POLICY IDEAS FOR BOOSTING DEFINED BENEFIT PENSIONS IN THE PRIVATE SECTOR

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EXECUTIVE SUMMARY

The prospect of retirement security seems more precarious today than in at least a generation. While access to an employer-provided retirement savings plan has increased, access levels still fall far short of including all working people.[1] Meanwhile, typical amounts saved for retirement are too low for many workers to maintain their pre-retirement standard of living.

The decline in the availability of defined benefit (DB) pension plans in the private sector has contributed to the sense of retirement unease among middle-class workers. The guaranteed income from a pension plan provides reliability in retirement and makes planning for retirement easier because there is no risk of outliving savings. Moreover, preparing for retirement is less burdensome because pension plans make decisions for their participants and generate retirement income in a more economically efficient manner.

Congress has expressed an interest in learning what the federal government can do to make it easier for private-sector employers, who wish to do so, to offer pension plans. This issue brief proposes six policy options for Congress to consider:

- Lowering the per-person rate of Pension Benefit Guaranty Corporation (PBGC) premiums for single-employer plans.
- Reducing the variable rate PBGC premium.
- Formally acknowledging risk-sharing plans in statute.
- Permitting greater flexibility in the use of funding surpluses in DB plans.
- Allowing pre-tax employee contributions in private-sector DB plans similar to state and local public pension plans.
- Formally acknowledging in statute that retirement benefits should be fungible for each individual and that transfers from defined contribution (DC) plans to DB plans and conversely in the vein of Revenue Ruling 2012-4 should be allowed.

INTRODUCTION

The retirement savings crisis in the United States is no longer looming: it is here, now. The U.S. Senate Health, Education, Labor, and Pensions (HELP) Committee acknowledged as much with its report and hearing on the retirement savings crisis in February 2024. The committee rightly recognized that it's not enough just to acknowledge the crisis; policymakers also should take action and implement solutions to solve the crisis. Regardless of the weight given to various policy concerns, whether it be reducing elder poverty or maintaining manageable costs for safety net programs as America's demographics grow older, the overarching need is the same: the U.S. needs workers to accrue more resources outside of Social Security so they can be self-sufficient and financially secure in retirement.

This issue brief is a response to the request for information issued by the HELP Committee. Policy discussions relating to employer-sponsored retirement plans often focus on two areas: modifying policies for defined contribution (DC) plans, typically to increase access to those plans, or managing unintended consequences in defined benefit (DB) pension plan policies. It is less common to discuss what DB plans could look like to be more attractive to employers and to reframe thinking about pensions more broadly.

Expanding access to any retirement benefit also must include a focus on small employers, where access to a retirement plan is low. The barriers for small businesses to offer a plan are plentiful, but simplicity could address many of the issues.

Expanding access to pensions also must consider where problems arose in the past and offer ideas that address those challenges. For DC plans, a major challenge has been the lack of retirement income generated by those plans; for DB plans, an ongoing challenge has been risk management for employers. There have been efforts in both the DC and the DB industries to produce better outcomes. The DC industry is working to solve post-retirement challenges with in-plan spend-down options that will be more efficient and effective, if retirees choose these options and utilize the tools that are available. And the DB industry has provided an array of innovative benefit designs including cash balance account-based formulas and variable annuity formulas to address financial risk to employers.

Expanding access to DB pensions should focus on plan design so that they meet the primary goals of retirement plans: broad participation, shared financing, targeted income replacement, pooled investment and longevity risks, and lifetime benefit payouts. Any workable solutions must address two key issues: 1) they must provide an avenue for retirement adequacy for the large majority of Americans without regard to their demographic profile or their income while working, and 2) they need to be both financially and administratively affordable and sustainable for employers to offer these programs that provide for retirement income adequacy. In order to promote these goals, Congress should consider:

- Lowering the per-person rate of Pension Benefit Guaranty Corporation (PBGC) premiums for single-employer plans.
- Reducing the variable rate PBGC premium.
- Formally acknowledging risk-sharing plans in statute.
- Permitting greater flexibility in the use of funding surpluses in DB plans.
- Allowing pre-tax employee contributions in private-sector DB plans similar to state and local public pension plans.
- Formally acknowledging in statute that retirement benefits should be fungible for each individual and that transfers from defined DC plans to DB plans and conversely in the vein of Revenue Ruling 2012-4 should be allowed.

