\textsuperscript{114} Under the amendments, a cross-tested defined contribution plan must pass muster in defined benefit terms and must also comply with the new contribution-testing requirements of the amendments. See id. § 1.401(a)(4)-8(b)(1)(i), 66 Fed. Reg. 34,535, 34,540.

\textsuperscript{115} Id. § 1.401(a)(4)-8(b)(1)(iv), 66 Fed. Reg. 34,535, 34,541. If there is more than one highly compensated employee, the one-third test applies to the allocation rate of the highly compensated employee with the highest rate. See id.

\textsuperscript{116} If the allocation rate for the highly compensated doctor were 12%, the minimum gateway contribution required for the nurse would be one-third of that figure, i.e., 4% of salary.

\textsuperscript{117} The 5% contribution mandated by the new amendments to the cross-testing regulations will become an annuity of $3023 upon the nurse's retirement. ($1500) x (1.085)^{34} = $24,027. $24,027/7.94844 = $3023. Thus, in defined benefit terms, the nurse's incremental benefit is slightly over 10% of his salary of $30,000 ($3023/$30,000) while the doctor's projected additional benefit for the year is 5.69% of his salary.
Finally, the recently-adopted amendments to the cross-testing regulations, like Notice 2000-14, condone a single track, age-weighted formula, but only if that formula constitutes a "smoothly increasing schedule of allocation rates." For these purposes, the formula must utilize "age band(s)" with "regular intervals," for example, the same contribution rate for employees grouped by five year cohorts. As to each such "age band," the contribution rate for that band cannot be more than five percentage points higher than the rate for the immediately prior band and in no event may the contribution rate for any age band be more than double the rate for the immediately prior band.

The amendments to the cross-testing regulations illustrate these rules via an age-weighted formula under which employees are grouped into ten year bands (for example, all employees ages twenty-five to thirty-four receive the same contribution as a percentage of salary) and under which each older band has a contribution rate which is 3% higher than the age band before (for example employees ages twenty-five to thirty-four get contributions of 6% of salary while younger employees get contributions of 3% of compensation, and each member of the band from ages thirty-five to forty-four receives contributions of 9% of compensation).

Thus, as a practical matter, the amendments generally condition new comparability, in either its category or superintegrated form, upon the non-highly compensated employees receiving the new minimum gateway allocation. However, many, perhaps most, age-weighted formulas continue to pass muster under these amendments. As a theoretical matter, the new amendments require cross-tested defined contribution plans to be double tested, i.e., to

119. See id.
120. See id.
123. See id.
124. See id.
125. I am skeptical that many new comparability formulas will, in practice, prove "broadly available" within the meaning of the proposed amendments.
be nondiscriminatory as to projected benefits and, in contribution terms, also to have allocation rates which are either “broadly available” or supplemented by the minimum allocation gateway.\(^{126}\)

It is difficult to reconcile the double testing mandate of the amendments with the disjunctive language of the Code. Under § 401(a)(4), plans may not discriminate as to “contributions or benefits.”\(^{127}\) In contrast, for hybrid individual account arrangements, the amendments require nondiscrimination both as to benefits and, in modified form, as to contributions.

It is, moreover, unclear as a matter of policy why cross-tested defined contribution plans should, per the recently-adopted amendments, be double tested as to both their contributions and their benefits when other types of qualified plans are not double tested in this fashion but are, instead, assessed in terms of either their contributions or their benefits. Consider again a conventional defined benefit plan which allocates pension resources among participants in the same manner as an equivalent new comparability plan. Under such a defined benefit plan, contributions are proportionately greater for older employees but projected benefits are deemed nondiscriminatory.\(^{128}\) As a matter of policy, the double testing approach embodied in the new amendments to the cross-testing regulations implies that there is something wrong with this defined benefit plan, that, notwithstanding the nondiscriminatory nature of the plan’s projected benefits, additional hurdles must be satisfied as to the plan’s pattern of contributions.

There is, however, no indication that the Treasury intends to apply this double testing approach to conventional defined benefit plans, nor does there appear to be any statutory basis for testing conventional defined

\(^{126}\) A prominent Treasury official is reported to have characterized the new regulations as “layer[ing]” a second nondiscrimination test onto new comparability plans. See Bonner Menking, IRS Officials Discuss Forthcoming Employee Benefits Guidance, 89 TAX NOTES 712 (2000) (“Richard Wickersham, manager of the IRS Employee Plans Technical Guidance and Quality Assurance Group, described the [then] proposed new comparability regulations as ‘a test layered on top of the current cross-testing rules.’”); see also supra note 107. I see no substantive difference between the characterization of the new regulations as layering or, as I prefer, double testing.


\(^{128}\) See supra notes 44-49 and accompanying text.
benefit plans as to both their benefits and their contributions. This highlights the questions of policy and statutory construction raised by the amendments: Why, as a matter of policy, should a hybrid defined contribution plan be double tested as to both its benefits and its contributions when an economically similar defined benefit arrangement is tested only as to its projected benefits? Where, as a statutory matter, does the Treasury derive authority for the double testing approach of the proposed new cross-testing regulations?

