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Pension Reform: Coming Legislation Just a Stopgap

By Jon Frandsen
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Congress will act soon to shore up the federal fund that takes over private pension plans that go bust and demand that employers do more to keep those plans solvent in the first place. But those steps will be just the initial ones required to fix America's brewing pension crisis. They may also be the easiest.

The legislation Congress ends up sending to President Bush in the next few months will help to keep the Pension Benefit Guaranty Corp. (PBGC) afloat, not solve its problems. Neither the House nor the Senate is as stringent as Bush wants to be in requiring employers to quickly shore up underfunded plans. After all, PBGC estimates a total shortfall of $450 billion in the pension plans that it guarantees for some 44 million retirees and workers. Even the most ambitious proposals do not try to fill that gap.

The overarching problem is that the country is in the

midst of a huge revolution in the way employers deal with retirees. Taking place is a shift from a promise of monthly checks for the rest of a retiree's life (a defined-benefit plan) to a system that requires a worker to both save more for retirement and become a savvy investor of his or her retirement funds. While the changeover has been taking place for two decades, many employees still are not saving enough to retire comfortably. Complicating the problem: Government regulations and policy have yet to catch up with the changes, and too many employers have continued to expand pension benefits without socking away enough money to pay for them.

Moreover, the woes of private pensions may be a drop in the bucket compared with problems facing pensions of public employees. Many state and local governments have promised generous pensions to workers, but in tight fiscal times have often used the funds for other purposes. There are no current, reliable figures of all such public pension plans, but pension adviser Wilshire Associates of Los Angeles conducts an annual survey of state plans that led it to conclude: "Our findings indicate that the asset shortfall for state pension plans is worse than that of corporate pension plans."

Although other components of the nation's retirement system—most notably Social Security and Medicare—are an even bigger fiscal headache, the pension solvency issue is the most immediate problem. Recently, United Airlines and Polaroid, both large employers, dumped their plans on PBGC. General Motors and Delta Air Lines may also do so soon.

The nonpartisan Congressional Budget Office recently issued a bleak warning, saying that if nothing is done, in the next decade the combination of underfunded pensions and deficits at the PBGC would result in either a huge taxpayer bailout of failing plans or the loss of benefits to pensioners.

Not everyone agrees with that assessment, however. The American Benefits Council, the group that represents businesses with defined-benefit plans, claims that fears of collapse are inflated and that the PBGC has sufficient assets for 15 to 20 years. The benefits council also says that the problem has been exacerbated in recent years by low interest rates and poor performance of the stock markets and that underfunding should improve in coming years as the investment outlook improves.

While Congress is likely to act in coming weeks, critics such as John C. Goodman, president of the nonprofit National Center for Policy Analysis in Dallas, argue that

it is in danger of not being tough enough about making companies get their plans into shape.

The Bush administration went so far as to issue a veto threat of the bill passed by the Senate last week, saying some provisions on full funding are weaker than current law. The problem is that lawmakers, under huge pressure from the business community, fear that being as tough as the administration wants could encourage companies to terminate their plans—making PBGC's situation even worse.

"In a voluntary system where people can terminate, freeze or decide to not start a plan, it's really difficult to find a proper balance between funding rules that will make sure they adequately fund their plan while at the same time not drive them out," says Frank Toohey, a lobbyist for AARP.

In recent years, another factor that has led some companies to freeze or terminate plans has been the lack of a less drastic option—converting to cash-balance plans that provide retirees with a lump sum instead of a monthly check. Lawsuits raising issues of age discrimination have kept many employers from making such a conversion since the late 1990s, but as part of pension reform, Congress is expected to clarify rules that would protect businesses from such claims. The Senate would require employers to make sure that older workers would receive roughly as much under the new plan as they would under the old one. The House does not have a similar provision.

The House, however, tries to address the problem of poor saving by employees by borrowing a simple idea from Goodman: automatically enrolling them in 401(k) plans with company contributions.

Workers could opt out, but if not, they automatically have 3% of their pay contributed, rising 1% a year with regular yearly increases up to 6%. Companies also could offer employees access to investment advice without threat of being sued.

"We dumped responsibility for pensions on employees who haven't been ready to save on their own or to make wise investment decisions," says Goodman.

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