PENSION RIGHTS CENTER

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# IRS/ASPPA Mid-Atlantic Benefits Conference

Luncheon Address by
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Hello. I'm Karen Friedman from the Pension Rights Center -- the nation's only consumer rights organization working solely to promote and protect the pension rights of workers, retirees and their families. I want to thank ASPPA and the Internal Revenue Service for inviting me to speak today. I'm pleased to be here.

Given the recent developments in the pension system and the focus on these issues nationally, I think this is a great time to take stock of where we are and ask the big questions about the state of the retirement income system in this country, both today and for the future.

When I started to think about what I wanted to say today, I pondered about how to get a handle on all that's happening. We're hearing reports lately that the defined benefit system is on life support…Major companies are bailing out of the defined-benefit pension system…Traditional pensions are no longer viable in today's economy…Workers' expected benefits are being cut. And I thought, "This could be a very depressing speech."

But then I found inspiration in an unlikely place. The other night, I went to see the opening of MISSION IMPOSSIBLE III starring Tom Cruise. And I figured if Tom Cruise, in role of secret agent Ethan Hunt, can swing from skyscrapers in Shanghai, jump over high guarded walls at the Vatican, escape from exploding trucks, transform himself into different people, save imprisoned people from certain death and fight mano-a-mano against his evil nemesis, played by Philip Seymour Hoffman – all in a period of two hours -- then surely, we in this room, can save the pension system.

Of course there are challenges ahead, but if we work together and have vision, solving retirement income issues is not an impossible mission.

So, for a moment, I want you to picture yourselves in the movie, as I give you your assignment. "Hello actuaries, lawyers, pension professionals and government employees, your mission should you decide to accept it, is to work with me to save the pension system… This message will self-destruct in 15 seconds."

(By the way, I heard that Tom Cruise was on Oprah Winfrey jumping on a couch the other day screaming, "I love defined benefit plans! I love defined benefit plans!")

If I had to define the theme of my speech today I'd say it's about having vision. It's about examining the problems that face this country, looking for solutions, and staying optimistic that we can solve the nation's pension problems. All it takes is vision, cooperation from all sides of the issue, and determination.

In the Mission Impossible movies, Tom Cruise's character is a master of disguise, playing different roles in order to get the job done. Similarly I'll be wearing two hats today – first, as policy director of the Pension Rights Center, offering the Center's views of the pension issue and legislation as an advocate for consumers and employees. Second, I will speak in my other role, as the director of the Conversation on Coverage, an unprecedented public policy initiative that has brought together experts from different sides of the issue -- from business, labor, financial institutions, retiree, and professional groups – to develop common-ground approaches to expanding pension coverage.

I am proud to say that the ASPPA Pension Education and Research Foundation is a long-time sponsor, along with 14 other organizations. I will devote the last part of my speech to discussing the Conversation's recommendations.

So let's start with a question that has been on many people's minds these days: Is the defined benefit system going the way of the dinosaur? Should we buy into this prognosis of doom?

As Bob Dylan once crooned, "Yes, times they are a-changing." But this does not mean that we should simply shrug our shoulders and accept change without trying to direct the course that change is taking. Is our vision that we

are going to abandon the features of a pension system that has worked -- and still works for millions of Americans and many businesses?

Or is our vision that we can stare down the substantial challenges that face us, and find a way of keeping defined benefit plans? Can we at least find ways to keep the features of defined benefit plans that have been crucial to building a middle-class among retirees, ensuring that people can retire with adequate income and dignity?

Contrary to those who say, "The pension system is dying," there is an emerging consensus among stakeholders on all sides of the issue that there must be an effort to work together to save employer-based guaranteed plans. Experts across the spectrum know that defined benefit plans are critical to providing solid income to people when they retire.

From an employee's point of view, the most important features of these plans are that they are:

Employer-paid;
Professionally-managed;
Insured;
Paid out as a lifetime benefit so that people can retire with predictable income.
For employers, these plans are still good tools to attract and retain workers. I know everyone in this room cares about pensions, and we have to work together to figure out how to make the system work.

