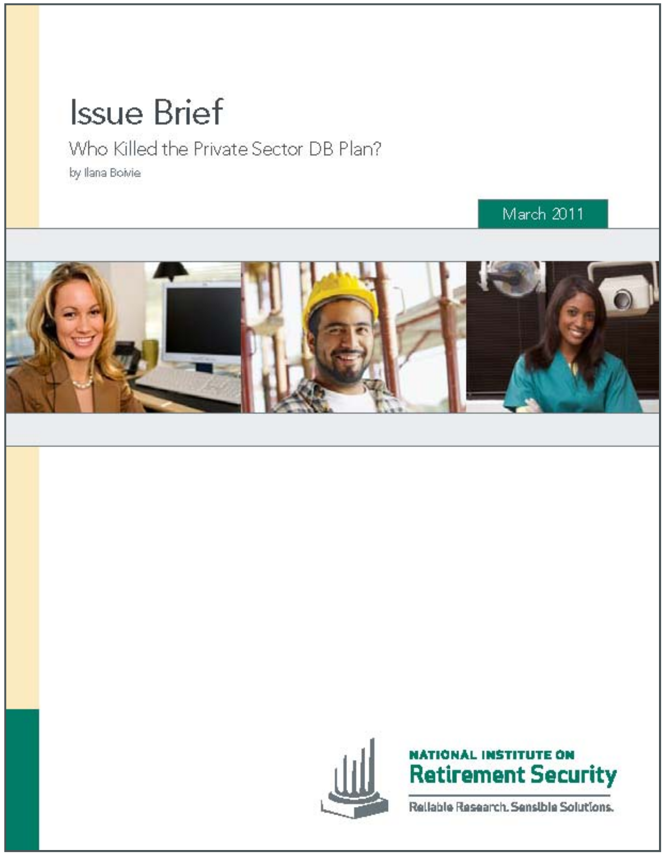
Who Killed the Private Sector DB Plan?



Why We Did This Study

- Pensions have many positive attributes, *especially* in current economic environment.
- Many people are unaware of positive aspects—for employers and employees.
- **Misperception** that pensions are “expensive dinosaurs,” especially in private sector.

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Why We Did This Study

- **Confronts the question**: “If pensions are so great, why is the private sector trending away?”
- Much attention paid to *this* fact, but….
- Substantially less attention paid to the actual reasons behind the trend.

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Key Findings

- Traditional DB pension plans still make sense:
  - **For employees:** Better ensure retirement security
  - **For employers:** Cost-efficient and effective recruitment and retention tool
- Yet employers have been closing DB plans since 1980s.
- This is due to several factors…

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Key Findings

- Employers closing plans due to:
  - Increased regulation
  - Industry changes
  - Poor knowledge of employee preferences for DBs

- Employers NOT closing plans due to the inherent cost of providing DB benefits – it's the ***volatility***.

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Key Findings

- Because DB plans still make sense for employees and employers…

- It is possible to bring back pension coverage to the private sector through:
  - Third party DB sponsorship
  - Amending regulations to decrease funding volatility
  - Incorporating employee contributions

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Traditional DBs Still Make Sense for Employees

- DBs are the best way for most Americans to stay middle class in retirement.
  - See *Retirement Readiness: What Difference Does a Pension Make?* (NIRS 2008)

- Americans with DBs more likely to be self-sufficient, less likely to need public assistance.
  - See *The Pension Factor: Assessing the Role of DB Plans in Reducing Elder Hardships* (NIRS 2009)

Pensions Are an Effective Recruitment and Retention Tool

- DB pensions remain important recruitment and retention tool for employers
  - Employees with DBs are 17% more likely to stay at their jobs in a single year (Allen et al.)
  - Among very large firms, quit rates were 40% lower among firms with pension coverage than at non-pension firms
  - Among very small firms, quit rates are 10% lower at firms with pension coverage (Even and MacPherson)

