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"Pensions Today and Tomorrow"
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Remarks delivered at the PBGC Policy Forum
The Future of Defined Benefit Plans
National Press Club
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I. Introduction

I'm delighted to be here today both to celebrate the 35th anniversary of ERISA and the PBGC *and* to share with you some thoughts on how, working together, we can further the PBGC's mission of encouraging "the preservation and maintenance of pension plans *for participants*."

We are celebrating today because we know that ERISA is an extraordinary law. It is an ingenious and delicate balance of measures to encourage employers to maintain plans, and provisions to ensure those plans achieve the law's principal objective: to fulfill the reasonable expectations of workers covered by private retirement plans.

We also know that the law has been amazingly successful in achieving its objective, and that millions of retirees have received and are receiving their expected pensions because of this law – *and* because of the critical role played by the PBGC in guaranteeing those pensions.

Of course, ERISA was not and is not a perfect law. Fortunately, many of its shortcomings were addressed in subsequent laws. But shortcomings remain, and others have emerged. At the Pension Rights Center we are confident that over time these, too, will be addressed.

II. Why pensions are important

Why do pensions matter? For those of you who are newer to the field there are really just two facts you need to know about pensions.

The most important is that they offer the best chance that workers have to make ends meet in retirement. Government statistics show that people with pensions have twice the income of those living on Social Security alone.[1]

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[1] Median income of aged units with only Social Security is $16,527. Median income of aged units with Social Security and a private pension is $31,227. Median income of aged units with both Social Security and a federal government pension is $33,918. Median income of aged units with both Social Security and some other type of pension (state or local government, military) is $39,364. An "aged unit" is defined as either a married couple living together in which at least one of the two is 65 or older or a nonmarried person 65 or older. Social Security Administration. "Number and median income of those receiving retirement benefits, by marital status and receipt of earnings and income from assets." Unpublished Supplemental Table to "Income of the Population 55 or Older, 2006" February 2009. This tabulation is an update to the 2004 report, Table 3.6

The second fact is that pensions are a critical source of the long-term private investment capital that is essential to job creation and the growth of the economy.[2]

There is also the fact that we all have a stake in the system. Since pensions are subsidized by all American taxpayers, all of us pay higher taxes or receive less in government services to support pensions (and other retirement plans).[3]

III. Measures to preserve pensions.

But we are here today, not to look backwards or debate why pensions are important, but to discuss what can be done to "encourage the preservation and maintenance of pension plans *for participants*" **today and tomorrow.**

A. First, I'd like to focus on what can be done to preserve plans for the estimated 17.6 million active workers now earning pensions under defined benefit plans. <u>This has to be a priority concern for all of us.</u>

In many cases these individuals have worked their entire careers counting on getting their promised lifetime benefits. They gave up significant portions of their paychecks in exchange for their pensions. <u>How do we protect them?</u>

1. In the very near-term, unless the stock market miraculously rebounds and/or interest rates increase, **we need to address the issue of emergency funding relief.**

a. Our position is that **ongoing single employer plans** should be allowed to automatically spread losses that are attributable to the market downturn over an extended period *if* they continue to allow all participants to earn benefits throughout the relief period.

<u>Frozen plans</u> should be able to apply for funding waivers from the IRS under an expedited process, if they can, as required by current law, show substantial business hardship, and that granting the waiver will not be adverse to the interests of participants.

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[2] There are $4.757 trillion in private defined benefit and defined contribution assets. When public plan assets are included the total is $8.3 trillion. Federal Reserve Board of Governors, Flow of Fund Accounts of the United States, Tables L.118-120, pp. 77-78 (pp. 18-19 of the PDF), September 17, 2009.

[3] The federal tax expenditure for pensions in 2009 is estimated to be $98 billion. This figure includes the revenue lost to the U.S. Treasury from employer contributions to both public and private pension plans. This is a combined total from defined benefit plans ($42.8B) and defined contribution plans ($55.2B). It does not include Individual Retirement Accounts and Keogh Plans, which are estimated to cost an additional $28.5 billion in foregone revenue in 2009. All taxpayers effectively pay for the tax subsidy to encourage retirement savings through higher taxes or fewer government services. Only the tax expenditure for deductions for health insurance premiums, at $127 billion is larger. The subsidy for mortgage interest deductions is expected to be $80 billion in 2009. (Joint Committee on Taxation, U.S. Congress, Estimates of Federal Tax Expenditures for Fiscal Years 2008-2012, Table 2 - "Tax Expenditure Estimates by Budget Function, Fiscal Years 2008-2012," p. 57 (p. 58 of the PDF), October 31, 2008.).