The first inquiry poses again the issue of substance and form: insofar as new comparability formulas mimic the results of pension resources achievable via conventional defined benefit plans, there is no apparent reason to disfavor those results when accomplished via a defined contribution arrangement. Moreover, as a statutory matter, there is no textual basis for conditioning the cross-testing of defined contribution arrangements on a benefits basis upon the additional satisfaction of the contribution requirements of the proposed amendments.

It is instructive, in this context, to reconsider the new minimum gateway requirement, i.e., non-highly compensated employees covered by new comparability plans without broadly available allocation rates must instead receive contributions of 5% of salary or one-third of the contribution rate of the plan’s highly compensated employee. In particular, it is instructive to compare this requirement with similar formulas for top-heavy plans and certain safe harbor 401(k) plans. As to the former, “non-key employees” must receive contributions equal to the lesser of 3% of salary or the contribution rate for the plan’s key employee. As to the latter, non-highly compensated participants must receive employer contributions equal to 3% of compensation. These top-heavy and 401(k) formulas were the apparent models for the new regulatory “gateway,” but are mandated statutorily. No one has suggested that the Treasury had the regulatory authority to impose these top-heavy and 401(k) requirements on its own. Where, then, does the Treasury find its authority to impose such requirements on hybrid defined contribution plans?

129. Section 401(a)(4) mandates nondiscrimination as to “contributions or benefits,” not both. I.R.C. § 401(a)(4) (1994).
131. Id. § 401(k)(12)(C) (Supp. II 1996).
As I noted earlier, the disjunctive terminology of I.R.C. § 401(a)(4) ("contributions or benefits") is difficult to square with the double testing approach of the new amendments (which effectively read the statute as mandating nondiscrimination as to "contributions and benefits"). Such an approach, if applied to conventional defined benefit and defined contribution arrangements, would wreak little short of havoc—which is why the Treasury is unlikely to go this far.

The preamble to the amendments unpersuasively invokes § 415(b)(6)(A), which authorizes Treasury Regulations governing the "computation of benefits under a defined contribution plan." However, the new cross-testing amendments go beyond mere computation and impose substantive minimum requirements, requirements which, as to top-heavy and 401(k) plans, were imposed legislatively, not through regulations.

E. The Real Target: Small Plans

The analytical weaknesses of Notice 2000-14 and of the recently-adopted amendments suggest a deeper, unstated basis for opposition to new comparability formulas. My appraisal is that most, if not all, new comparability opponents dislike all small employer plans, viewing them as tax shelters for the affluent which drain the fisc and mistreat rank-and-file workers. From this perspective, new comparability is simply the most recent abuse to be combated. From this vantage, it is no great loss, and possibly a boon, if the typical small employer elects against a qualified plan, since that plan would deplete the Treasury with no compensating increase in retirement security for non-highly compensated employees.

However, in their opposition to new comparability formulas, these critics find themselves constrained in three ways. First, the Treasury regulations specifically authorize the cross-testing which the new comparability methodologies utilize. Second, the failure in 1994 of efforts to outlaw age-weighted formulas indicates that, as a

132. In the current climate, it confuses, rather than clarifies, to label small plans as "tax shelters" since these plans have economic substance. See infra note 142 and accompanying text.

133. See Barry J. Bidjarano, Coping with the Reduced Limitation on "Compensation" Used Under Qualified Retirement Plans, 68 ST. JOHN'S L. REV. #
political matter, opposition must be focused upon the new comparability approaches; hence, the unpersuasive, but politically necessary, distinction between “good” cross-testing in the form of single track, age-weighted formulas and “bad” cross-testing in the form of superintegrated and categorized new comparability plans.

Finally, while overregulation has, as a practical matter, killed the small defined benefit pension, the nondiscrimination norm remains on the books for small plans, legitimating the defined benefit distribution of pension resources favoring older, long-term employees. The statutory authority to test for discrimination in terms of projected benefits thereby provides a baseline against which new comparability achieves, by different forms, the same substance as do defined benefit formulas.

Given these constraints, it is not surprising that the critique of new comparability is unconvincing, a piecemeal attack on a single type of plan which ignores other pension arrangements implementing the same results. The piecemeal nature of that attack undermines its persuasiveness: it is difficult to understand what is so terrible about new comparability formulas when, in substance, they achieve the same results as conventional defined benefit pensions and single track, age-weighted plans.

F. Revisiting Substance and Form

To summarize: opposition to cross-testing in general and to new comparability in particular is analytically insecure as long as the issue is framed in terms of substance and form. There is no reason why a distribution of pension resources substantively acceptable when effected through the defined benefit motif should be deemed discriminatory when accomplished via the defined contribution form. Similarly, there is no reason why defined contribution-style allocations become inappropriate when implemented by means of defined benefit arrangements.

357, 400 (1994); see also GRAFF, supra note 2 (“In 1994, Treasury made a legislative proposal to prohibit ‘cross-testing’ which was soundly defeated.”).

134. The tendency of defined benefit plans to favor older, more senior workers is commonly denoted as “backloading.” See Zelinsky, Cash Balance Controversy, supra note 1, at 688-91.
Could, however, opponents of cross-testing and new comparability challenge the notion that the issue is merely one of form? Could they instead contend that there are reasons to restrict the distributional patterns of defined benefit plans to such plans and not permit similar outcomes through defined contribution arrangements?