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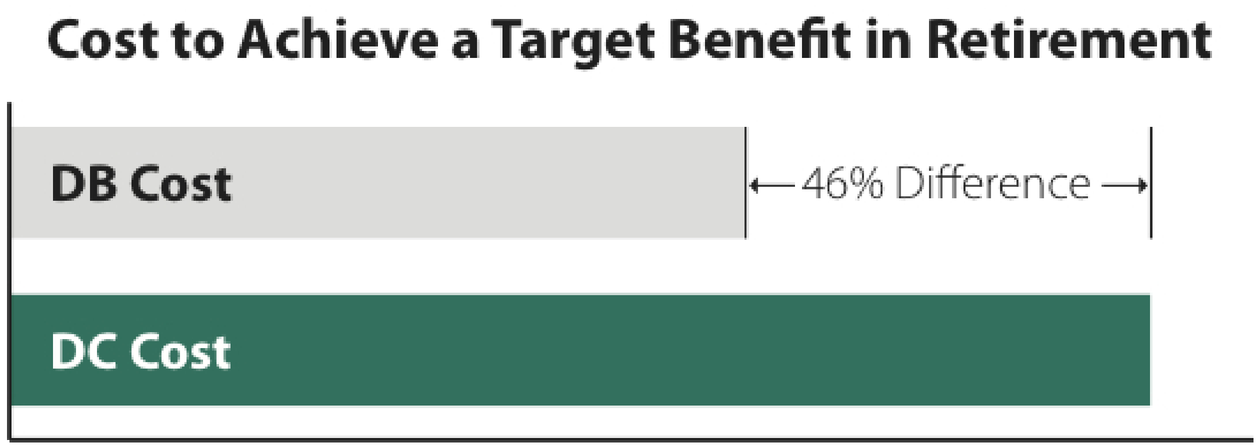
Pensions Cost-Effective for Employers

DB plans remain the most economical way to fund retirement.



> "The [DB] plan is an efficient vehicle in the delivery of retirement benefits."
>
> *–Hewitt survey of DB plan sponsors*

Source: A Better Bang for the Buck (NIRS 2008)

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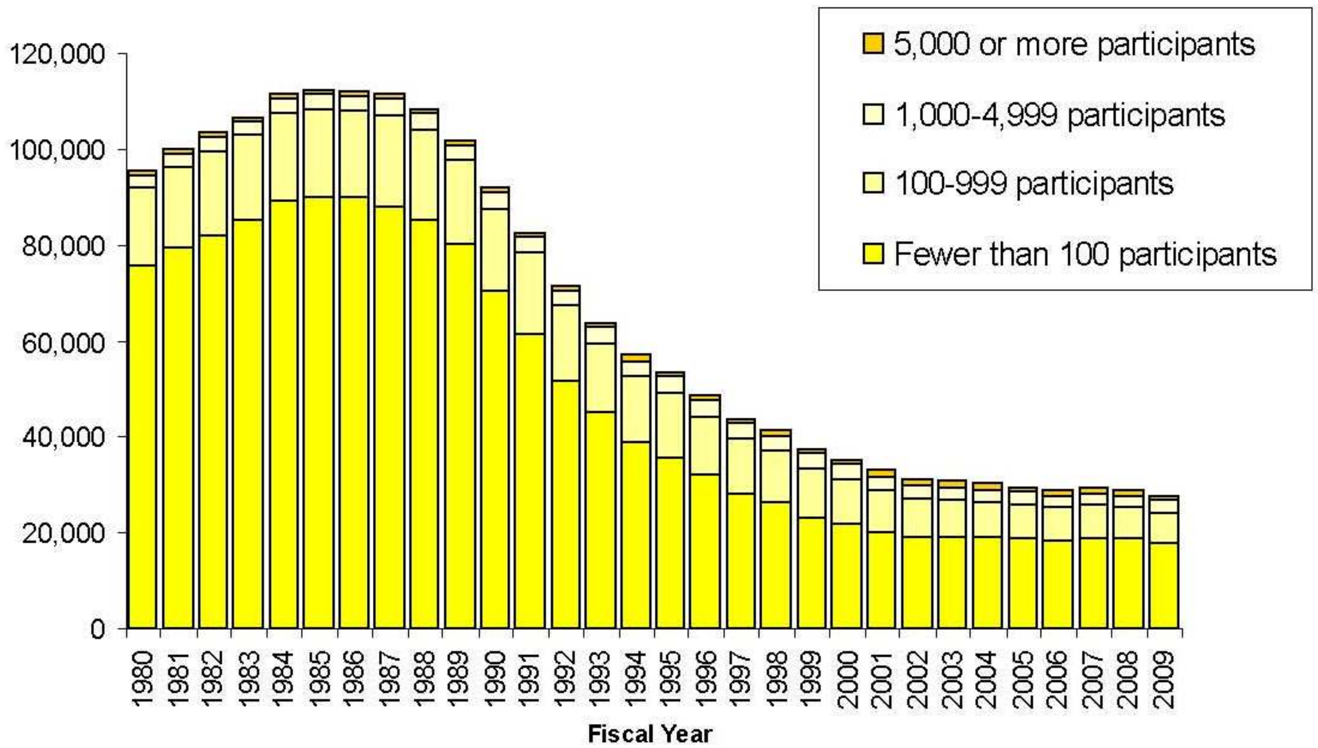
Yet, Companies Continue Freezing Plans

