Chicago Tribune

August 16, 2006

Sweeping pension reform expected to become law

By William Neikirk,

WASHINGTON -- The pension bill that President Bush plans to sign into law on Thursday will give a boost to 401(k) retirement savings plans and impose tougher funding requirements that could cause more companies to freeze or abandon the old-fashioned pension that once was common in America.

The 907-page measure, the most extensive revamping of the nation's pension laws in a generation, represents a decided shift in government policy. It favors such defined-contribution retirement plans as the highly popular 401(k) to which employees contribute money from their paychecks at a time when the number of Americans with company-funded pensions has been gradually declining.

Not only would the legislation give companies the right to automatically enroll new employees in their tax-deferred 401(k) plans, but it also would allow financial companies in which employees invest to offer them investment advice, a change that critics called a conflict of interest. Under the bill, the Labor Department would have to approve the way investment advice is given.

At the same time, the bill would force companies with traditional defined-pension plans to move toward fully funding them over a seven-year period. Troubled airlines would get 17 years to meet the legislation's new standards.

Representatives of both business and labor said that the tougher standards could cause more firms either to freeze or drop their defined pension programs – a threat frequently made by corporations when the legislation was before Congress.

"The biggest long-term threat is that well-funded (pension) plans will exit the system," said James Klein, president of the American Benefits Council, an employer-backed group. He predicted that more companies would freeze their pensions as a result of having to put up more resources to fund their plans.

The measure also sanctions the use of cash-balance pension plans, essentially annual company contributions to workers that can be built into retirement nest eggs. Firms had virtually stopped offering them after courts had ruled that they discriminated against older workers.

The bill's provisions favoring 401(k) savings plans is clear recognition that they are the "wave of the future," said Matt Moore, senior policy analyst for the National Center for Policy Analysis, a Dallas-based think tank.

About one-third of workers typically don't sign up for these plans, he said, but as company-funded pension plans begin to dry up, the 401(k) plan is gradually replacing it. Nearly 75 percent of workers age 40 to 59 belong to 401(k) plans, Moore said, while only 47.5 percent of those ages 29 and under, many of whom tend to be lower-income workers.

"But it pays to start sooner rather than later," he said. "Automatic enrollment of new employees will help workers _ particularly younger workers _ build a nest egg for retirement."

Mark Warshawsky, a former Treasury Department official who recently joined Watson Wyatt, a global consulting firm, said research shows that once people find they automatically belong to 401(k) plans, they tend to stay. "It's something they don't have to think about," he

said.

Karen Ferguson, director of the Pension Rights Center, an advocacy organization partially supported by labor unions, lamented the change. "It certainly will accelerate the shift from secure pensions to insecure do-it-yourself savings arrangements. And that is exactly what the bill was intended to do," she said.

More than 40 million Americans have 401(k) savings plans, and millions more have individual retirement accounts.

Once companies automatically enroll workers in 401(k) plans, the bill would require them to initially put 3 percent of a worker's pay into accounts. This could be increased to 6 percent over the following three years. Companies would be required to fully match the first 1 percent of pay, and contribute half of the next 5 percent of pay.

The legislation also makes permanent increased contribution limits for 401(k) plans and individual retirement accounts approved in 2001. For example, this year an employee may put as much as $15,000 into a 401(k) plan, and these limits are indexed to increase in $500 limits every year. Those over 50 may contribute an extra $5,000 this year, and this amount is also indexed to increase every year.

Ferguson said these contribution levels discriminate against lower-income Americans. "The bill institutionalizes unneeded tax breaks for highly paid people," she said. "It's totally unnecessary. It is something Wall Street wanted and they got it."

But the bill would also make permanent a "saver's tax credit" which helps low-income Americans get a tax break when they invest in qualified savings accounts. More than 5 million people are using these accounts, said Sen. Charles Grassley, R-Iowa, chairman of the Senate Finance Committee.

Unions have also sharply criticized the legislation on grounds that it would allow for pension cutbacks in some cases for workers who belong to multi-employer plans and are entitled to special early retirement benefits _ such as a so-called "30 years and out" provision. Teamsters have led the opposition.

If one of these negotiated plans should be under-funded by 65 percent or more, according to Ferguson, then their trustees could recommend pension reductions of 6 percent a year for those who have taken special early retirement plans. But the unions would have to agree to cuts in negotiations before they would go into effect.