An argument along these lines would start with the widely-accepted premises that qualified plans receive tax-favored treatment and that the only rationale for such treatment is to encourage and reward employers who provide adequate retirement income for rank-and-file employees. Starting from these premises, such an argument would then cite the advantages to employees of defined benefit arrangements, in particular, the security arising from the employer's guarantee of a specified retirement income. Finally, the argument would conclude, it is a fair bargain to give the employer the distributional advantages of a defined benefit plan (greater contributions for older participants) but only when the employer extends to its employees the greater security of a defined benefit.

Cross-testing gives the employer the advantages of the defined benefit motif—pension resources favoring older, typically highly compensated, participants—without obligating the employer to provide rank-and-file workers with a specified benefit.

This criticism sweeps more broadly than Notice 2000-14 and the new regulations since it indicts all cross-testing of defined contribution plans on the ground that defined benefit-type distributions of pension resources, more favorable to older workers, should only be permitted when the employer guarantees specified benefits. Notice 2000-14 and the recently-adopted regulations, in contrast, indicate that single track, age-weighted formulas pass muster.

135. See Stein, supra note 62.
136. Of course, the distributional pattern of defined benefit plans, favoring older workers, is only deemed an advantage when the employer seeks greater pension resources for such older workers. This will often be the case for professional and other closely-held employers. However, much of the impetus behind conversion to the cash balance format is the reduction of contributions for older participants to decrease the employer's costs, to increase contributions for younger employees—or both.
137. One opponent of new comparability has alluded to an argument along these lines. See, e.g., Corry, supra note 67 (“Importing only a defined benefit testing method to a defined contribution plan without transferring other important safeguards leaves plan participants short-changed.”).
Indeed, the argument I postulate reflects a fundamentally different orientation than do Notice 2000-14 and the new regulations. The Notice and regulations criticize new comparability as inconsistent with the purposes of defined contribution plans. The argument I posit criticizes new comparability as inconsistent with the purposes of defined benefit arrangements.

For five reasons, I am ultimately unpersuaded by this contention that defined benefit-style allocations of pension resources should, as a substantive matter, be limited to defined benefit plans. First, the premise that qualified plan law constitutes a tax expenditure, while widely accepted, is unconvincing. Without that premise, it is difficult to justify much of the regulation of qualified plans, regulation rationalized on the grounds that it controls and channels the putative tax subsidy to qualified plans. If there is, as I believe, no qualified plan tax expenditure, there is no basis for tying a particular version of that expenditure (defined benefit-style allocations favoring older workers) to specific kinds of plans (true defined benefit arrangements).

Second, while many believe that the employer's assumption of the risks and obligations of providing fixed pension payments makes defined benefit plans important devices for providing retirement income, in the current environment, many others view defined benefit plans as dinosaurs. In a prolonged bull market, defined benefit arrangements appear to many, not as boons to the employee, but as banes which capture superior investment performance for the employer rather than for the employees. Of course, a sustained bear market will reveal to many participants, now used to soaring 401(k) and IRA accounts, the advantages of defined benefit arrangements under which they have fixed claims. For now, however, many would reject the notion that defined benefit plans are something good for them. Without that notion, it makes

138. See sources cited supra note 63.
139. See supra note 55.
140. E. Philip Davis reports such a phenomenon in the United Kingdom during the 1970s. See E. PHILIP DAVIS, PENSION FUNDS 63 (1995) (In the United Kingdom, "[o]ccupational defined-contribution plans declined in popularity during the mid-1970s, an era of high inflation and low real rates of return to investment.").
141. It is important to emphasize that for many (if not most) of us concerned about the stagnation of defined benefit plans, the issue is balance. Just as I am concerned about a world in which many private sector employees rely solely
little sense to force employers to establish defined benefit plans by limiting defined benefit-style allocations, favoring older workers, to defined benefit plans.

Third, an indictment of cross-testing along the lines I have postulated ultimately reflects the policy of ERISA and the legislation which has followed ERISA and further tightened the regulation of defined benefit plans. Heightened regulation has played an important role in the demise of small employer defined benefit plans and in the stagnation of such plans among larger sponsors. For those who believe that this regulation has gone overboard, limiting defined benefit-style allocations to defined benefit plans represents more Rube Goldberg regulation of a system already overregulated. The appropriate course ought not be restrictions to coerce employers into the defined benefit regime, but deregulation to resuscitate defined benefit pensions.

Fourth, the argument I posit, like opposition to small employer plans in general and to new comparability in particular, at its core reflects hostility towards professionals and small business owners who save significant amounts for retirement via qualified plans. If, as an ethical or policy matter, there is something wrong with such saving, it is plausible to tie such saving to some putative public good, such as the provision of employer-guaranteed retirement benefits. Since, however, I do not share the hostility towards affluent persons who save significantly toward retirement via qualified plans, I do not feel the need to constrain their ability to engage in such savings.