There's no question that we are facing huge challenges. Just as Congress is finishing a bill purporting to address underfunding in pension plans, the issue of the day is freezes.

Companies have frozen pension plans before, but what's new is that healthy companies, like Verizon and IBM, are freezing their plans – not just for new workers but for everybody.

As you can imagine, employees -- both those who are affected and those who fear they will be affected -- are angry, bewildered and upset. After Verizon froze its plan, the Pension Rights Center heard from more than 400 employees who told us their stories. Margo Bryerton of Syracuse, New York, who has worked for the company for 17 years, said, "We used to believe that the future of the company was our future. How can there be corporate loyalty when they

do this?" Another woman said that the announcement felt like "a kick in the stomach" and estimated she would lose $400,000 in expected benefits.

These people exemplify the American Dream and believe that Verizon and other companies are breaking long-standing pension promises to them. When they took these jobs, they were told that as long as they did their job, and met their end of the bargain, they would earn pensions based on all their years of work. In many cases, they were also promised that they could retire early on full subsidized early retirement benefits if they met specific requirements.

When companies change these plans midstream, the employees feel betrayed. Their dreams of an adequate retirement are shattered.

So why are companies freezing their pensions? What are employees saying in response? And what can we do to stop this trend?

There are a number of reasons for freezing pensions, which I've heard from the business community and that have been outlined in a study by Boston College's Center for Retirement Research:

(1) Companies say they need to reduce pension costs to compete both in the United States and internationally and most of their competitors offer only 401(k) plans;

(2) There is too much volatility in funding and companies need predictability;

(3) Companies don't need qualified defined benefit plans to provide for their own retirement – since they can put away a fortune into nonqualified executive plans -- and hence don't value defined benefit plans

(4) Companies think their employees don't value traditional pensions and like 401(k) plans better.

Also, businesses tell me the pending pension reform legislation, which will require more stringent funding rules, is likely to make even more companies sound the death knell for their plans.

And if the legislation doesn't do it, economists say that new FASB accounting rules could cause freezes -- if not outright terminations -- because these rules will not only increase the liabilities companies have to report to their shareholders, but could also wipe out profits.

So how do the employees respond to these arguments?

They say, “Sure, we understand the pressures of the global marketplace, but why should companies cut costs on our backs?” Employees look at these cuts as broken promises, and call them “pension pay cuts.” Older employees know the value of defined benefit plans, since many of them have stayed with their employer because of these secure retirement benefits.

Employees say, “Keep your pension promises to us and make changes for the future.” They question the fairness of CEOs taking away promised money to working people while continuing to give themselves astronomical pension and compensation packages (as recently profiled in New York Times and Wall Street Journal).

As an example, while freezing the pensions of its salaried employees, Verizon CEO Ivan Seidenberg was given a 48 percent pay increase last year. His total compensation was $19.4 million in salary, bonuses, stock and other benefits. Employees tell us, if companies want to cut pensions, then they should cut the pay of CEOs, too. This may not bring back their pensions but it’s only fair.

And let’s not forget the importance of pensions to the economy as one of the largest and most stable pools of investment capital. According to one estimate, public and private pension funds account for up to 35 percent of total global investment.(1)

In the U.S., the Federal Reserve reported more than eight trillion dollars in private and public pension assets by the end of September 2005(2) (four trillion in private pensions). Pension funds support long-term growth for businesses and the economy – particularly fueling venture capital investment.

We have too much invested, literally and figuratively, to throw the system overboard.

Some big employers, like Verizon and IBM, that have frozen their defined benefit plans, say, “But look! We’re offering these generous 401(k) matches instead! And these are better for our workers.”

Is this true?

These contributions might be better for younger, higher-paid employees that can afford to stash away the maximum over a period of years, but the numbers tell a different story for older employees.

