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EXECUTIVE SUMMARY

Savings Needed for Health Expenses in Retirement: An Examination of Persons Ages 55 and 65 in 2009

GENDER DIFFERENCES: This report updates earlier EBRI research on estimated savings needed to cover health insurance to supplement Medicare and out-of-pocket expenses for health care services in retirement. It finds that men age 65 in 2009 retiring this year will need anywhere from \$68,000–\$173,000 in savings to cover health insurance premiums and out-of-pocket expenses in retirement if they want a 50–50 chance of being able to have enough money, and \$134,000–\$378,000 if they prefer a 90 percent chance. With their greater longevity, women will need more: a women retiring at age 65 in 2009 will need anywhere from \$98,000–\$242,000 in savings to cover health insurance premiums and out-of-pocket expenses in retirement for a 50–50 chance of having enough money, and \$164,000–\$450,000 for a 90 percent chance. For those seeking a median (50 percent) chance of having enough money for health care in retirement, these estimates are about 9 percent higher than a year ago for men and married couples, and 16 percent higher for single women.

ACTUAL COSTS LIKELY TO BE HIGHER: Many individuals will need more money than the amounts cited in this report because this analysis does not factor in the savings needed to cover long-term care expenses, nor does it take into account the fact that many individuals retire prior to becoming eligible for Medicare. However, some workers will need to save less than what is reported if they choose to work during retirement and receive health benefits as active workers.

401(k) Sponsors Suspending Matching Contributions Are Generally Also Funding Defined Benefit Pension Plans

401(K) MATCHES AND PENSION FREEZES: A review by EBRI of 251 401(k) plan sponsors that have suspended 401(k) matching contributions for their 4.4 million workers finds that those employing 50 percent of the workers also maintained an open defined benefit plan. An additional 16 percent of workers were with employers that were still obligated to fund a frozen defined benefit plan. Further, 8 percent of the workers were with an employer that had both an open and a frozen defined benefit plan that carried funding obligations.

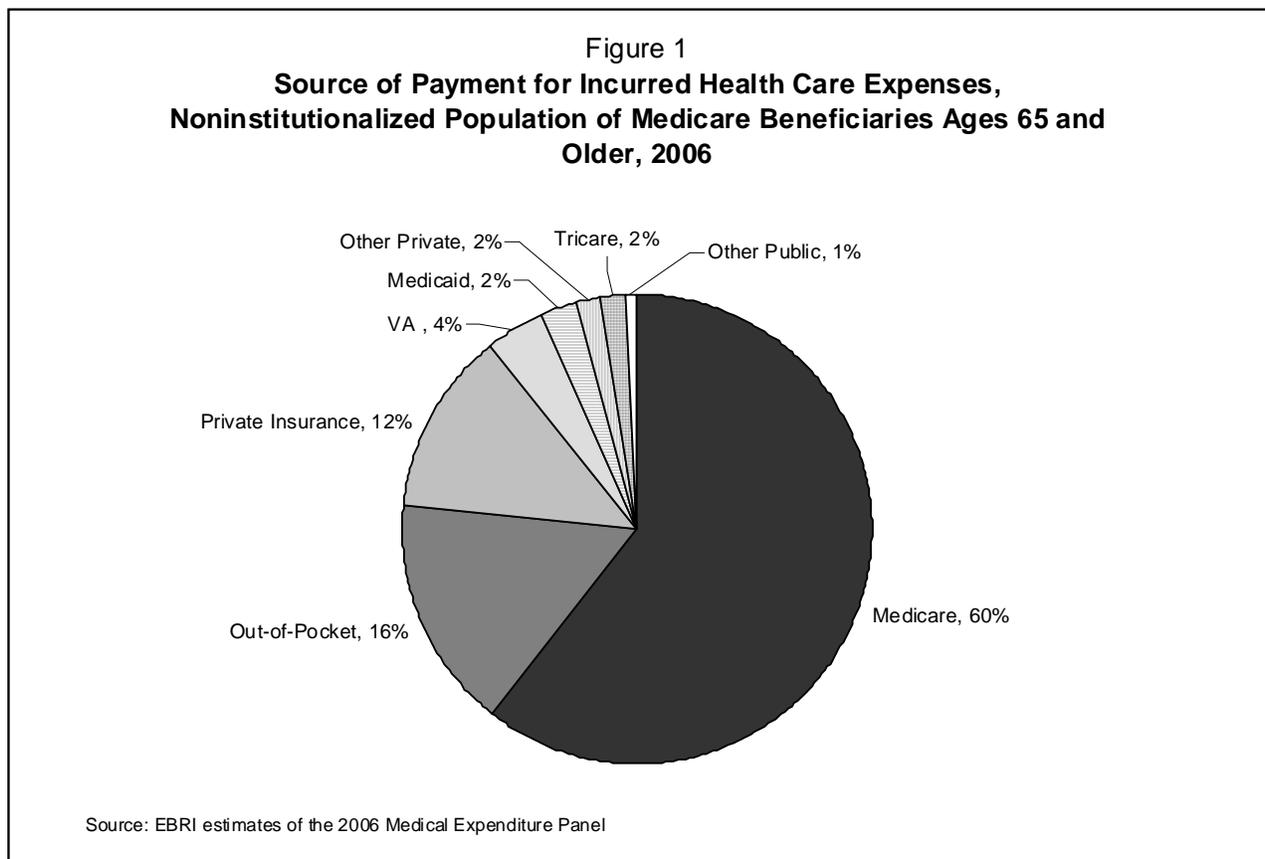
MANDATORY VS. DISCRETIONARY FUNDING: Because of the current economic conditions, many of these employers must make what are unexpected contributions to the defined benefit plan as a result of asset losses and liability growth, but they can eliminate what are discretionary matching contributions to a 401(k)-type plan. For the 50 percent of the workers in this group of 251 employers, the 401(k)-type retirement plan is an additional benefit to the open defined benefit pension plan; thus, retirement benefits are still being provided by the employer, in spite of the suspended 401(k) matching contribution.