Figure 1. PBGC Insured Plans, Single Employer Program, 1980-2008



Source: Pension Benefit Guaranty Corporation. 2010. *PBGC Databook*

Regulatory Changes Led to Increase in Freezes

- Legislative and regulatory changes enacted since the 1970s increasingly complex, and increased regulatory burden of plan sponsors. (Clark & McDermed)
- Complicated funding rules, accounting rules, and operational requirements resulted.
- Employers prefer to have steady, easily estimable costs from year to year. (Hustead)

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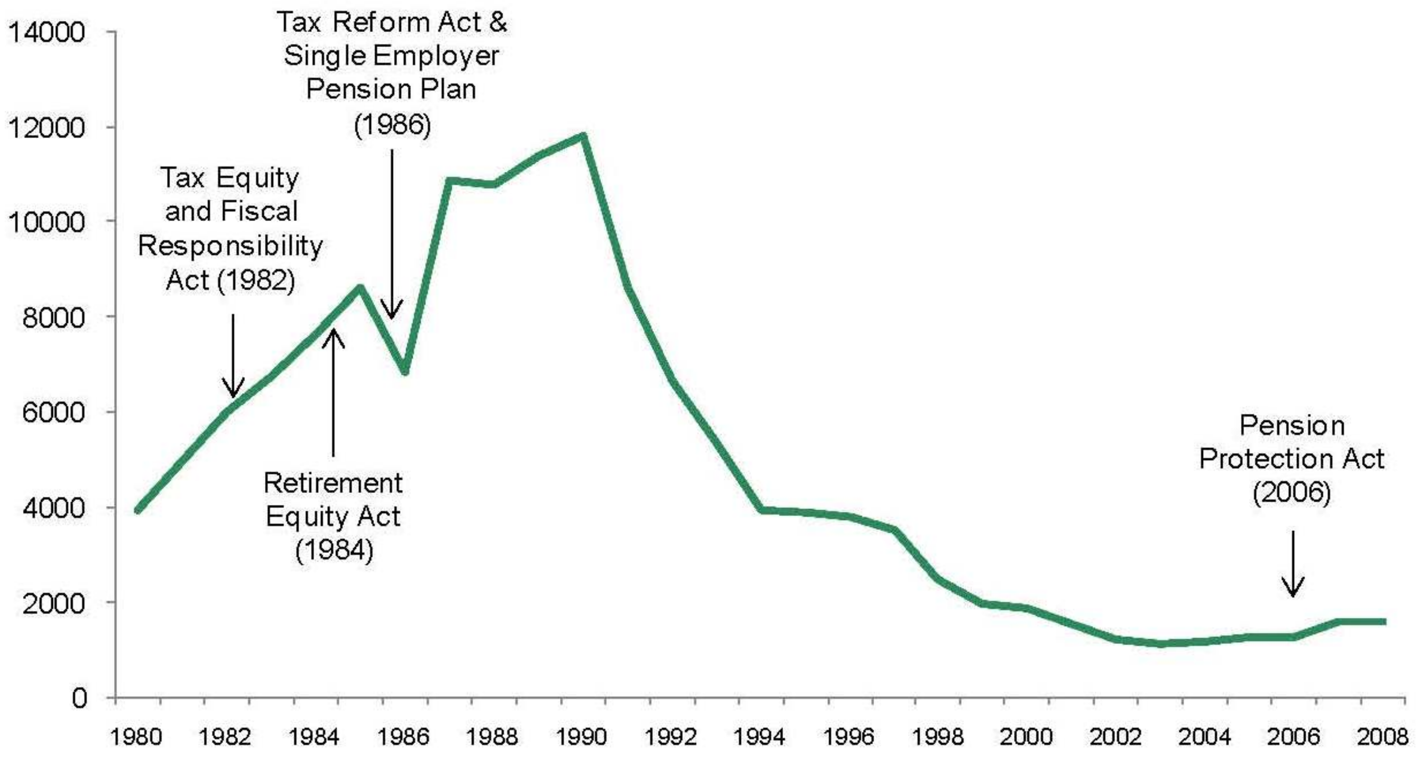
Regulatory Changes Led to Increase in Freezes

Figure 2. PBGC Standard Single Employer Terminations, 1980-2009



Source: Pension Benefit Guaranty Corporation. 2010. *PBGC Databook 2009*. Washington, DC: PBGC. and Pension Benefit Guaranty Corporation. 2001. *PBGC Databook 2001*. Washington, DC: PBGC.