According to a recent study by the Employee Benefit Research Institute, you would need whopping matches to even begin to make up the losses that older employees suffer in final pay plans. Companies would need to make at least eight percent contributions that earn an eight percent return, and even then, these optimistic conditions would not make up the losses for older employees. Furthermore, the study doesn't even calculate losses in subsidized early retirement benefits.

A study by the Center for Retirement Research at Boston College echoes those results, saying, "Mid-career employees have far more to lose from a pension freeze than their younger counterparts."

That's why there's a growing pension activist movement among employees and retirees who are protesting cut-backs in pensions. These are not your typical activists. I'm talking about Izod-shirt/green-pants-wearing, white-collar employees. Many of these folks were former executives who once happily considered themselves company men and women, and they're mad as heck.

There are groups like the National Legislative Retirees Network and the Coalition for Retirement Security, who bring together hundreds of thousands of employees and retirees who have all faced pension and retiree health injustices (from such companies as IBM, USWest, BelTel Retirees, Lucent, Duke Energy).

There are the flight attendants who were upset about losses in United and put out a provocative calendar called "STEWARDESSES STRIPPED -- OF THEIR PENSIONS" (I'd pass out copies, but I'm afraid that once you see the pictures, you'd lose interest in me). There are Verizon employees, who are organizing on a web site, verizonretirementwatch.com.

And just recently a 60-year-old United pilot started a new group called the Pension Preservation Network, to organize against broken pension promises.

To paraphrase John Lennon, "All they are saying is, 'Give pensions a chance.' " Let's keep promises to workers and let's shape a system that makes sense. If white-collar employees are losing faith in the companies they so loyally served, then where are we?

Again, we need vision. If companies continue to freeze their plans, they may get a boost in corporate profit today -- in the short-run -- but what are the long-term consequences?

The essential question is, if these plans continue going south, will employees and retiree have adequate income?

We need ways of keeping companies in the system – and on that I'd love to hear your ideas.

There are efforts afoot (such as those produced by the Conversation on Coverage) to create leaner, more predictable forms of defined benefit plans and also new kinds of hybrid plans that combine the best of defined benefit plans and 401(k) plans.

Can we design tax credits to favor employers that provide guaranteed benefits?

While certainly some companies are freezing, let's also keep in mind there are still numerous corporations that have plans. A recent Watson Wyatt study shows that 37 percent of Fortune 100 still offer defined benefit plans to new hires. This is down from a few years ago, but hopefully companies will stay in the pension game. And there are other signs that all is not lost:

Not many people know that, after USAirways and United terminated their single-employer plans, they joined the machinists union's multiemployer plan for certain workers. Also, in a recent issue of Workforce Management magazine, there was a story on Aerospace Corp. and how it reinstituted its pension plan, recognizing that providing good benefits attracts skilled workers.

There's no question that we need to educate society -- from the corporate boardroom on down -- about the importance of pensions to workers, employers and the economy. We need employees to fight for these plans and to tell employers why they're important.

As long as freezes are looked at as ways of increasing corporate income, then companies will feel obligated to shareholders to keep doing them. This is short-term corporate policy with long-term negative impact. We need to turn conventional wisdom on its head and instead assert that companies with good pensions can be competitive.

Without guaranteed benefits, we are moving more and more towards a do-it-yourself savings society. Certainly 401(k) plans are a good supplemental savings tool that should be encouraged. However, the evidence is mounting that these plans alone may not be able to accumulate sufficient savings for the majority of Americans.

According to the Survey of Consumer Finances, half of all households have less than $35,000 in their defined contribution accounts.(3) And if you look at individual savings, the Congressional Research Service reports that the median account balance is even less -- $15,000 for younger workers and about $23,000 for those between 45 and 65. Hardly enough for adequacy.

A spokesperson for the National Association of Manufacturers, quoted in the CQ Researcher, said, "There has to be some sort of replacement for the assets that defined-benefit plans pay people… I'm not saying defined contribution plans are bad, but trends show that people are just not amassing the large amounts of wealth people figured they would when they put these plans in."