Savings Needed for Health Expenses in Retirement: An Examination of Persons Ages 55 and 65 in 2009

By Paul Fronstin, Dallas Salisbury, and Jack VanDerhei, EBRI

Introduction

Most retirees have never been eligible for health benefits from a former employer in retirement, and the eligibility rate has been declining. Specifically, in 1988, only about one-third of workers ages 46–64 reported that they would be eligible for employment-based health benefits to supplement Medicare upon retirement (Fronstin, 1996). In 2005, only about 23 percent of Medicare beneficiaries had retiree health benefits through a former employer as a supplement to Medicare (Fronstin, Salisbury, and VanDerhei, 2008). It is important not only that *retirees* understand their responsibility for these costs and the associated risks (such as health care cost inflation and longevity risk), but that *workers* also understand these realities before they retire. In 2006, Medicare covered 60 percent of the cost of health care services for Medicare beneficiaries ages 65 and older (Figure 1).



During the 30-year period from 1975–2005, health care cost increases outpaced growth in the economy by 2.1 percent (U.S. Congressional Budget Office, 2007). More relevant for retirement planning is the fact that growth in Medicare costs has outpaced growth in the economy by 2.4 percent. The compound effect of such excess cost growth has implications for workers, retirees, and the overall economy. Even when the nonpartisan Congressional Budget Office (CBO) assumes that excess cost growth will decline in the future, that projected slowdown will not be “painless”—CBO assumes that cost sharing will increase and that new and potentially useful health technologies will be introduced more slowly or utilized at lower rates than would occur otherwise. In other words, while the growth rate may decline, the real level of health care costs will continue to increase.