Regulatory Changes Led to Increase in Freezes

- 2006 Pension Protection Act (PPA) increased volatility of pension funding, decreased predictability of contributions. (CRR)
- In 2004, 4% of Fortune 1000 plan sponsors had frozen DB plans; by 2009, 31% percent were frozen. (Watson Wyatt)
- 26% of plan sponsors would consider forming a new DB plan if funding requirements had more predictability and less volatility. (GAO)

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Cost, Cash Flow, Contributions

- **Cost:** Firms NOT closing plans due to inherent cost of DB benefits.
- **Cash Flow:** Many firms cite contributions' affect on cash flow as impediment to sponsorship.
- **Contributions**: As firms have frozen their DBs, contributed less to the new DC plans. (Ghilarducci and Wei)

> "Whatever the arguments about the merits of the new wave of [DC plans], if you put less money in, you will get less money out."
>
> –*The Economist*

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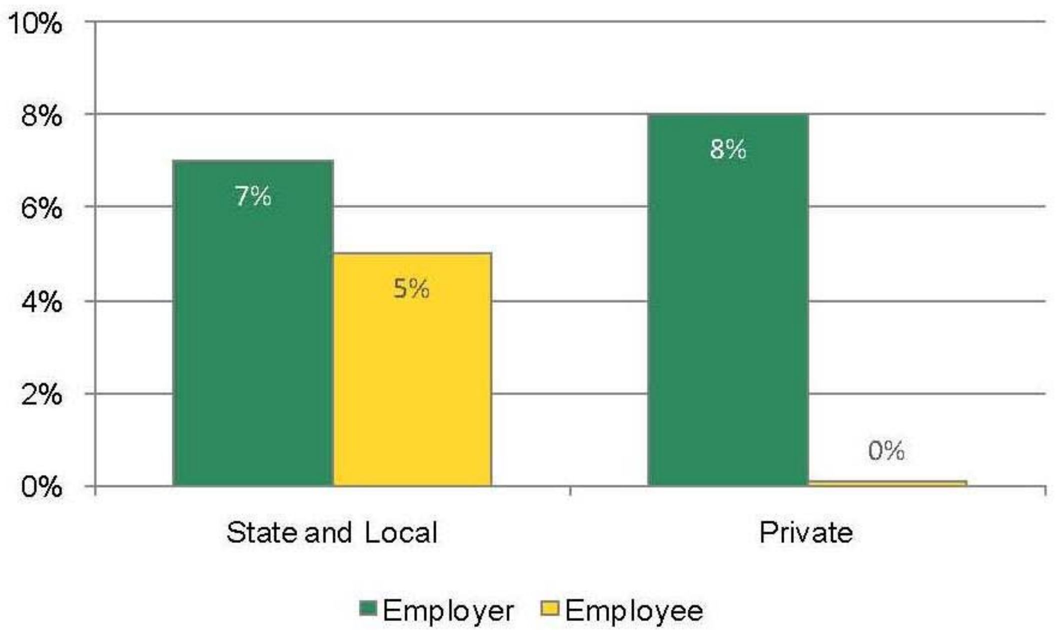
Cost, Cash Flow, Contributions

Contributions may be more manageable in the public sector, due to employee contributions (CRR)

Figure 3. Employer and Employee Contributions as a Percentage of Payroll, by Sector, 2006



Industry Changes Also Impact

- Industry shifts and technological changes have also contributed to the decline in DB coverage.

- Example: Manufacturing has declined…
  – Highly unionized
  – Many long-tenured employees
- While IT has emerged….
  – Much less unionized
  – Shorter tenured employees

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Employers May Not Understand Employee Preferences for DBs

- Employees value DB plans quite highly, but employers may underestimate preference
- Ex: A 2008 MetLife survey found that:
  - 72% of employees cited retirement benefits as an important factor in loyalty to the company.
  - Just 41% of employers agreed with this sentiment.
  - Employers may not see a significant HR reason to continue to offer a DB benefit, especially in light of the increasing regulations.