Opponents of small plans often dismiss them as abusive tax shelters. However, in the current environment, it confuses, rather than clarifies, to label small employer plans “tax shelters.” That moniker today has meaning, if not precision, when used to describe highly formalistic arrangements which lack economic substance beyond tax

upon defined contribution arrangements, equivalent dependence upon defined benefit devices seems just as problematic. It is accordingly consistent to believe that, to achieve balance, social security and public pensions should incorporate elements of an individual account system, but that important segments of the private pension system have become overly dependent on defined contribution arrangements and should strive for a more balanced mix of defined benefit and defined contribution devices.
The small employer plan, in contrast, has economic substance since the employer commits real resources to the plan. The complaint that too little of these resources goes to rank-and-file employees and too much is allotted to the professionals and business owners differs from the argument that a particular device lacks economic substance. It only confuses to lump together as “tax shelters” both small plans and arrangements devoid of economic content.

Finally, there is the matter of intergenerational symmetry. Abolishing cross-testing for defined contribution plans says to the older business owner that he can embrace greater, defined benefit-style allocations only if he provides guaranteed benefits to his employees. Why then permit the young business owner to embrace the individual account arrangement more attractive to him? If the business owner’s ability to save significantly for himself should be linked to defined benefits for his workforce, that policy is equally compelling when the young professional or entrepreneur is better off with an individual account arrangement. A rank-and-file employee should not be deprived of a guaranteed benefit simply because her employer is a young person better served by an individual account plan.

The corollary—young highly compensated employees should get defined contribution coverage only if defined benefits are extended to the rest of the workforce—is not a conclusion many would find congenial. Why then tie the qualified plan design most attractive to an older employer to her provision of defined benefits to her workforce?

On balance, I conclude that the case for limiting defined benefit-style allocations of pension resources to defined benefit plans is substantively weak. That conclusion leaves us back where we started in terms of substance and form: There is no reason that an allotment of pension funds, nondiscriminatory when achieved via a defined benefit

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142. There is today much discussion about the existence and extent of tax shelters used by large corporations. See, e.g., Daniel N. Shaviro, Economic Substance, Corporate Tax Shelters, and the Compaq Case, 88 TAX NOTES 221 (2000). The point in the text is that small employer plans should not be categorized with these shelter arrangements, which lack economic substance other than tax savings.

143. See infra text accompanying notes 23-27.
plan, should be deemed discriminatory when accomplished through a defined contribution arrangement—or vice versa.

III. THE INCOHERENCE OF THE NONDISCRIMINATION NORM

The analysis so far reveals the theoretical and practical incoherence of the nondiscrimination norm. As a theoretical matter, the nondiscrimination norm ignores the time value of money. The pension concept of nondiscrimination equates nominally identical benefits which, because they will be paid at different times, have significantly different present values. Similarly, the nondiscrimination norm equates significantly different contributions because, over differing time frames to retirement, these contributions will produce the same nominal benefits.

Consider, again, our initial example of a fifty year old business owner and her thirty-five year old secretary. In that context, contributions which, as a percentage of current salary, favor the highly-compensated owner prove nondiscriminatory when translated into projected benefits. However, the projected benefits of the owner will commence in fifteen years at normal retirement while the benefits of the secretary are fully thirty years away. To compare these benefits in nominal terms is to ignore the discrepant present values stemming from the extra fifteen years that the secretary’s benefits will be delayed.

The imbalance in contributions for the business owner and her secretary accurately reflects an imbalance in the present values of their respective benefits. Since the owner gets her plan distribution a decade and one-half sooner than does her secretary, relatively more must be contributed to fund the owner’s greater entitlement measured in present value terms. By comparing nominal benefits and ignoring the different times at which those benefits will be paid, the nondiscrimination norm ignores the economic reality of the time value of money.

Given the centrality to the modern Internal Revenue Code and to much tax policy analysis of time value of money.

144. See supra text accompanying notes 13-20.
money concerns, it is anomalous for the qualified plan regime to utilize a nondiscrimination norm devoid of such concerns. Indeed, it is particularly anomalous for the qualified plan nondiscrimination rules to ignore the time value of money when the conventional characterization of the qualified plan regime as a tax expenditure rests upon the economics of deferring participants' income tax liabilities until their plan benefits are actually distributed to them. The nondiscrimination norm is, in short, a product of an earlier era, less sensitive than ours to the time value of money.

In practical terms, when participants are of significantly different ages, allocations of pension resources which flunk nondiscrimination testing in defined contribution terms may pass muster on a defined benefit basis. In particular, when highly compensated employees are substantially older than the rank-and-file members of the workforce (not an uncommon situation), proportionately larger contributions for the highly compensated accrue investment earnings for less time because older, better paid workers are relatively close to retirement. Consequently, contributions for these older, highly compensated employees translate into deferred annuities which are nondiscriminatory as a percentage of current salary. Conversely, if the highly compensated members of an employer's workforce are younger than their less well paid co-workers, allocations of pension resources which discriminate in defined benefit terms prove nondiscriminatory when analyzed as contributions.