Using excess cost growth to predict how fast health care costs have increased suggests that health care cost inflation for Medicare beneficiaries averaged about 7 percent during 2003–2008. However, most retirees have been experiencing even larger cost increases for part or all of their health insurance premiums and out-of-pocket expenses for health care services. For example, Medicare Part B, which covers among other things doctors' services, outpatient care, and diagnostic tests, is financed by beneficiary premiums that cover only 25 percent of the program's cost. General tax revenues finance the balance. Because beneficiary premiums cover a fixed 25 percent of the premium, increases in the premium reflect underlying increases in the cost of operating the program. During 2003–2009, Medicare Part B premiums increased an average of 8.9 percent, with more than 13 percent increases in 2003 and 2005 and a 17.4 percent increase in 2004. While average annual premium increases under current law are projected at 3.5 percent during 2010–2017, they may grossly understate needed savings if they use current-law projections to estimate the amount of money that will be needed for Part B premiums in retirement.

Under current law, Medicare updates to physician payment rates are projected to be negative each year through 2016. Although a physician payment reduction of -4.8 percent took effect in 2002, that was the only year during 2003–2007 in which a scheduled cut actually took effect, despite the fact that other negative updates were scheduled—Congress, responding to pressure from physicians, blocked the reductions. It is expected that Congress will continue to override future expected cuts in physician payments, which will have the effect of increasing Part B premiums above the existing law's estimates. Were physician payment updates assumed to match the Medicare Economic Index, Part B premiums would increase at an average annual rate of 6.1 percent during 2010–2017.

Individuals can expect to pay even more in premiums and out-of-pocket for health care services in retirement because of the deteriorating financial condition of the Medicare program. The Part A trust fund is expected to become insolvent in 2017, under intermediate cost assumptions. Tax revenue collected in 2017 would be able to cover only 81 percent of the expected benefits in that year, meaning that Medicare will be unable to pay promised benefits.

In order to address the funding shortfall, the Medicare trustees indicate that the payroll tax would need to be increased immediately from 2.9 percent to 6.78 percent if the funding shortfall is to be paid by workers and employers. If the funding shortfall is to be paid by Medicare beneficiaries, an immediate 53 percent reduction in government spending on the Part A portion of the program would be necessary. Given the magnitude of the changes needed to address the Part A trust fund funding shortfall, it is likely that future retirees will have to pay more for health care services.

The present value of lifetime Medicare benefits for a husband and wife turning age 65 in 2010 has been estimated at about \$376,000.¹ Hence, because Medicare on average covers 60 percent of health care costs for beneficiaries, the average husband and wife will need about \$250,000 in savings to cover what is not covered by Medicare. However, the problem with using this average is that individuals cannot simply *assume to be* average: While 50 percent of men turning age 65 in 2009 will live to age 81 and 50 percent of women will live to age 84, 25 percent can be expected to live until ages 87 and 90, respectively. Furthermore, 1 in 10 men currently age 65 can expect to live until 91, while 1 in 10 women can expect to live to 95. Obviously, in the case of a married couple both currently age 65, the probability that at least one of the spouses will still be alive at these various ages is even greater.

Ultimately, the real issue that retirees will face in planning for health care expenses in retirement is uncertainty. The remaining number of years an individual will live is uncertain. Health care cost increases are uncertain. Inflation is uncertain. Interest rates are uncertain. And health status is uncertain. As workers and retirees become increasingly responsible for planning for retirement, the risk of uncertainty will make retirement planning increasingly complicated.

This report examines the uncertainty of health care expenses in retirement. The research presented here builds on past research by examining the randomness of longevity and investment risk as well as the uncertainty of future health care cost increases. It updates data presented in the May 2008 *Issue Brief* (Fronstin, Salisbury, and VanDerhei, 2008), available online at www.ebri.org/publications/ib/index.cfm?fa=ibDisp&content_id=3933.

Modeling Technique

Determining how much money an individual or couple needs in retirement to cover health care expenses is a complicated process. The amount of money a person needs will depend on the age at which he or she retires; length of life after retirement; the availability of health insurance coverage after retirement to supplement Medicare and the source of that coverage; health status and out-of-pocket expenses; the rate at which health care costs will increase; and interest rates and other rates of return on investments. In addition, public policy that changes any of the above factors will also affect spending on health care in retirement. While it is possible to come up with a single number that individuals can use to set retirement savings goals, a single number based on averages will be wrong for the vast majority of the population.

