ERISA AT 30: THE DECLINE OF PRIVATE-SECTOR DEFINED BENEFIT PROMISES AND ANNUITY PAYMENTS

WHAT WILL IT MEAN?

EBRI-ERF Policy Forum
May 6, 2004
Current Pressures

- Declining stock market and economic environment has had a major impact on all areas of retirement benefits
- Three out of every four US company Defined Benefit pension plans are under-funded
- Cost of medical care and prescription drugs have soared
- Employees saw large drop in Defined Contribution accounts
- Employees delaying retirement
Regulatory Uncertainty

- Fiduciary Requirements
  - Enron
  - Mutual fund industry
- Defined Benefit Plan Funding Rules
  - Replacement VanDerheiaar Treasury
- Defined Benefit Accounting Rules
  - Mark to market volatility
Employers

• Feeling cost pressure
  – Operations
  – Benefits
• Reduce pension expense and cash requirements
• Reduce pay increases
• Staff reductions
Employer Reaction: Issues & Considerations

- Rising costs
  - Retirement plans
  - Medical (including retiree medical)
  - Stock option expensing
- Volatility (Surprises)
- Regulatory uncertainty
- Employee reaction
- Administrative costs of change
Employer Reaction

- Employers less likely to maintain DB plans
  - Re-evaluating/halting move to hybrid plan designs
- Provide more retirement planning education for employees
- Greater emphasis on documentation and adherence to fiduciary responsibilities
- Increasing administrative burdens combined with thin HR staff will increase need for outsourced services
## The ERISA Years

<table>
<thead>
<tr>
<th></th>
<th>1974</th>
<th>1978</th>
<th>2003</th>
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</thead>
<tbody>
<tr>
<td>Private Non-Farm Workforce</td>
<td>62 million</td>
<td>71 million</td>
<td>109 million</td>
</tr>
<tr>
<td>Active Participants in a Private DB Plan (single-sgl+multi)</td>
<td>43.7%</td>
<td>40.8%</td>
<td>17-22%</td>
</tr>
<tr>
<td>65+ With Private DB Pension Annuity</td>
<td>15.9%</td>
<td>Highest Year Was 24.8%</td>
<td>22.8%</td>
</tr>
<tr>
<td>DB CB %</td>
<td>0%</td>
<td>0%</td>
<td>22-25%</td>
</tr>
<tr>
<td>DB LSD % Take When Offered</td>
<td>?</td>
<td>?</td>
<td>66-98%</td>
</tr>
</tbody>
</table>
Reasons for DB Decline

- New Economy Firms Did Not Do DB
- Small Firms Favor DC
- Decline of Manufacturing Employment
- Bankruptcy/Insolvency DB Terminations
- Workforce Preferences When The Baby Boom Was Young and Exploding Into The Workforce
- Changes in Domestic and Global Competition
- Changes in Relative Program Costs
Freezing Pension Plans

Aon Consulting October 2003 Survey
Single Employer Defined Benefit Plans

- Already Frozen as of January 1, 2001
- Froze by October 2003
- Will freeze by year-end 2003
- Considering a freeze
- No activity as of October 2003
Freezing Pension Plans

Aon Consulting October 2003 Survey
Reasons for Freezing Plan
(Multiple reasons may apply)

- Other
- Unrelated to Pension Plan Funding
- Pension Expense
- Lump Sums
- Volatility of Contributions
- Unpredictability of Contributions
- Amount of Contribution

0% 2% 4% 6% 8% 10%
Reasons for Annuity Decline

- Early Departing Executive and Worker Preferences
- Competition with DC Plans
- IRS Rulings On Equal Treatment
- Interest Rate and Rate of Return Environment
- Desire To Shift Longevity Risk
- Relative Marketing Emphasis of Financial Services Organizations and Planners
Where Benefit Dollars Go

Figure 2
Employer Spending on Benefits as a Percentage of Total Benefit Spending, Selected Years, 1960–2002

Percent With Public and Private Pension and Annuity Income 1988-2002

Source: EBRI CPS tabulations, EBRI Notes v24n12, 12/03
Average and Median Monthly Private Pension Income Amounts, By Age

Proportion of Non-Workers By Age

Under 16 | 16 to 64 | 65+

Policy Forum Issues

• What is likely to happen in the future to DB plans?
• What will alternative outcomes mean?
• What if all DB plans are frozen?
• What if only annuities were paid from all plans?
• What are the possible implications for future retirement security?
• How will different constituencies react/respond to alternative regulatory actions and design futures?
Let’s move to the analysis.

Jack VanDerhei and Craig Copeland