According to the Office of Management and Budget, the federal tax expenditure for pensions in 2009 is estimated to be $96 billion. This is a combined total from employer plans ($45.6 B) and 401(k) plans ($51.0 B). It does not include Individual Retirement Accounts and Keogh Plans, which are estimated to cost an additional $24.7 billion in foregone revenue in 2009. (Executive Office of the President, Office of Management and Budget, Analytical Perspectives, Budget of the United States Government, Fiscal Year 2009, Table 19-1, Page 291 www.whitehouse.gov/omb/budget/fy2009/

If IRS resources are insufficient to provide expedited waivers, Congress should consider establishing a temporary emergency funding relief panel to process waiver applications.[4]

b. There is also need for funding relief for **multiemployer plans**. But this relief must be coupled with increased protections for participants. These protections should include very substantial increases in PBGC guarantees, and, once plans are again adequately funded, a restoration of the very unfair cutbacks of already-earned benefits that were allowed by the Pension Protection Act.[5]

2. Looking beyond the immediate financial crisis, those of us who care about preserving pensions need to work together to come up with reforms that address the concerns of both employers and employees. I'd like to share with you a sampling of proposals developed by an informal study group of policy experts at organizations representing participants, many of whom are here today.

Our **Pension Preservation Package** includes four types of proposals:

(1) Proposals aimed at encouraging employers to maintain defined benefit plans by addressing their concerns about volatility and cost.

(2) Proposals designed to discourage employers from freezing and terminating their plans.

(3) Proposals to make defined benefit more appealing to employees, since lack of appreciation for DB plans is often used as a justification for jettisoning them.

(4) And, finally, proposals targeted at current rules and practices that make DBs less attractive than 401(k)s to some employers.

Some of the specific proposals are very modest, others are more far-reaching. The list of proposals is not intended to be a definitive list, but has been put forward to promote discussion. Since the proposals are included in the handouts, I will only provide a few examples.

- To address employer cost concerns about increased longevity, one proposal would allow plans to increase normal retirement age to Social Security full retirement age for new employees and those under age 40.

- To discourage employers from terminating plans unnecessarily, we propose giving those individuals who do not receive their full benefits from the PBGC a

[4] It is important to remember that funding relief is effectively a loan from participants (and the PBGC) to a corporation, and that although companies with frozen plans claim that automatic blanket relief will allow them to save jobs, there is no assurance that the money won't be used for bonuses or stock grants for executives.

[5] If these measures require increased PBGC premiums (even to the 2010 single employer flat rate $35 a year level), participants are likely to be more than happy to foot the bill. A premium of less than $3 a month to guarantee benefits that can be worth hundreds of thousands of dollars is very cheap insurance.

claim in bankruptcy for the difference between what the PBGC provides and what the plan promised.

- We were pleased to see that one of our proposals to help level the playing field between pensions and 401(k)s was reflected in "The Lifetime Income Disclosure Act" introduced in the Senate last week. It would require companies sponsoring 401(k)s to inform participating workers of the projected monthly income they could expect at retirement based on their current account balance.[6]

3. Others outside of the study group have suggested other ways of preserving DB plans. One is to significantly increase the limits on how much executives can receive from pension plans (and how much of their compensation can be taken into account in figuring their benefits) in order to bring high-paid company officials back into qualified plans.

And, there are also important initiatives undertaken in other countries that were highlighted in a recent GAO report.[7] For example, a majority of the DB plans in the Netherlands have moved from a final-average pay to a career-average formula, and plans in Switzerland have adopted an innovative cash balance-type approach.

4. In addition to preserving plans now in existence, **considerable creative thought has been devoted to developing new designs that might encourage more employers to adopt plans.** As you know, new DB-K plans will be available for small firms next year, and other designs are under consideration. My favorite of these is POPP, the Plain Old Pension Plan, developed by our common-ground initiative, the Conversation on Coverage. POPP is a career-average DB plan that greatly simplifies administration and funding for employers and allows them to provide past service credits, and also to provide bonus benefits in good years. A fact sheet describing POPP is in the handouts.

IV. What about everyone else?

All of the measures I have discussed so far would help provide secure lifetime guaranteed benefits for a great many of today's workers, and all should be seriously considered. But what about everyone else in the workforce **today**? And what about **tomorrow's workers**?

My guess is that everyone here knows that there is a problem. As a leading consulting firm recently noted, it is that Americans are **"adrift at sea and sinking when it comes to retirement security.**"[8]

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[6] http://aging.senate.gov/hearing_detail.cfm?id=320420&

[7] U.S. Government Accountability Office, "Alternative Approaches Could Address Risks Faced by Workers But Pose Trade-offs," GAO Report #09-642, revised September 1 , 2009 http://www.gao.gov/new.items/d09642.pdf

[8] David Hunt, Salim Ramji et al.,*Restoring Americans' Retirement Security: A Shared Responsibility*, McKinsey & Company, undated, received October 2009, p. 11.

There are many reasons for this, but one is that for the last 28 years, we have allowed retirement policy to be largely based on a fable. You are likely to be familiar with it. It is Aesop's fable of the ant and the grasshopper. As interpreted by the then-Under Secretary of the Treasury in a *Washington Post* article dated November 8, 1981, the fable stands for the proposition that **people can and should provide for their own retirement**. Significantly, the *Post* article appeared two days before the issuance of the Treasury regulations that gave the green light to 401(k)s.

Sadly, millions of hard working "ants" – workers who did all the "right things" – have learned the consequences of basing retirement policy on a fable. Even before the market dive, the 401(k) account balances of most Americans were a small fraction of the amounts they will need in retirement.[9]

Of course, the shift to savings plans occurred for many practical as well ideological reasons, which we could debate all afternoon. But the bottom line is that **the rugged individualism reflected in "do-it-yourself retirement" has turned out to be too rugged on too many individuals**.