These policy changes would create a more favorable environment for private-sector employers to offer DB pension plans to their employees. This would promote retirement security for workers while helping address employee recruitment and retention issues in a tight labor market.

WHY POLICYMAKERS SHOULD VALUE THE ROLE OF DB PLANS

DB pensions remain a vital part of the retirement equation for many working and retired Americans today. Pension plans are alive and well in the public sector, where most state and local government employees still have access to a pension. While pension plan access in the private sector went from 20 percent of the workforce in 2010 to 15 percent in 2023, many working Americans still participate in pension plans. Nevertheless, it is true that overall participation in DB pension plans has declined markedly over the past four decades.

Employers have many reasons to consider offering pensions to employees today. First, workers like pensions. Recent public opinion research from the National Institute on Retirement Security (NIRS) found more than three-fourths of Americans have a favorable view of pensions and 83 percent say that all workers should have access to a pension to be self-reliant in retirement.[2] Also, 77 percent of Americans indicated that workers with pensions are more likely to have a secure retirement while more than three-fourths of Americans agree that the disappearance of pensions has made it harder to achieve the American Dream. The research also found that American workers believe that pensions help with recruitment and retention of workers. The vast majority of workers (87 percent) without a pension say they'd be more likely to stay at their company longer, even if another job opportunity came along, if their current employer provided a pension. And more than half (57 percent) of workers said they are more likely to choose the job that offers a pension. This sentiment is backed up by the experiences of public-sector employers that have seen higher turnover since closing or changing their pension plans.[3]

Second, employers themselves have good reasons to offer pensions. Defined benefit plans are more economically efficient than defined contribution plans and can provide a given level of retirement benefit at half the cost of a typical DC plan.[4] JP Morgan Asset Management found compelling business reasons for employers to reconsider pensions.[5] Many large corporate pension plans currently have "trapped" surpluses as a result of recent favorable asset performance and rising interest rates. Many of those companies realize it would be a beneficial use of that surplus to reopen the plan, but they are concerned about both the administrative burden and financial volatility of most contemporary private-sector DB plan designs. However, reopening the plan could be a win-win for both employees, who would have a certain level of income protection as well as the ability to invest their 401(k) balance more freely, and for employers, who could make an efficient use of their surplus.

The value of pensions for employees and employers is significant, but these plans offer societal benefits as well. Many workers struggle to save adequately on their own for retirement. A recent report from NIRS found that the median amount saved in private retirement accounts for Generation X – a generation fast approaching retirement – was a dismal $40,000 for the typical household.[6] Among Americans who do have retirement accounts, the savings levels are largely inadequate except for a minority of those with the highest incomes. According to the recent Survey of Consumer Finances (SCF), almost half of American households (46 percent) had no savings in retirement accounts in 2022. Twenty-six percent had saved more than $100,000, and only nine percent had more than $500,000. About half of American households are "at risk" of not having enough to maintain their living standards in retirement. This lack of preparedness will end up raising the cost of our social safety net programs.

There are reasons for this lack of retirement savings. Only about half of the private-sector workforce is participating in an employer-sponsored retirement savings plan at any time. Moreover, participation in 401(k) plans is optional and workers choose how much to contribute if they do choose to participate. Many contribute far less than what is needed for adequate retirement savings, sometimes because they choose not to, but at least as often because they simply do not have the means to do so. Still others contribute enough, but incur unsustainable credit card debt to do so.