Of course, efforts to increase participation through automatic enrollment and automatic escalation of contributions are good steps to increasing savings. In fact, provisions to encourage these features are included with bipartisan support in the pension reform bill currently moving in Congress. There are studies that show that if employees have to opt out, instead of opt in, participation will increase, and providing employer matches are good inducements. Certainly making the Savers Credit refundable and adjusted for inflation would also encourage savings.

But even with these incentives, we need to ask whether individual savings alone will lead to adequate income.

To put this into perspective, the median wage for employees is $40,000 per year and for women, it's only $31,000 (and this is for full-time workers, so it is the most optimistic statistics).

Even with encouragements to save, the fact is individuals have only one pot of money to use toward a variety of critical needs. With health care and education costs soaring, and more and workers having to work one than job just to make ends meet, there's a question of whether typical families will be able to accumulate enough money in their 401(k)s. And, even if they do, will that money stay in the accounts if it is needed for other purposes?

There was a story in a recent Parade magazine, called, "Is the American Dream still possible?" The story quoted a man who did everything right -- worked in the beer industry for 23 years, saved in his 401(k) -- but when he was hit with a major health crisis, he couldn't return to work, and he had to use his 401(k) money to meet his living expenses well before retirement. He said, "This is stressful, everything has gone up – except wages."

That's why more and more experts say that we need to keep plans with employer contributions, that have guarantees plans and that lock in the money.

Congress is reportedly working on shoring up the defined benefit system but Reuters reported that Senator Trent Lott, in reference to the pension reform legislation, said that companies should fund up their plans and pay off their obligations, so that they can switch to a 401(k). I'd just like to note that Trent Lott can expect to receive a little over $3 million from his indexed federal defined benefit pension.

And some of you may have seen the recent news reports about the Department of Energy announcement that it will not longer reimburse contractors for the expenses associated with traditional pensions. Instead it will reimburse only for the cost of 401(k)s and similar plans. This move covers contractors employing about 100,000 workers on DOE's behalf.

Syl Shieber of Watson Wyatt reacted to this news by saying, "The fact that a government agency is forcing private employers to provide only do-it-yourself 401(k)-style plans is outrageous. For decades, public policy has supported the notion that the best way to ensure American's retirement security is through guaranteed pensions."

The current pension reform bill is also a very mixed bag. Certainly, we believe that pension plans should be sufficiently funded to ensure that employees' pensions are paid in full. But we, along with many businesses and unions, are concerned that, in trying to decrease what may be only temporary funding shortfalls, the bill could penalize the very companies that are trying to do right by their employees.

We also take issue with benefit freezes that are triggered by arbitrary funding levels – if companies are able to meet their funding obligations.

I should note that the Center has focused most of our attention on the bill on issues unrelated to funding, and I'd like to take a few minutes to discuss the provisions that we are most concerned about.

As you know, over the years we've heard from thousands of older employees who lost 50 percent of their expected benefits in cash balance conversions. With the recognition that hybrid plans are the wave of the future, we support the Senate provisions on such conversions. We think the Senate strikes the right balance by legalizing cash balance plans in exchange for providing transition protections to older employees in those conversions and eliminating the most egregious forms of wearaway.

These Senate provisions, which are patterned after Treasury Department proposals, are a fair compromise to address this issue.

We also oppose provisions in the House bill that would allow certain underfunded multiemployer plans to eliminate already-earned subsidized early retirement benefits, affecting hundreds of thousands of rank-and-file workers. These rollback provisions would create a dangerous precedent.

We also oppose House provisions that allow for conflicted investment advice and others that would eliminate fiduciary protections under ERISA that guard against conflicts of interest between pension plan service providers and trustees

Such provisions do not belong in a so-called pension protection bill.

As far as promoting new defined benefit plans, the bill includes a proposal for a new kind of hybrid called a DB-K, which combines features of defined benefit plans and 401(k)s. This proposal is similar in some ways to a proposal developed by the Conversation on Coverage, which leads me back to the Conversation.

