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New Research from EBRI:
Survey Shows Employers Continuing to Cut “Traditional” Pension Plans, But Often Add to 401(k) Benefits As Well

WASHINGTON—A new survey shows that about two-thirds of “traditional” (defined benefit) pension sponsors have either changed the plan in the last two years or intend to do so in the next two years. The most frequent plan changes have been to close the defined benefit plan to new hires or freeze the plan for all members.

Pension plan sponsors say the driving forces behind these pension benefit reductions are a new law by Congress that in some cases significantly increases their pension plan costs, and pending accounting rule changes that are also expected to dramatically increase the cost and risk of offering a pension benefit to workers.

However, the survey also finds that the vast majority of employers that have closed their pension plans have also increased contributions to workers’ defined contribution (401(k)-type) plans, and that a large share of those planning new limits on their pension plan may well do the same. These findings are significant, because they indicate that reductions to workers’ “traditional” pensions are being at least partially offset by added benefits on the 401(k) side. In addition, employers that are reducing pension benefits are adopting “automatic enrollment” of their workers in 401(k) plans, which research has shown could significantly increase retirement coverage and savings.

“There are major structural changes under way in the American retirement system, driven mainly by cost and accounting pressures,” said the study’s author, Jack VanDerhei, Temple University and EBRI Fellow. But, he added, it’s not necessarily a zero-sum game for American workers: “There is a clear trend among employers that are reducing their traditional pension benefits to add automatic enrollment in their 401(k) plans and increase the 401(k) benefits for workers whose pensions are affected. Changes are occurring on both sides of the retirement plan ledger—workers’ retirement wealth is being affected both negatively and positively at the same time.”

EBRI data show that among private-sector American workers who have a retirement benefit at work, about 37 percent have a defined benefit pension and 63 percent have a 401(k)-type defined contribution retirement plan.

The survey results appear in the July 2007 EBRI Issue Brief, and are based on a survey by the nonpartisan EBRI and Mercer Human Resource Consulting. The Issue Brief, available at www.ebri.org, includes these highlights:

- In the last two years, just over 35 percent of the respondents had made at least one change to their defined benefit plan. The most frequent responses were to close the plan to new hires (25.3 percent) or to freeze the plan for all members (12.9 percent).
- Looking forward, just over 33 percent of respondents that had not already changed their defined benefit plan in the last two years indicated they were likely to make a change in the next two years. Again, the most common change was to close the plan to new hires (19.0 percent), while 14.2 percent said they planned to freeze their defined benefit plan for all participants.
Among plan sponsors that closed their defined benefit plan to new hires in the last two years, 78 percent reported they would increase employer contributions to the defined contribution plan, typically a 401(k) plan. For those that plan to close their pension in the next two years, 80.9 percent reported they would increase employer contributions to their defined contribution plan.

The EBRI-Mercer survey also showed that automatic enrollment in 401(k) plans is popular among many defined benefit plan sponsors. Of those sponsors that have already closed the pension plan to new hires, 59 percent have adopted automatic enrollment features in the 401(k) plan, as opposed to 42 percent of those that have not. Of those sponsors that will close the plan to new hires in the next two years, 61 percent have adopted automatic enrollment features, compared with 39 percent of those that do not plan to close the plan in the next two years.

Defined benefit plan sponsors either have imposed or are considering new limits on their pension benefits because of new funding requirements in the Pension Protection Act of 2006 (PPA) and/or new and pending accounting rules by the Financial Accounting Standards Board (FASB), the EBRI-Mercer survey showed.

In addition, the survey noted that any analysis of the retirement income adequacy of future retirees must factor in the extraordinary plan changes among defined benefit sponsors in the last few years, as well as their likely reaction to PPA and FASB rules—especially the widespread phenomenon of employers providing new or additional contributions to a defined contribution plan in an attempt to at least partially indemnify workers for the reduction in future pension benefits.

The EBRI-Mercer survey, conducted in the spring of 2007, was designed to gauge defined benefit plan sponsors’ recent activity as well as planned modifications with respect to both defined benefit and defined contribution (401(k)-type) plan design, and investment behavior within the defined benefit plans. The survey also was able to determine what, if any, increases in employer contributions to defined contribution plans were provided in conjunction with the defined benefit modifications. A total of 162 plan sponsors participated.

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