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Retirement Policy

Innovative Defined Benefit Plans Could Be Key to Retirement Security, Speakers Say

Pension plans can play a key role in establishing retirement systems that reduce risk and provide lifetime income options for participants, speakers said Feb. 22 at a conference on innovative pension plan design.

"We all care deeply about where our nation's retirement system is headed," said Richard C. Shea, a partner at Covington & Burling in Washington, D.C. "It is a mistake to rely exclusively on defined contribution plans" for financial security in retirement, he said.

Covington & Burling, the Urban Institute, and the Pension Rights Center sponsored the conference, titled Re-Imagining Pensions: Using Innovative Pension Plan Design to Reduce Risk and Increase Retirement Income, aimed "at creative private-sector retirement solutions," said Karen D. Friedman, executive vice president and policy director at the Pension Rights Center in Washington.

A session on pension designs to share and reduce risk addressed four proposals: the Plain Old Pension Plan, the Adjustable Pension Plan, the Portfolio Cash Balance Plan, and Retirement Security Funds.

Other proposals were discussed during other sessions of the event (see related report in this issue).

Plain Old Pension Plan. The Plain Old Pension Plan, or POPP, is a "no-frills defined benefit plan" under which contributions would be made according to conservative actuarial assumptions, said Judith F. Mazo, recently retired from the Segal Co. and speaking on her own behalf. All benefits from the plan would be paid in the form of a qualified joint and survivor annuity, she said.

Other features of the POPP would include:

- flexible benefits based on company performance;
- simplified administration;
- coverage for all workers with at least 500 hours of service, excluding seasonal employees;
- past-service credits;
- permissible pretax employee contributions; and
- lower Pension Benefit Guaranty Corporation premiums than in traditional defined benefit plans. Mazo suggested that no PBGC involvement would be necessary if the plan "were funded and invested as conservatively as it might be."

"I think this would be an interesting way to reintroduce defined benefit plans," Mazo said. POPPs could be a "way to integrate a defined benefit concept into the more exotic ideas that have come along," she said.

Adjustable Pension Plan. Under another proposal, the Adjustable Pension Plan, or APP, risk would be shared by both the employee and the employer, said Richard Hudson, principal consulting actuary at Cheiron in New York.

"Traditionally, risk in any type of retirement plan is an all-or-nothing approach," Hudson said. "You either put the risk on the participant or you put the risk on the employer," and participants are unprepared to manage that risk, he said.

Like in a traditional defined benefit plan, employers would bear mortality risk by utilizing pooling, and the monies pooled would be managed professionally with no individual accounts, Hudson said. But unlike a traditional defined benefit plan, the risk of investment performance would be shared, he said.

It's a "variable annuity program with a floor defined benefit," Shea said.

Portfolio Cash Balance Plan. Like in the APP plan, the Portfolio Cash Balance Plan "shares risk among employer and employees," said Robert Newman, a partner at Covington & Burling in Washington.

The Portfolio Cash Balance Plan would be entirely employer-funded, he said. Other plan features would include:

- automatic employee enrollment;
- benefits expressed as individual account balances;
- annuities for employees and their surviving spouses; and
- subsidized benefits paid upon death, disability, or premature job loss.

"Longevity risk . . . is borne by the employer, which makes sense because the employer can average mortality among all participants and may be able to hedge against that with investments in the plan," Newman said.

"The individual doesn't bear the burden of allocating investments . . . and the individual can eliminate the risk of outliving one's savings," he said.

Retirement Security Funds. A fourth proposal discussed during the session was a Pension Rights Center plan called Retirement Security Funds, or RSFs.

"Our proposal would propose a new, voluntary, private retirement structure that would take all risks and all responsibilities away from employers for everything except making very modest contributions," said Karen W. Ferguson, director of the center.

RSFs are licensed, single-purpose retirement institutions that provide for risk-sharing by participants and incorporate a ''reverse-match'' benefit formula, Ferguson said. ''Financial institutions that are awarded RSF licenses would be required to commit to conservative investment practices and to meet capital and other requirements prescribed by the regulating agency,'' she said.

The idea for RSFs borrows from a concept in the Netherlands called collective defined contribution plans, under which all participating employees and retirees share risks, including investment risk, longevity risk, and interest rate risk, Ferguson said.

An RSF would operate similarly to a reverse tax code Section 401(k) plan, she said, in which ''employees match the contributions of their employers. Any employers choosing to participate in an RSF, or required by a collective bargaining agreement to participate in an RSF, would contribute a minimum of 3 percent of each employee's pay.''

Pension Regulation a Burden on Employers. Government speakers from the Treasury Department and PBGC in large part supported the proposals but cited concern about potential regulatory burdens employers may face in implementing pensions plans.

''I would invite us to all think together about the process for translating terrifically interesting ideas such as these into evidence, trying them out on an evidence-based methodological basis, so we can move things forward based on more than an intuitive sense of what's likely to work or get support," said J. Mark Iwry, deputy assistant secretary (tax policy) for retirement and health policy with the Treasury Department in Washington.

''I think this is just the right way to talk about the ideas, that you're not just focused on breaking down the barriers between [defined benefit plans] and [defined contribution plans], but breaking down risk and allocating resources," Iwry said.

Joshua Gotbaum, director of PBGC in Washington, said that overly burdensome regulatory ''hoops'' may make offering pensions less desirable to employers.

''The world of pensions has gotten to the point where it is sufficiently complicated that many companies don't want to deal with it at all,'' Gotbaum said. ''To advance this discussion, [Congress and Treasury] are going to have to offer more discretion and less prescription,'' he said.

Questions on Proposal Implementation. While panelists generally praised the proposals for pension-based retirement solutions, a number of questions arose regarding their implementation.

For instance, ''several plans refer to a conservative investment requirement. I don't know what that means'' in terms of who would set that standard and how it would be applied, said Mark J. Ugoretz, president and chief executive officer of the ERISA Industry Committee in Washington. ''Most of these plans are less simple than they appear to be,'' he said.

Damon A. Silvers, policy director and special counsel for the AFL-CIO, noted that all four proposals shift or share investment risk. However, he said, ''the key question these plans raise is . . . at what price? There's a price that makes sense, and there's a price where we're being gouged.''

In addition, companies that choose to offer some type of pension plan to their employees need some ''core assurance that the rules won't change from under them every four years,'' Mazo said.

By Stefanie Trilling

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