At a time when there are so many divisions in this country, and people seem to bickering about everything, this initiative, now in its fifth year, has been an oasis of civil discourse that has been aimed at developing common ground, common sense proposals to expand coverage for low- and moderate-wage earners.

The Conversation on Coverage has been praised by policymakers on both sides of the aisle. It has been called "relevant to every community in America," by

Senate Finance Committee Chairman Charles Grassley and been called "extraordinary" by Congressman Earl Pomeroy.

The Conversation has a wide range of impressive supporting organizations. The sponsors are AARP, the Employee Benefit Research Institute, MetLife, Nationwide, and the Retirement Security Project. Co-sponsors are the American Academy of Actuaries, American Benefits Institute, American Benefits Institute, American Council of Life Insurers, AFL-CIO, Capital Research and Management Company, Fidelity Investments, International Association of Machinists and Aerospace Workers, National Committee to Preserve Social Security and Medicare, Prudential Financial and the U.S. Chamber of Commerce.

The Conversation was first launched with a grant from the Ford Foundation in 2001 at a two-day conference bringing together folks of all different backgrounds to figure out how to increase coverage rates, which have stalled at about 50 percent in the private sector for two decades.

The Center started the Conversation because we knew this was a huge issue and we couldn't do it alone. We needed a lot of great thinkers to figure out answers. The first event produced numerous promising concepts and also established a strong sense of camaraderie among participants.

The success of the first event led to the launch of the second stage of the Conversation in 2003, which brought together 45 experts of varying perspectives in three Working Groups. The Working Group participants gave hundreds of hours of volunteer time collectively to hammer out specific common-ground proposals.

The interim recommendations of the Conversation on Coverage were released at a national policy forum in 2004, and published in a working report called, "Covering the Uncovered." You can read these recommendations at www.pensioncoverage.net, and I have brought copies of the report with me.

What makes the Conversation on Coverage unique -- and I would even say magical -- is that, during this process, the participants have taken off their advocacy hats, transcended personal ideologies, participated with passion and focus and refused to take no for an answer. They focus on where they agree, not disagree. They participate as individuals – not representatives of organizations, with the Pension Rights Center acting as a neutral facilitator.

The Working Groups have focused on creating good, not perfect, proposals -- those that have the buy-in of the range of stakeholders in the private system and hold the promise of increasing coverage, particularly among low-and moderate-wage earners.

And here, I'd like to give you a brief summary of interim recommendations. The Working Groups are working now to refine their final proposals, which should be released in early 2007.

Working Group I is looking at new designs and new models for the delivery of guaranteed benefits. It has come up with two proposals:

The first proposal is the GAP, or the Guaranteed Account Plan -- a money-purchase-type plan with a guaranteed account balance with the potential for a 401(k) feature. It is a hybrid plan with both defined benefit and defined contribution features. In this plan:

The employer credits the account of each participant with an annual contribution.
Benefits are funded by the employer, based on standardized and conservative funding assumptions.
Employees can also elect to contribute on a pre-tax basis.
The plan includes a generous past service credit
The employer guarantees the annual rate of return on the assets in participant accounts.
The employer invests the plan assets.
The plan offers an annuity as pay-out option or it can be offered as a lump sum.
The attractiveness of GAP is that it provides a type of minimal guaranteed benefit, resembling a cash balance plan, but, because it is in a money purchase framework, it avoids the legal issues. Because of its structure, the contributions and funding are more predictable, and we hope it will be marketable to small businesses that now don't have a plan.

The second proposal from Working Group I is the POPP plan, or the Plain Old Pension plan -- a simple traditional defined benefit plan with modest basic benefits to allay employer concerns about funding the plan. The features of POPP include:

The final basic benefit is based on a percentage as low as one percent, of an employee's career average multiplied by years of service.

The employer may give a bonus benefit to employees without committing to a permanent benefit increase.
Contributions will be made under conservative actuarial assumptions using government-authorized tables. This would simplify administration and reduce funding volatility.
All benefits are paid out in annuity form.
Again, this plan offers a kind of stripped down defined benefit plan that still offers a guaranteed benefit but has predictable funding.