This analysis uses a Monte Carlo simulation model² to estimate the amount of savings needed to cover health insurance premiums and out-of-pocket health care expenses in retirement. Separate estimates are presented for persons who supplement Medicare with 1) employment-based retiree health benefits, and 2) a combination of individual health insurance through Plan F Medigap coverage and Medicare Part D for outpatient prescription drug coverage. For each source of supplemental coverage, the model simulated 65,000 observations allowing for the uncertainty related to individual mortality and rates of return on assets in retirement,³ and computed the present value of the savings needed to cover health insurance premiums and out-of-pocket expenses in retirement at age 65. These observations were used to determine asset targets for having adequate savings to cover retiree health costs 50 percent, 75 percent, and 90 percent of the time. Estimates are also jointly presented for a stylized couple both of whom are assumed to retire simultaneously at age 65.

The 50th percentile represents the savings needed if the individual's goal is to have a 50–50 chance that he or she will have enough money saved to cover health insurance premiums and health care expenses in retirement. An individual who wants to have a 75 percent chance of having enough savings in retirement to cover premiums and other expenses would need to have the amount of money shown for the 75th percentile. And for a 90 percent chance of having enough money to cover health insurance premiums and out-of-pocket expenses in retirement, he or she will need to have saved the amount of money shown for the 90th percentile.

Although the median (mid-point) amount needed for a *couple* is approximately the same as the sum of the amounts needed for *each individual spouse* at the median, the same is not true at the larger percentiles. Due to the benefits of pooling available with even two people, the 75th percentile total needed for a couple is less than the sum of the 75th percentiles for the male and female separately. The difference between the 90th percentile for a couple and the sum of the 90th percentiles for a single male and a single female are even more pronounced.

Savings Needed for Health Care Expenses in Retirement: The Case of Employment-Based Retiree Health Benefits

Figure 2 provides estimates of savings needed to pay for health insurance premiums, Medicare Part B premiums, and out-of-pocket health care costs during retirement for a person with employment-based retiree health benefits as a supplement to Medicare. The amounts that a married couple will need are also shown. There are two columns of estimates: one assumes that the employer subsidizes a portion of the premium, and the other assumes that the retiree is responsible for paying the entire premium. Prior research has found that, when employers provide a subsidy, retirees are responsible for about 40 percent of the premium;⁴ however, it is becoming more common for employers to provide “access-only” plans where the retiree pays the entire premium, if any retiree health benefit is provided at all.

This model uses predicted excess cost growth in Medicare plus per capita growth in the economy to predict health care premium increases. It also assumes that at age 65 an individual spends nearly \$900 out-of-pocket annually on health costs and that this amount grows at the same rate as premiums grow. Separate estimates are presented for men and women. Because women have longer life expectancies than men, women will generally need larger savings than men to cover health insurance premiums and health care expenses in retirement when examining needed savings at the median and at the 75th and 90th percentiles. In other words, women will need greater initial savings than men when

both set a goal—for example, of having a 90 percent chance of having enough money to cover health expenses in retirement.

Figure 2 shows that a 65-year-old man retiring in 2009 with retiree health benefits from a former employer and *premiums subsidized by that former employer* will need \$68,000 if he is comfortable with a 50 percent chance of having enough savings to cover health care expenses in retirement. In contrast, a man who wants a 90 percent chance of having enough money to cover health care expenses in retirement would need \$134,000. Women, because of their higher life expectancy, would need savings of \$98,000 and \$164,000, respectively, or 44 percent more than a man at the median and 22 percent more than one at the 90th percentile because of women's higher life expectancy. A married couple would need savings of \$165,000 at the 50th percentile, \$214,000 at the 75th percentile, and \$256,000 at the 90th percentile.