In practice, nondiscrimination proves a meaningful constraint on qualified plan design in two settings: if a workforce is relatively homogeneous by age or if the age distributions of the highly and non-highly compensated portions of the employer's workforce are comparable. If workers are of similar ages (for example, a thirty year old

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146. Indeed, many tax policy analysts have focused exclusively on time value of money concerns and have thereby ignored other legitimate considerations. See Zelinsky, supra note 63, at 594.
147. Id.
148. See supra text accompanying notes 40-49.
149. See supra text accompanying notes 40-49.
150. See supra text accompanying notes 23-27.
doctor and her thirty year old nurse), all employees have the same (or reasonably comparable) terms of years to retirement. Consequently, across the workforce, plan contributions will accrue investment earnings for the same number of years and will ripen into similar deferred annuities as a proportion of current salary. Hence, the young doctor cannot minimize her pension outlay for her equally young nurse by switching to either a defined benefit or a defined contribution methodology for nondiscrimination testing. Under either approach to the nondiscrimination norm, the doctor will be required to provide the nurse with contributions and annuity equivalents which are the same percentage of current compensation as the doctor contributes for herself, since the doctor and nurse are of the same age.

Similarly, the nondiscrimination norm meaningfully constrains qualified plan design when the age distribution of the employer's highly compensated workforce mimics the age profile of its rank-and-file workforce (for example, two physicians, ages thirty and fifty; two nurses, also ages thirty and fifty). In this kind of setting, defined benefit formulas favoring the older doctor also advantage the older nurse. Likewise, insofar as a defined contribution format increases pension contributions for the younger physician, that format also favors the younger nurse.

However, when there is significant correlation between compensation and age—as there often is for professional and other closely-held employers—the nondiscrimination norm is substantively empty because relatively small contributions for younger persons yield relatively large projected annuities, and comparatively large contributions for older persons translate into comparatively small annuity equivalents. In such a context, measuring contributions for nondiscrimination produces conclusions totally at variance with the conclusions which emerge from assessing projected benefits. In this setting, the outcome of the nondiscrimination inquiry depends upon the form in which the inquiry is framed: contributions or benefits.

The practical incoherence of the nondiscrimination norm is most clearly manifested in the context of small plans, the design of which can readily be manipulated to benefit an owner or a few owners. Thus, for those who indict small plans as abusive tax shelters for professionals and closely-held business persons, the nondiscrimination
principle fails precisely when it is most needed, i.e., when the plan can be designed to advantage the affluent principals of a professional practice or other closely-held business at the expense of the rank-and-file workforce and the fisc.\textsuperscript{151}

The problematic nature of the nondiscrimination norm is not a new phenomenon; the underlying arithmetic is straightforward. For younger participants, contributions have more years to compound investment income and thus translate into relatively larger annuities; for older participants, the reverse is true. Qualified plan advisors and commentators have long understood that defined benefit plans are more attractive for older persons seeking greater contributions and that individual account formulas tend to favor younger workers in search of greater plan contributions.\textsuperscript{152}

Why, then, is the incoherence of the nondiscrimination norm manifesting itself so dramatically now, three generations after that norm was introduced into the Internal Revenue Code? Or, to phrase the question somewhat differently, why are arrangements like cash balance and new comparability plans (plans which reveal the incoherence of the nondiscrimination norm) arising now?

The answer is in part regulatory and in part cultural. The regulatory burdens which have been placed on defined benefit plans and the emergence of a defined contribution culture have triggered the aggressive search for hybrid formulas, a search which underlines the incoherence of the nondiscrimination principle.

While ERISA and the legislation following in its wake encumbered both defined benefit and defined contribution plans, the burdens placed on defined benefit arrangements have been greater, leading many employers, particularly smaller ones, to abandon the defined benefit format or to avoid that format \textit{ab initio}. As part of this flight from the defined benefit motif, some employers and their plan advisors have searched for hybrid plan designs under which less heavily-regulated defined contribution arrangements replicate the substance of defined benefit pensions. That

\textsuperscript{151} In contrast, large employers, disciplined by labor market forces and industry standards, typically have less flexibility in structuring their qualified plans.

\textsuperscript{152} See \textsc{McGill et al.}, \textit{supra} note 5, at 611-19.
search, in turn, underscores the incoherence of the nondiscrimination norm.

Five regulatory factors, in particular, have pushed employers to eschew defined benefit plans for the individual account motif: (1) I.R.C. § 4980, (2) I.R.C. § 412, (3) PBGC premiums, (4) compliance costs, and (5) impenetrability.

First, I.R.C. § 4980 effectively denies employers sponsoring defined benefit plans the ability to recoup directly superior investment performance in the form of surplus pension assets. Section 4980 thus skews the risks and rewards for employers maintaining defined benefit plans. An employer sponsoring a defined benefit arrangement retains the full risk of poor investment performance since, having promised employees specified benefits, the employer must contribute the amounts necessary to fund such benefits but, per I.R.C. § 4980, the employer cannot directly recover superior investment performance by terminating the plan and reclaiming surplus assets.

Second, I.R.C. § 412 and the funding standards it creates constrain the employer’s discretion both to reduce defined benefit funding in times of financial difficulty and to prefund anticipated benefits when economic conditions are good. Third, most employers maintaining defined benefit arrangements must pay premiums to the Pension

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153. For a comprehensive discussion of these factors, see Zelinsky, supra note 6, at 6-2 to 6-11.