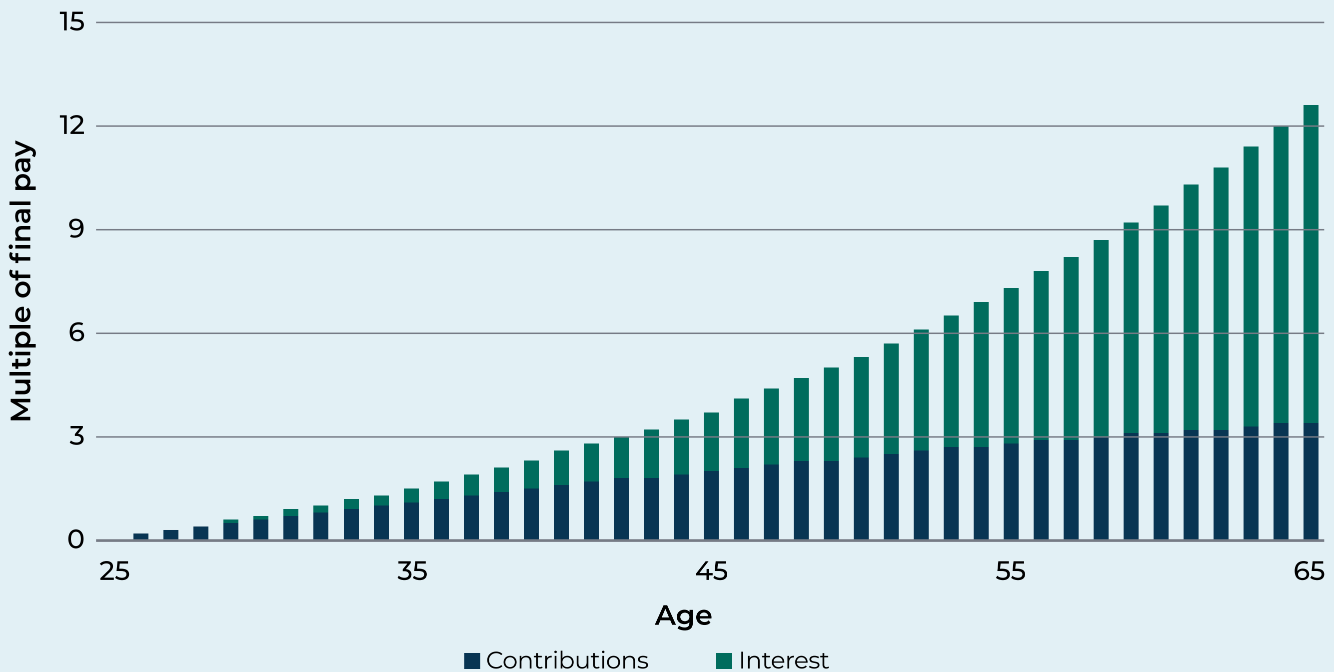
Pensions do the opposite. Participation in a pension plan is automatic as part of the employment package and, in the private sector, workers typically do not contribute to their pension, so they don't have to make any decisions about how much to contribute. Unlike many DC plans, the employer contribution and subsequent benefit accruals in a DB plan do not depend on employee participation and contribution.

The pension plan also pools both longevity risk and investment risk, so the pension fund is able to generate retirement income for the worker, instead of retirement savings that has to be converted into income. And, pension plans typically do not experience high rates of employees cashing out accrued benefits, unlike 401(k) plans that see cashouts roughly 40 percent of the time when a worker changes jobs.