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Public Sector DBs Endure

Reasons for private sector decline not relevant to the public sector…

1. Not subject to private sector regulations.
2. Industry changes in the private sector have limited bearing on public sector employment.
3. Public employees known to value pension plans highly, and willing to give up higher wages to keep pension coverage. (Ippolito)

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Several Solutions to Bring DBs Back to the Private Sector

Because DB plans still make sense, several solutions exist to bring back coverage to the private sector:

- Third party DB sponsorship
- Amend regulations to decrease funding volatility
- Incorporate employee contributions

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Third-Party Sponsorship

- Third party sponsorship can provide employees a DB benefit while reducing employer's responsibility.
- Models include:
  - Multi-employer plans in private sector
  - Pooled municipal plans in public sector
  - The ERISA Industry Committee's New Benefits Platform for Lifetime Security

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Amend Regulations

- Plan funding volatility could decrease by easing Federal regulations.
- Smoothing asset values over 20 years could result in lower contributions, less volatility, and higher funding levels. (Weller and Baker)
- The Pension Relief Act of 2010 gave sponsors more time to fill funding gaps—but only a stop-gap measure.
- The law shows certain PPA requirements did not meet first real-world test.

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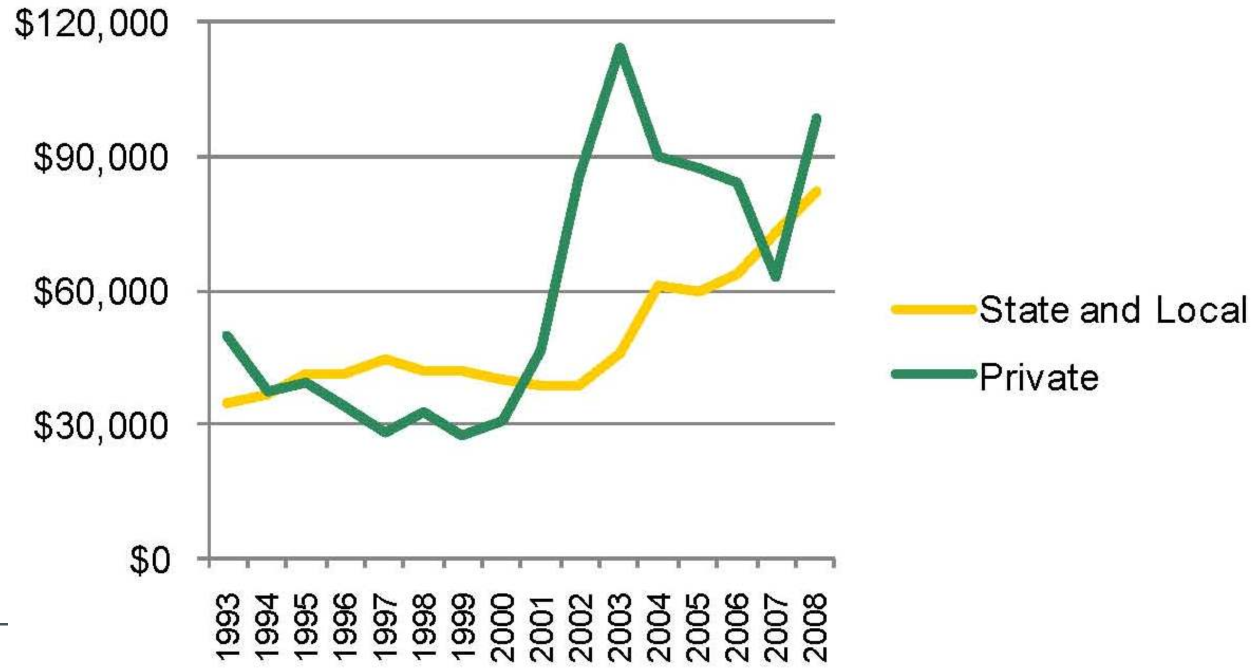
Include Employee Contributions

Contributions much more volatile in the private sector, largely because noncontributory. (CRR)

Figure 4. Employer Contributions to Defined Benefit Plans, By Sector, Billions, 1993-2008



Conclusion: 3 Take Aways

- Pensions still make sense for employees and employers alike.
- Yet the private sector has been trending out of DB plans largely due to funding volatility, regulatory burdens.
- Several solutions exist to bring back DBs to private sector – but takes leadership, action.

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Conclusion: Americans Need Pensions

- Americans agree:
  - 86% believe the U.S. retirement system is under stress and needs reform
  - 83% believe that the government should make it easier for employers to offer pension plans.

  Source: *Pensions and Retirement Security: A Roadmap for Policymakers, 2011.* (Forthcoming from NIRS)
- Policymakers should look to all available options to bring DB plans to more Americans.

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