154. Surplus pension assets do yield an indirect advantage to the employer since such assets permit reduction of future contributions to fund benefits under the plan. See Zelinsky, Cash Balance Controversy, supra note 1, at 714. Alternatively, surplus assets may permit the employer, without contributing its own resources to the plan, to increase benefits of strategic importance to the employer. Most commonly, surplus defined benefit funds may permit the employer, at no direct cost to it, to create early retirement windows to encourage older workers to quit. See, e.g., Bennett v. Coors Brewing Co., 189 F.3d 1221 (10th Cir. 1999). However, the asymmetry remains: the employer is directly liable for any funding shortfall, but cannot directly recoup any surplus assets for itself.

155. For purposes of the present discussion, the relevant rules impose minimum funding obligations on employers, I.R.C. § 412(a)-(b) (1994 & Supp. III 1997), impose maximum funding limitations, id. §§ 412(a)(7), 404(a)(1)(A) (1994), penalize employers’ failure to meet their minimum funding obligations, id. § 4971 (1994 & Supp. II 1996), and penalize employers for overfunding. Id. § 4972.
Benefit Guaranty Corporation (PBGC), the government-run insurance corporation which underwrites basic pensions promised by insolvent defined benefit plans. Fourth, the actuarial, legal and accounting costs associated with defined benefit plans are generally greater than the compliance costs associated with individual account arrangements.

Finally, the legal rules for defined benefit plans have made such plans harder for employers and employees to understand than defined contribution arrangements. The resulting impenetrability deters employers from embracing defined benefit plans and the comparatively opaque set of obligations associated with them.

Not all of these factors have had the same impact on all employers and all plans. Small businesses and professional employers are typically more sensitive to the legal, accounting and actuarial fees associated with defined benefit arrangements than are publicly-traded corporations. Small professional employers are not covered by the PBGC insurance scheme and thus do not owe PBGC premiums if they maintain defined benefit plans. New comparability and age-weighted formulas, though they are defined contribution plans, no doubt entail administrative and compliance costs which rival those of defined benefit plans—and are probably as hard for employers to understand.

Nevertheless, on balance, the regulation imposed by ERISA and by the legislation coming after ERISA has burdened defined benefit plans more heavily than individual account arrangements. While some employers have absorbed the regulatory costs placed upon defined benefit plans, others have switched to defined contribution arrangements, for example, the now-ubiquitous 401(k) plan.

156. Small professional employers are exempt from both PBGC coverage and premiums. See ERISA § 4021(b)(13), 29 U.S.C. § 1321(b)(13) (1994).
157. Congress has geared these premiums to the plan’s solvency and, hence, its risk of default. See id. § 4006(b)(13), 29 U.S.C. § 1306(b)(13). The result is higher premiums for some plans and lower PBGC premiums for others.
158. Anyone who doubts the opacity of the legal rules pertaining to defined benefit plans need only peruse the Internal Revenue Code and ERISA provisions identified in the three preceding footnotes.
159. See id. § 4021(b)(13), 29 U.S.C. § 1321(b)(13).
160. See U.S. GEN. ACCT. OFF., supra note 45, at 9 (“The rules for defined benefit plans generally are more extensive and complex than for defined contribution plans.”).
Of employers embracing defined contribution arrangements, many (particularly smaller employers) have sought to retain the distributional patterns which, before ERISA, such employers would have achieved via defined benefit arrangements. Hence, the search for hybrid plans, which, as defined contribution arrangements, avoid the regulatory burdens of defined benefit plans but, via cross-testing, emulate the distributions of pension resources achieved by defined benefit arrangements.

In this context, new comparability is the actuarial equivalent of the search for the perfect wave, an effort to fine-tune defined contribution plans via cross-testing to concentrate pension resources on older employees, typically the principals of the sponsoring employer. Prior to ERISA, this search was unnecessary; the defined benefit motif was used to achieve such results. The recent and dramatic growth of new comparability exposes the hollowness of the nondiscrimination norm because pension contributions, discriminatory when viewed as such, become nondiscriminatory when converted to annuity equivalents.

The increased regulation of defined benefit plans has reinforced the emergence of a defined contribution culture. A generation ago, most people, when they thought about pensions, thought in defined benefit terms, envisioning retirement income as a specified amount guaranteed by the employer as an annuity. Today, pensions are popularly conceived in defined contribution terms. For many Americans, the paradigmatic pension is now the 401(k) or the individual retirement account.

Like most cultural shifts, the emergence of a defined contribution culture has many causes. As the greater regulatory burdens imposed upon defined benefit arrangements moved employers to individual account plans, more employees experienced retirement savings in the defined contribution form and came to accept that form as normative. The bull market of the 1990s fortified the defined contribution culture, as burgeoning 401(k) and individual retirement accounts made the employer's promise to provide a specified benefit seem unnecessary—indeed stodgy. The decline of labor unions, bastions of the defined benefit pension, bolstered the transition to a defined contribution culture as comparatively less of the workforce heard the unions' argument for defined benefit arrangements. Instead, more of the workforce was exposed
to the heavy advertising of the financial services industry, advertising which emphasizes the benefits of holding and investing retirement savings through 401(k) arrangements, IRAs, and other defined contribution devices.