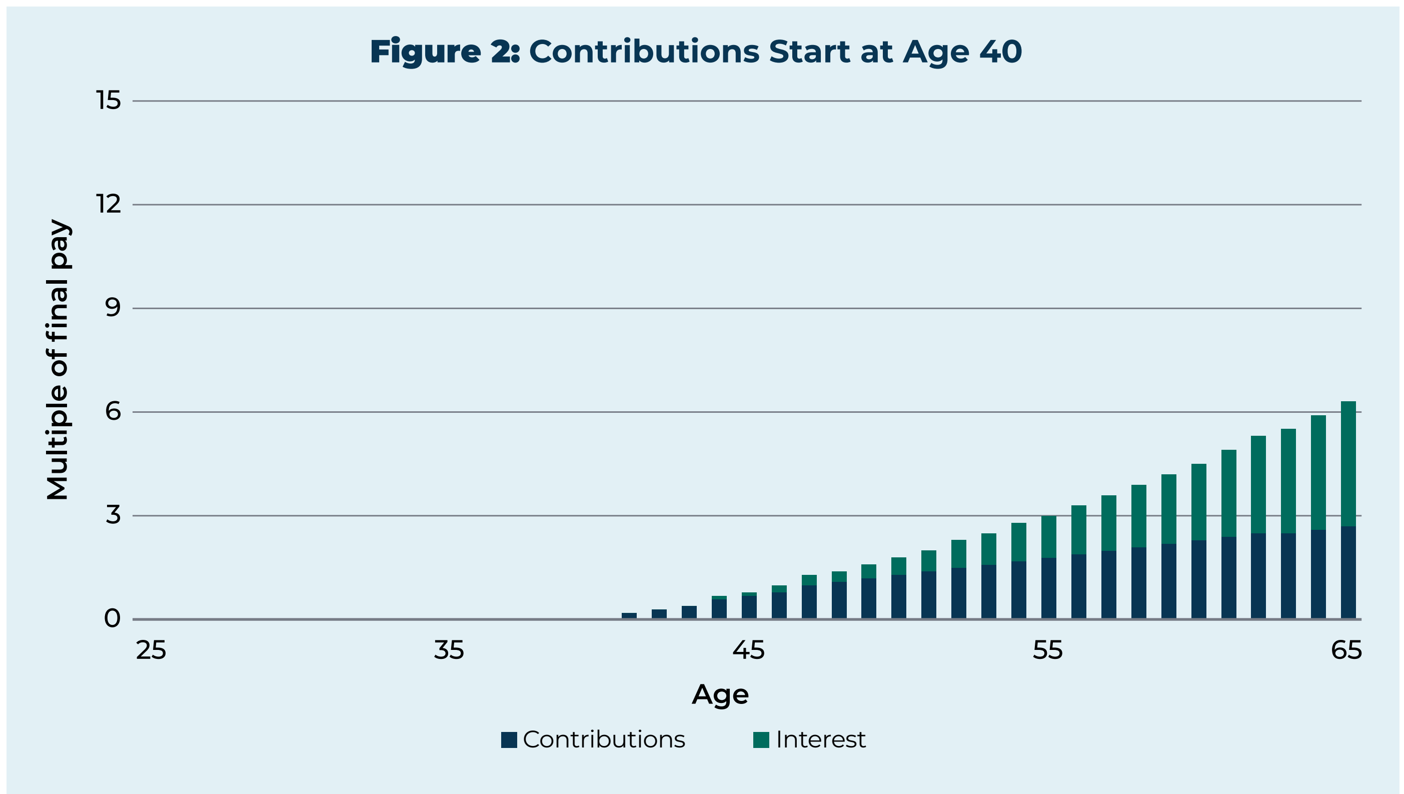
NIRS research found that retirees with pensions are less likely to be in poverty and less likely to rely on government supports in old age. Moreover, those anti-poverty effects are more equitably distributed with pensions. Typically, there are wide dispersions of both income and wealth based on educational attainment with those with more education often having both higher incomes and more wealth than those with less education. A recent NIRS analysis, though, found that 85 percent of those with a high school degree who had a pension were above 200 percent of the federal poverty line (FPL) compared to 94 percent of those with a bachelor's degree and a pension being above the same threshold.[8] For those without a pension, the respective numbers were 49 and 77 percent. In other words, the gap more than triples for those without a pension from 9 percent to 28 percent.

Earlier NIRS research found that 73 percent of older households with income from both a DB plan and Social Security were above 200 percent of FPL.[9] That same report found that without DB income, the number of poor older households (incomes less than FPL) would increase by 19 percent and the number of near-poor older households (incomes between 100% and 200% of FPL) would increase by 17.5 percent.

Pensions can be especially helpful for mid-career savers. Ideally, everyone would begin saving for retirement when they begin working full-time in their early to mid-twenties. But the reality is that many workers don't start saving for retirement until closer to age 40 (while many Gen Z and Millennial workers are using their 401(k) plans, they have shown a pattern of taking withdrawals when they change employers). This results in missing out on crucial years of contributions and investment earnings that can't be replaced. For a worker in this situation, the ability to participate in and earn a pension benefit can be a lifeline to retirement security. NIRS projected that, in a full career DC plan model and assuming consistent, annual contributions, two-thirds of the accruals by retirement are due to the contributions made during the first half of their career.[10] To be clear, much of the accruals occurred later, but they were attributable to investment earnings on the contributions made during those early years. This means that, when saving starts late, the cost is higher and the overall effort is less efficient.



Finally, pensions provide crucial retirement income to workers who are not well-served by the DC savings system. Women tend to live longer than men, so the guaranteed income from a pension helps to ensure women don't outlive their savings in retirement. This is especially true for married women if their spouse predeceases them and they exhaust many resources providing end-of-life care. Pensions have long been a vital source of retirement income for Black workers, who have sought employment in jobs with pensions due to a history of occupational segregation in other sectors of the economy. NIRS research found that pension income boosts the net worth of the median older Black family by more than 86 percent.[11]



THE IMPACT OF PBGC PREMIUMS ON PLAN SPONSOR DECISIONS

The escalation in premiums charged by the Pension Benefit Guaranty Corporation (PBGC) has become a major concern for plan sponsors. While minimum cash contribution requirements overall were eased by legislation that extended interest rate relief in the American Rescue Plan Act and the Infrastructure Investment and Jobs Act, both passed in 2021, PBGC variable rate premiums do not reflect interest rate stabilization. As such, plan sponsors with plans that are fully funded on an IRS minimum funding contributions basis still may have non-zero variable-rate premiums, which leads to an undesirable outcome.