We hope these plans are attractive to small businesses – and we look forward to seeing if they can be marketed by some of you.

Working Group II has two missions. It first looked at ways of getting more individuals to save in already-existing 401(k) plans. In this respect, the Group generally endorsed the concepts of automatic enrollment, automatic escalation of contributions, and expansion of the Saver's Credit. But as its larger mission, the Group developed a structural blueprint for a new government clearinghouse for individual savings in addition to Social Security. These savings accounts are called Retirement Investment Accounts, or RIAs. RIAs are meant to create an efficient mechanism to get people who now aren't covered in either a savings or pension plan to put money aside for retirement. The idea is that everyone not covered by another kind of plan could open a Retirement Investment Account.

The features of the RIA include:

Investment accounts would be managed by a central clearinghouse that could be run by the private sector.
Contributions can be made through payroll deduction. The system could potentially receive contributions from employers.
The individual will indicate contributions on W-4 forms and these would be forwarded to the clearinghouse – maybe through Treasury, maybe not.
There would be simplified investments, probably chosen by the clearinghouse.
To ensure that RIAs are not competing with employer-based system, the contribution limits would likely be lower than 401(k)s and higher than IRAs.
Working Group III is designing a framework for a new kind of multiple-employer plan, called the Model T plan. It would be administered by financial institutions and marketed to small businesses in one particular region.

Working Group III started with the notion that coverage rates are lowest in the small-business sector. They tried to design a plan that addresses some of the

reasons small employers don't have plans: administrative hassles and costs, fiduciary issues and simplicity.

The Model T has as its building blocks:

It is a multiple-employer plan.
Any regulated financial institution could be authorized to offer a simplified plan to groups of employers.
There would be simplified investment options – and a default option for ease and simplicity.
Employers could automatically enroll workers.
The plan administered by third-party provider.
There would be discretionary contributions by employers with incentives for employers to contribute.
A key component of the Model T from the start is a community-based marketing model. Once details are complete, the Group wants to launch it in a particular community – say Milwaukee or Peoria. The idea would be for a financial institution to offer it and then it could be marketed to Joe's Pizza Parlor, or Moe's Bowling Alley – as a kind of community-based pension plan, gaining the endorsement of city and state legislators, local businesses and employees.

All of these ideas can be found on www.conversationoncoverage.org.

I wanted to end on the Conversation because, as I said earlier, these proposals are all innovative and, because of the buy-in from such a range of stakeholders, they hold promise for implementation.

These ideas will be out in final form in 2007 and we welcome your input. The Conversation is a model that has worked and I hope we can use this kind of practical dialogue to address other issues.

Finally, I'd like to tell you that the Center provides technical assistance to the Administration on Aging's six regional Pension Counseling and Information Projects that help individuals with pension problems in 25 states. I thought, since this speech is in Philly, you'd like to know that the Pennsylvania Pension Rights Project provides personalized pension counseling to people who need assistance in this state. This Project operates out of the Senior Law Center. It can be reached at (877) 727-7529 or (215) 988-1244. This is a great program I just wanted to let you know about. For more information about all of the Projects, please see our website at www.pensionrights.org

So, I want to end as I began.

In the same way that secret agent Ethan Hunt knows he has to stand up for what he believes, no matter what the odds, so do we have to fight for what we know is right, so that people will have decent retirement.

Ladies and gentlemen, this is a Mission Possible.

Thank you.

Footnotes

(1)"United Nations Secretary-General Launches "Principles for Responsible Investment" Backed by World's Largest Investors, United Nations press release, April 27, 2006.

(2) Board of Governors of the Federal Reserve System Flow of Funds Accounts of the United State, March 9, 2006.

(3)"Recent changes in U.S. Family Finances: Evidence from the 2001 and 2004 Survey of Consumer Finances," Brian K. Bucks, Arthur B. Kennickell, and Kevin B. Moore, Federal Reserve Bulletin, vol. 92 (February 2006), pp. A1-A38.