The upshot has been a sea change in the way Americans experience and think about pensions. For the purposes of the present discussion, the most important manifestation of a defined contribution culture has been the remarkable growth of cash balance plans, defined benefit arrangements designed to resemble defined contribution schemes. \(^6\) Such plans were literally inconceivable to earlier generations, for whom a pension was a defined benefit annuity. Cash balance plans can mimic defined contribution arrangements because employees have come to think of pensions in defined contribution terms.

IV. AGE DISCRIMINATION

While the principal focus of this article is nondiscrimination as to rank-and-file employees, the controversy sparked by the growth of cash balance plans—in particular, debate about whether such plans discriminate on the basis of age—underscores the incoherence of the nondiscrimination norm. Again, the arithmetic is straightforward: as participants age, the same dollar contribution purchases less annuity income at retirement since there is less time for that dollar to accrue investment earnings. Hence, if two employees earning the same salary receive the same contribution to their respective notional cash balance accounts, the annuity value of that contribution is less for the older of them. \(^6\)

Does this constitute age discrimination? As a matter of law, I conclude that it does since cash balance arrangements are defined benefit plans and (unlike the statute proscribing discrimination in favor of highly

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\(^{161}\) But this is by no means the only manifestation of the defined contribution culture. See Zelinsky, supra note 6, at 6-14 to 6-29. When I wrote this article, the movement towards public employee defined contribution plans was nascent. It has since developed with remarkable speed. See, e.g., Michael Bologna, State Retirement Systems, Legislatures Developing Wide Range of Innovative Plans, 27 Pens. & Ben. Rep. (BNA) 1752, 1753 (July 25, 2000) (“The most innovative of such changes included the creation of optional defined contribution retirement plans in four states.”).

\(^{162}\) See Zelinsky, Cash Balance Controversy, supra note 1, at 722, 734; Zelinsky, Cash Balance Controversy Revisited, supra note 1, at 561-62.
compensated employees) the statute outlawing age discrimination in pensions lacks sufficient flexibility to authorize cross-testing in that context.\textsuperscript{163} As a matter of policy, I conclude that this result, while mandated by the statute, is wrong.

For present purposes, the issue is not whether I am correct or whether those taking a different tack have the better argument. Rather, the issue is the fashion in which this controversy illuminates the incoherence of the nondiscrimination norm. There is no doubt that, if cash balance plans can test for discrimination on the basis of contributions, they pass muster since such plans typically credit theoretical contributions as a percentage of salary, regardless of age.\textsuperscript{164} In contrast, if cash balance contributions are converted into the projected annuities they purchase, a quite different picture emerges, one in which, as active employees age, the annuity values of their respective contributions decline.\textsuperscript{165}

In short, debate about cash balance plans and age discrimination has been unproductive because, \textit{inter alia}, the fundamental concept—nondiscrimination—is in this context incoherent, producing fundamentally different results if the issue is framed in terms of contributions than if the issue is posed in terms of ultimate benefits.

A second corollary flows from the Code’s failure to authorize cross-testing in the context of age discrimination:

\textsuperscript{163} Compare I.R.C. § 401(a)(4) (1994) (“contributions or benefits provided under the plan [can] not discriminate in favor of highly compensated employees”) with id. § 411(b)(1)(G) (“a defined benefit plan shall be treated as not satisfying the requirements of this paragraph if the participant’s accrued benefit is reduced on account of any increase in his age or service”) and id. § 411(b)(2)(A) (“A defined contribution plan satisfies the requirements of this paragraph if, under the plan, allocations to the employee’s account are not ceased, and the rate at which amounts are allocated to the employee’s account is not reduced, because of the attainment of any age.”).

\textsuperscript{164} Indeed, some cash balance plans actually increase theoretical contributions with age.

\textsuperscript{165} Those who assert that cash balance plans are not age discriminatory under current law often cite the arithmetic of post-retirement benefit accruals. See Zelinsky, \textit{Cash Balance Controversy Revisited}, supra note 1, at 570-73. In some (perhaps many) cases, annual contributions after normal retirement may produce increasingly larger annuities because of increasing mortality. However, even in these examples, the math before normal retirement indicates that, as active employees get older, the same dollar contribution has less time to compound interest and therefore produces less annuity income as of normal retirement.
plans which do not discriminate against rank-and-file employees when cross-tested may, under current law, nevertheless discriminate as to age because, as to age, there is no statutory basis for cross-testing. For example, consider again a defined benefit plan which provides smaller annuities for older, non-highly-compensated participants. Via cross-testing, this plan may be deemed nondiscriminatory on a contribution basis since contributions are proportionate to each employee's compensation.

As a matter of policy, there is no reason why this pattern of contributions should not also be deemed age neutral since each participant, regardless of age, receives the same contribution as a percentage of his salary. Nevertheless, under the current statutes, the relevant test for age discrimination under a defined benefit plan is the pattern of projected annuities. There is no authority in this context for cross-testing, i.e., assessing the presence of age discrimination vel non on the basis of a defined benefit plan's pattern of contributions. Since the plan's anticipated benefits decline as employees get older, this plan age discriminates under present law.