In addition, the basis for PBGC premiums has significantly increased over time presenting an extra cost burden for plan sponsors. For example, the variable-rate premium basis that was once below one percent of a plan's underfunding is now more than five percent. While it was helpful for the variable rate premium basis to be stabilized at 5.2 percent of a plan's underfunding, the fact that fixed-rate premiums and the variable rate premium cap continue to increase each year with cost of living adjustments results in annual premium increases for plan sponsors.

Concerns over PBGC premiums have contributed directly to many plan sponsors engaging in pension risk transfer solutions. The strategies used in third party transfers such as annuity purchases and lump sum window transactions are almost always specifically designed to lower the cost of the plan by reducing PBGC premiums: when the cost of future premiums exceeds the cost of insurance, plan sponsors choose to purchase annuities. The exit of relatively well-funded plans out of the defined benefits space could ultimately weaken the funded status of the PBGC. This exodus no doubt adds to the retirement crisis facing Americans with insufficient lifetime income.

Looking at PBGC premiums through another lens, it can be argued that they also represent a barrier to entry for plan sponsors who are considering shifting retirement spending from defined contribution plans to defined benefit plans. Economic opportunities exist for DB plan sponsors, but the prospect of insurance cost escalation is formidable, especially given that the more prevalent hybrid plan designs are inherently less risky than traditional pension plans, which were based on highly leveraged final average earnings formulas. Hybrid plans, such as cash balance plans and variable annuity plans, have become a popular means for employers to offer valuable retirement benefits for employees given the degree of risk sharing between a plan sponsor and a plan participant. As such, PBGC premium calculations should reflect this risk reduction inherent in the plan designs of sponsors of hybrid pension plans. Perhaps a safe harbor class of plan designs can be designated for reduced insurance premiums.

The American Academy of Actuaries (AAA) recently released an issue brief discussing the challenge of aligning PBGC premiums for private-sector single-employer plans with the mission of the PBGC to maintain retirement security for plan participants and beneficiaries.[12] The brief from the Academy offers several ideas for how to better align these different objectives. They include:

- Lowering the per-person rate of PBGC premiums
- Reducing the variable rate premium
- Risk-based premium-setting
- Lowering premiums for risk-sharing plan designs

The authors acknowledge that there would be a transition period in implementing these proposals that could negatively affect some plan sponsors, but they contend that the PBGC's existing surplus in the single-employer plan program could be used to smooth the transition for certain plan sponsors.

Another aspect that could be addressed is taking the PBGC "off-budget." When the PBGC is included in federal budget projections, it is tempting to set premiums at a level to produce surpluses in this typically obscure area in order to pay for other federal priorities. But this practice is not a fair distribution of the tax burden. It also incentivizes more de-risking that harms the PBGC's finances in the longer-term by encouraging plans to reduce headcounts by off-loading inexpensive benefits. If this trend persists, it will leave the PBGC insuring mostly more expensive benefits, which will require more premium hikes in the future. It has a similar impact on premiums as a health insurance plan that is attracting more high-risk insureds.

ACCESS, FLEXIBILITY, AND ADDRESSING CURRENT WEAKNESSES

Small employers represent a serious weak spot in the nation's retirement infrastructure. According to the Bureau of Labor Statistics (BLS), while 78 percent of workers at firms with 500 or more employees have access to a workplace retirement plan, only 37 percent of workers at firms with less than 49 employees do.[13] With half of U.S. workers employed at a small business, the importance of improving coverage in this space is vital. Fidelity's Small Business Retirement Index provides more context: 48 percent of small business owners believe they can't afford to offer a plan, 22 percent say they are too busy, and 21 percent don't know how.[14] At the same time, 73 percent of small business owners believe they can't compete with the benefits offered at larger employers.

This is occurring because managing a retirement plan takes resources, and large firms have the scale to take on this responsibility with less overhead as a share of their revenues. Thus, the workforce benefits to the employer outweigh the costs. When a business has very few employees, it is harder to establish a plan, pay for overhead costs, and manage the plan compared to larger employers.