V. What is to be done?

1. Some have suggested that what needs to be done is to make 401(k) plans look more like defined benefit plans. A start on what is sometimes called the "DB-ification" of 401(k)s was made by the Pension Protection Act's auto-401(k) safe harbor rules.

Simply stated, these rules offer employers a trade off. They can avoid nondiscrimination rules that limit the amounts that they and their higher-paid employees can contribute to their 401(k)s **if** the company adds certain features to the 401(k). These include: automatically enrolling newly hired employees; withholding a specified percentage of pay; defaulting employees into lifecycle funds; increasing the percentage of pay withheld each year; and providing a prescribed matching contribution.

Suggestions for building on this concept range <u>from</u> significantly increasing the amounts withheld and the amount of increases each year <u>to</u> requiring plans to offer a prescribed limited menu of investment choices and annuities as a default option.[10]

Since these proposals would only reach those employers that sponsor 401(k)s, another proposal would require all private sector firms with 10 or more employees that do not sponsor 401(k)s or other plans to automatically enroll their employees in IRAs.

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[9] Even the most optimistic numbers – households approaching retirement and including public plans and IRAs, showed median accumulations of less than $100,000. The median number for private sector workers of all ages in defined contribution plans, not including IRAs but including accounts from prior employment, was a fourth of that amount – $25,000. See http://www.pensionrights.org/policy/stats/401k_statistics.html

[10] See The Retirement Security Project, "The Automatic 401(k): Enhancing Retirement Security for American Workers," http://www.retirementsecurityproject.org/pubs/File/RSP-2pg-Auto401K_2.pdf and the McKinsey & Company report supra.

Although DB-ified 401(k)s and mandated payroll deduction IRAs **would certainly be helpful "life preservers" for many, too many other people would still sink into the sea.**[11]

The reality is 401(k)s and IRAs are neither efficient nor effective retirement savings vehicles for most workers. They are excellent tax shelters for those who can afford to take full advantage of them, and they can be helpful as an add-on to a pension. But they will continue to impose unrealistic levels of risk and responsibility on individuals, and will never be able to provide the **comprehensive, sufficient, and safe** supplement to Social Security that American workers need and deserve.

2. **In short, the current situation is unacceptable and we need something new for the future**. We need to work on different tracks. In the short term, we need to do everything possible to preserve DB plans, improve 401(k)s, and expand coverage for today's workers. But at the same time we need to also be working for a better system in the long-term for tomorrow's workers.

As I see it, it is up to us to do what the architects of ERISA did so successfully 35 years ago. They identified the problems of the private retirement system, they studied other models – they looked to the then-recently adopted Ontario private pension reform law – they then came up with possible solutions, and worked together to secure their enactment.

As many of you know, a start in rethinking our private retirement income system has already been made. As part of a new initiative called **Retirement USA**, our organization, along with the AFL-CIO, the Economic Policy Institute, the National Committee to Preserve Social Security and Medicare, and the Service Employees International Union, has developed 12 principles for a new retirement system to supplement Social Security. You have the principles, which are also supported by 19 other organizations, in the handouts.

The most important of these principles are that any new system should be universal, secure, and adequate – the U, S, and A in Retirement USA.

Another principle is that employers and employees should share responsibility for retirement security, with government subsidizing contributions for lower-income employees.

Some of the other principles come from traditional DB plans – money should be pooled and professionally invested, locked in until retirement age, and paid out over retirement. And some come from 401(k)s, such as portability and supplemental voluntary tax deferred savings.

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[11]Enhanced 401(k)s and payroll deduction IRAs would also not address the short-termism of our capital markets, which has been exacerbated by the perceived need by fund managers to maximize short-term performance in order to attract and retain 401(k) participants.

Retirement USA issued a call for proposals that reflect these principles, and six were presented at a conference in October on “Re-Envisioning Retirement Security.” You will be hearing about one from Mark, and there are others in the handouts. Summaries of all the proposals we received are on the Retirement USA web site, www-retirement-USA.org.[12]

But we are not the only ones looking for new solutions. You will be hearing from Mark about ERIC’s efforts. In addition, the Society of Actuaries Retirement 20/20 initiative has called for proposals that will be presented next year. The President’s Economic Recovery Advisory Board headed by Paul Volker is examining new solutions. Beth’s National Institute on Retirement Security has announced that it will also be exploring “Policy Solutions for Improving Retirement Security.” And the ERISA Advisory Council recommended last month that a presidential commission be established “to develop new structures for lifetime security.”

Since each of these groups, and hopefully others, will be coming up with very different solutions, conceivably one outcome of today’s discussion could be an agreement to convene a retirement security summit a year from today where we can all share our ideas, and possibly even move toward a consensus solution that would ultimately ensure that everyone would get a pension paycheck – a “predictable, secure benefit for life.”

[12] http://www.retirement-usa.org/about/re-envisioning-retirement-security/proposals-for-a-new-retirement-system/