By contrast, the typical new comparability defined contribution plan, which passes muster under § 401(a)(4) by cross-testing for anticipated benefits, is not age discriminatory under current law since contributions increase (rather than decrease) for older participants. And, under present law, it is the pattern of contributions, not of projected benefits, which determines whether or not an individual account arrangement is age discriminatory.

V. IMPLICATIONS

From all of the foregoing, I conclude that the concept of nondiscrimination should be purged from the pension law since the outcome of the nondiscrimination inquiry turns on the form in which pension resources are measured, i.e., as contributions or as projected annuities. Whatever the merits of formalism in other contexts, in the pension

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166. See supra text accompanying notes 30-33. This is the cash balance paradigm.

167. See supra text accompanying notes 47-49.

168. There are many contexts in which legal systems properly emphasize form, principally when it is important to reduce transaction costs. In the tax
setting, there is no sound reason for treating allotments of pension resources as nondiscriminatory when measured as contributions, but as discriminatory when assessed as projected annuity benefits. The form by which particular allocations of pension resources are accomplished should not entail disparate legal results.

The simplest response to this reality is to abolish the nondiscrimination rule. Others, confronted with the practical and theoretical incoherence of the nondiscrimination norm, might instead be tempted to reformulate that norm to reflect time value of money concerns. One could, for example, envision a new version of the nondiscrimination rule under which all benefits are reduced to present value prior to comparison for discrimination. Starting with a deep skepticism of much of the present framework governing qualified plans, that approach strikes me as unwise, compounding the complexity of a regulatory scheme that is already too complicated and intrusive.

I suspect that, even for many favoring a more paternalistic pension policy than I support, the nondiscrimination norm has outlived its usefulness. For those troubled by the outright abolition of the nondiscrimination norm but skeptical of introducing more complexity to the qualified plan regime, a viable alternative to the status quo is to replace the nondiscrimination norm with straightforward minima, for example, any defined contribution plan must provide each participant with a contribution of at least 3% annually; any defined benefit arrangement must provide each participant yearly with a minimum annuity of 3% of that year's income.

law, for example, it is often said that taxpayers are stuck with the form in which they cast their transactions, primarily to facilitate review and enforcement by the taxing authorities. See, e.g., Nestle Holdings, Inc. v. Comm'r, 152 F.3d 83, 87 n.4 (2d Cir. 1998) (asserting "the general rule that a taxpayer is bound by the chosen form of its transaction"). But see Kenneth L. Harris, Should There Be a 'Form Consistency' Requirement? Danielson Revisited 78 Taxs 88 (2000). Emphasis on form can also be understood as enhancing predictability and fairness in a legal system: When everyone knows that certain forms produce specific outcomes, the legal system is predictable and treats everyone embracing those forms similarly. For purposes of the present discussion, none of these considerations bolster the highly formalistic nature of pension law's nondiscrimination norm.
The Code already contains rules of this sort for plans deemed “top-heavy” and for safe harbor 401(k) arrangements. It would be both simpler and more coherent to generalize these rules to the universe of qualified plans and then purge the concept of nondiscrimination from the pension law.

In light of all of this, is cross-testing a mistake? I conclude not. As long as we retain the nondiscrimination norm, cross-testing is a textually plausible reading of the statute which imparts useful flexibility to the body of law which overregulates qualified plans. Underlying this conclusion is the premise that the form through which pension allocations are achieved should not matter and that, consequently, devices like cash balance plans, age-weighted arrangements, and new comparability plans (in both their superintegrated and categorization forms) are legitimate insofar as they mimic the outcomes obtainable under more conventional defined benefit and defined contribution plans. As long as such conventional plans provide a statutorily-approved baseline, there is no principled basis for opposing hybrid plans, which, via cross-testing, achieve substantively similar outcomes.

Cross-testing does highlight the hollowness of the nondiscrimination norm, by condoning on the basis of projected benefits allocations of pension resources which flunk on a contribution basis, and vice versa. However, the appropriate response is not to kill the messenger, but to reassess the message. Before ERISA, the incoherence of the nondiscrimination norm did not matter in practice because employers were relatively free to pick between defined contribution and defined benefit arrangements. Only with ERISA and the subsequent decline of the defined benefit plan has it become necessary for employers to push the envelope in terms of plan design. That the resulting, cross-tested hybrid devices reveal the hollowness of the nondiscrimination norm suggests, not that there is something wrong with cross-testing, but that there is something wrong with that norm.

CONCLUSION

When probed, the controversies currently absorbing the qualified plan community—Are cash balance plans legitimate? Should new comparability be permitted?—reveal an underlying issue: the propriety of the cross-testing which facilitates these hybrid pension arrangements. Cross-testing, in turn, reveals the incoherence of the nondiscrimination norm, as allocations of pension resources deemed discriminatory when characterized in defined benefit terms become acceptable when framed in defined contribution terms, and vice versa.

The allocations of pension resources achieved by the controversial hybrid devices, via cross-testing, mimic the allocations achievable by more conventional defined contribution and defined benefit plans. There is no reason for the form by which retirement resources are allocated to be of controlling legal significance.

Cross-testing imparts useful flexibility to the body of law which overregulates qualified plans. Insofar as cross-testing highlights the theoretical and practical incoherence of the nondiscrimination norm, it is that norm, not cross-testing, which has outlived its usefulness.