Existing multiemployer plans may seem an ideal vehicle for small businesses. For participants, multiemployer plans provide benefit portability and protection against retirement benefit disruption if an individual employer goes out of business. Pooling of administrative expenses can also help reduce the cost of sponsoring a plan compared to an individual employer plan. Although much of the recent news regarding multiemployer plans has focused on the financial difficulties of a few large plans, over 70 percent of multiemployer plans are in the "green zone" and financially healthy. However, due to the decline in union labor in the US, over 93 percent of private-sector workers are ineligible to participate.

To expand access for small employers, it may be worthwhile to consider establishing a DB plan analogue to the Pooled Employer Plans (PEPs) that were created by the Setting Every Community Up for Retirement Enhancement (SECURE) Act of 2019.[15] Consider what is now available to Canadian businesses of all sizes. The CAAT pension system:

- Runs a fixed cost-DB plan with variable benefits and is 124 percent funded.
- Any Canadian business can join.
- With a fixed and customizable contribution rate, CAAT will use its economies of scale to bring buying power to large and small employers.
- Employers will not have any duties in managing the plan, only providing participant data annually.
- There is no balance sheet risk and no withdrawal liability.
- With employers able to join from all sectors of the economy, union or non-union workplaces, employer diversity provides more security to plan participants and less risk to the plan itself.

The CAAT example illustrates a serious attempt to make DB benefits more accessible to employers and workers, with significant cost controls.[16] It also represents a model of plan sponsorship that makes pensions user-friendly for employers as well as workers, with all responsibilities consolidated among industry professionals.

The stark contrast between DB offerings available to small employers in the U.S. and Canada has grown larger, as policy in Canada moves toward coverage expansion and benefit flexibility and away from sector-based plans and limitations on benefit design.

Another aspect of flexibility that Congress should consider is formally acknowledging in statute the fungibility of retirement assets for each individual. This would entail permitting the transfer of assets between DC and DB plans in the vein of IRS Revenue Ruling 2012-4.[17] This transferability of assets would bolster retirement security for workers with savings in a DC plan whose employer begins offering a DB plan as it would allow that worker to purchase additional lifetime income via an annuity.

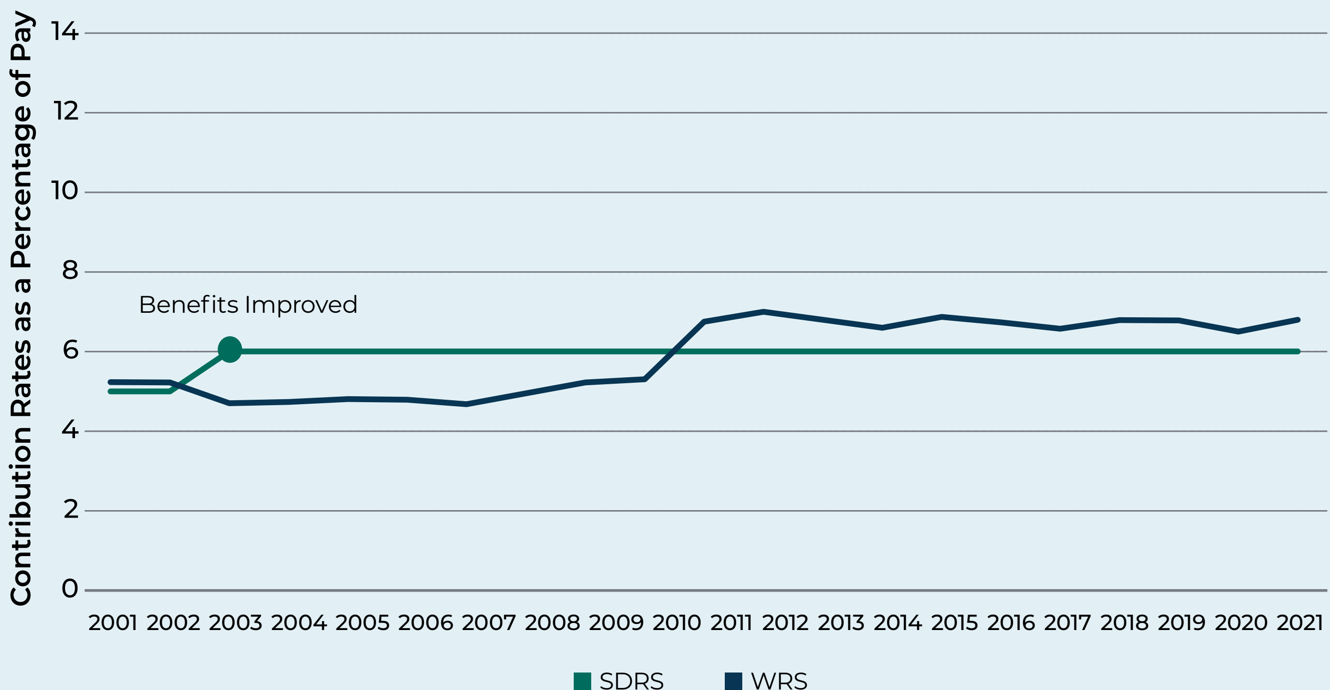
FORMALLY APPROVE RISK-SHARING IN STATUTE

Risk management becomes more important when plan membership gets retiree-heavy. This is worth remembering because our national demographics are becoming more retiree-heavy. By formally approving more risk-sharing strategies, beyond those allowed today such as Market-Return Cash Balance (MRCB) plans and variable annuity plans, employers and actuaries would have more room to explore creative solutions for their situation without incurring regulatory risk and waiting on Internal Revenue Service (IRS) determination letters, sometimes for quite long periods. This would be good for employers, help promote DB plans for greater worker access, and reduce risks to the PBGC.

Increased use of risk-sharing would present some serious policy decisions. Consider risk-sharing with retirees, for instance. While future, post-retirement benefit increases, such as cost of living adjustments (COLAs), are uncommon in private-sector pension plans, the law could allow a profit-sharing mechanism that provides increases but also allows those increases to be reversed if a plan's health is in jeopardy. This is a central concept behind variable annuity plan designs.

Two plans in the public sector, the Wisconsin Retirement System (WRS) and the South Dakota Retirement System (SDRS), offered retiree risk-sharing for many years before the Great Recession. The stability of employer costs has been remarkable for the employers participating in these plans, as shown in the figure below.

With the public sector moving in this direction and some multiemployer plans adopting the variable annuity plan design, retiree risk-sharing has the potential to help reduce future PBGC payouts and premiums. Given this potential benefit, stakeholders may want to make this tool explicitly available to private-sector pension plans without fear of regulatory problems years after adoption.



FUNDING STABILITY AND THE USE OF SURPLUSES

The minimum required contribution rules and the required discount rate policies in effect today for Employee Retirement Income Security Act of 1974 (ERISA) plans represent an improvement over those passed in the Pension Protection Act (PPA) of 2006. While this issue brief does not propose changes to the current rules, it is worth understanding how plan sponsors were impacted over the past 18 years.

PPA was intended to protect benefits by moving to a more "mark to market" system of funding pensions. Although well-intentioned, this had the effect of creating a considerable amount of volatility around year-to-year contributions. The PPA rules became effective right before the Great Recession, and the result was that employers were subject to large contribution spikes just as the country was on the verge of a depression. Congress took admirable steps to remedy the issues, but those reforms took years and were enacted piecemeal over an approximately 15 year period. Specifically, Congress passed the following seven bills to correct some of the problems with PPA:

- The Workers Relief and Employer Recovery Act of 2008 (WRERA),
- The Pension Relief Act of 2010 (PRA),
- Moving Ahead for Progress in the 21st Century Act (MAP-21),
- The Highway and Transportation Funding Act of 2014 (HATFA),
- An additional three-year extension of the MAP-21/ HATFA interest rate stabilization provisions as part of the Bipartisan Budget Act of 2015 (BBA),
- The American Rescue Plan Act of 2021 (ARPA),
- The Infrastructure Investment and Jobs Act of 2021 (IIJA).

Concerns with the funding rules (and PBGC premiums) are exacerbated by the fact that many of the law changes were driven, in material part, by goals entirely unrelated to sound retirement policy. It is reasonable for policymakers to want to protect benefits by ensuring that pensions are fully funded using conservative estimates of future outcomes. However, the rules should ensure that employers have funding obligations that are stable and predictable. Funding volatility is a substantial disincentive for employers to adopt and maintain pensions.

Another disincentive to offering a pension is that the plans can become overfunded, effectively locking up large surpluses that could be used to fund other benefits. Generally, we agree with the following concepts as laid out in *The Pension Protection Act: Successes, Shortcomings, and Opportunities for Improvement*[18]:

> *Incentives to fund; flexibility: Sponsors should be able to fund and deduct the unfunded ABL [accrued benefit liabilities] at year-end or anytime. They should be encouraged to fund their plans better by: 1) allowing them to build up funding margins in good years, without deductions and excise taxes; and 2) allowing them access to "super-surpluses" for other purposes, such as employee health benefits, without incurring the reversion tax.*

Experience clearly shows that employers are hesitant to overfund plans because the permitted uses of surpluses are narrow. Plans currently have the ability to use some of their surplus to fund health benefits (see IRC 420), but they are hesitant to do so because of the restrictions on the use of transferred funds. Congress should consider broadening the permitted uses for super-surpluses. For example, the excess funding could be used to pay for medical or long-term care benefits.

ALLOWING PRE-TAX EMPLOYEE CONTRIBUTIONS IN DB PLANS

An employer considering offering a DB plan, whether starting a new plan or reopening a frozen or closed plan, may find that the inability to allow tax-deductible employee contributions to a DB plan presents difficult tradeoffs. Much like the discussion of risk sharing with retirees above, allowing employees to contribute pre-tax to the pension plan is another way to share risk and maintain more level funding.

If an employer currently sponsors a DC plan in which employees share the cost of retirement via their own contributions, a transition to a DB plan would either mean that the workers lose the retirement contribution tax deduction (if they contribute to the DB plan on a post-tax basis) or the employer would pick up more of the cost of retirement (if the employees don't contribute to funding the DB plan).[19]

This uneven playing field causes an actuary's cost analysis of a DB plan to look less attractive to employers who have already implemented cost-sharing in their DC plans. And, it limits bargaining flexibility for union plans that may be willing to contribute some of their salaries to retain a DB plan, as occurred in the public sector after the Great Recession.[20] Cost-sharing with workers has helped to maintain high levels of access to DB plans in the public sector. Allowing pre-tax employee contributions might necessitate a nondiscrimination testing safe harbor for the plans that adopt this option in order to make it more attractive for plan sponsors. Regardless of whether this option would be widely adopted, it is yet another tool that could be used by workers and plan sponsors looking to share risks and costs in order to offer a DB pension plan.

CONCLUSION

Defined benefit pensions can be a valuable workforce management tool for employers that are looking to remain competitive in a tight labor market. Pensions help with the three R's: recruitment, retention, and retirement. While it is true that pension plan coverage has declined in the private sector, it is a misconception that no one has pensions anymore. This issue brief provides several policy options Congress could consider that would likely increase the availability of pension plan offerings for today's workforce. A greater availability of pension plans could be a win-win for employees and employers as well as a boost to the economy as a whole.

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Our Mission

The National Institute on Retirement Security is a non-profit research and education organization established to contribute to informed policymaking by fostering a deep understanding of the value of retirement security to employees, employers, and the economy as a whole.

Our Vision

Through our activities, NIRS seeks to encourage the development of public policies that enhance retirement security in America. Our vision is one of a retirement system that simultaneously meets the needs of employers, employees, and the public interest. That is, one where:

- employers can offer affordable, high quality retirement benefits that help them achieve their human resources goals;
- employees can count on a secure source of retirement income that enables them to maintain a decent living standard after a lifetime of work; and
- the public interest is well-served by retirement systems that are managed in ways that promote fiscal responsibility, economic growth, and responsible stewardship of retirement assets.

Our Approach

- High-quality research that informs the public debate on retirement policy. The research program focuses on the role and value of defined benefit pension plans for employers, employees, and the public at large. We also conduct research on policy approaches and other innovative strategies to expand broad based retirement security.
- Education programs that disseminate our research findings broadly. NIRS disseminates its research findings to the public, policy makers, and the media by distributing reports, conducting briefings, and participating in conferences and other public forums.
- Outreach to partners and key stakeholders. By building partnerships with other experts in the field of retirement research and with stakeholders that support retirement security, we leverage the impact of our research and education efforts. Our outreach activities also improve the capacity of government agencies, non-profits, the private sector, and others working to promote and expand retirement security.

The National Institute on Retirement Security is a non-profit, non-partisan organization established to contribute to informed policy making by fostering a deep understanding of the value of retirement security to employees, employers, and the economy as a whole. NIRS works to fulfill this mission through research, education and outreach programs that are national in scope.

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