Retirees who have employment-based retiree health benefits to supplement Medicare and whose former employer *does not subsidize premiums*—an increasingly common situation—will need to save more money than retirees whose premiums are subsidized. A man without subsidized premiums would need \$111,000 in savings to cover health care costs in retirement if he wants a 50 percent chance of having enough money to cover health care expenses in retirement, while a woman would need \$159,000. To have a 90 chance of having enough savings to cover health care costs in retirement, a man would need \$217,000 and a woman would need \$266,000 if the benefit is through a former employer and not subsidized. A couple with unsubsidized retiree health benefits will need \$268,000 at the 50th percentile, \$346,000 at the 75th percentile, and \$414,000 at the 90th percentile.

The 2009 savings target for a 50 percent chance of having enough money are about 9 percent higher for men and 16 percent higher for women than the same estimates just one year ago for individuals retiring at age 65 in 2008 (Fronstin, Salisbury, VanDerhei, 2008). The joint estimate for a married couple retiring at age 65 in 2009 is also about 9 percent higher than the same number in 2008.

Retirees Without Employment-Based Retiree Health Benefits

Figure 3 contains the savings estimates for a person who does not have employment-based retiree health benefits to supplement Medicare and instead purchases Medigap Plan F and Medicare Part D outpatient drug benefits. Like a person who has employment-based retiree health benefits, there will be uncertainty related to a number of variables. Among persons with Medicare Part D, there is also the uncertainty related to health status and prescription drug use. Projections of savings needed to cover out-of-pocket expenses for prescription drugs are highly dependent on the assumptions used for drug utilization. There are three columns of estimates in Figure 3: one where prescription drug use is at the *median* throughout retirement, one where prescription drug use is *higher* (at the 75th percentile throughout retirement), and one where prescription drug use is *much higher* (at the 90th percentile throughout retirement).

Median: According to Figure 3, a man with median drug expenditures would need \$86,000 in savings and a woman would need \$125,000 if each has a goal of having a 50 percent chance of having enough money saved to cover health care expenses in retirement. If an individual instead wanted a 90 percent chance of having enough savings, \$177,000 would be needed for a man, and \$221,000 would be needed for a woman.

75th percentile: Among individuals with drug expenditures at the 75th percentile, needed savings would be \$101,000 for a man and \$140,000 for a woman if each wanted a 50 percent chance of having enough savings to cover health care expenses in retirement. A man would need \$212,000 and a woman \$250,000 to have a 90 percent chance of having enough savings.

90th percentile: At the 90th percentile in drug spending, a man would need \$378,000 and a woman would need \$450,000 to have a 90 percent chance of having enough money to cover health care expenses in retirement.

Figure 2
Savings Needed for Employment-Based Health Premiums, Medicare Part B Premiums, and Out-of-Pocket Costs for Retirement at Age 65 in 2009

	Employer Subsidizes Premiums	No Employer Subsidy of Premiums
Men		
Median	\$68,000	\$111,000
75th percentile	104,000	168,000
90th percentile	134,000	217,000
Women		
Median	98,000	159,000
75th percentile	129,000	209,000
90th percentile	164,000	266,000
Married Couple		
Median	165,000	268,000
75th percentile	214,000	346,000
90th percentile	256,000	414,000

Source: *EBRI Notes*, June 2009, authors' simulations based on assumptions described in the text.

Figure 3
Savings Needed for Medigap Premiums, Medicare Part B Premiums, Medicare Part D Premiums and Out-of-Pocket Drug Expenses for Retirement at Age 65 in 2009

	Median Prescription Drug Expenses Throughout Retirement	75th Percentile of Prescription Drug Expenses Throughout Retirement	90th Percentile of Prescription Drug Expenses Throughout Retirement
Men			
Median	\$86,000	\$101,000	\$173,000
75th percentile	134,000	159,000	279,000
90th percentile	177,000	212,000	378,000
Women			
Median	125,000	140,000	242,000
75th percentile	168,000	190,000	336,000
90th percentile	221,000	250,000	450,000
Married Couple			
Median	210,000	241,000	416,000
75th percentile	277,000	349,000	614,000
90th percentile	338,000	451,000	807,000

Source: *EBRI Notes*, June 2009, authors' simulations based on assumptions described in the text.

A couple both with median drug expenses would need \$210,000 to have a 50 percent chance of having enough money to cover health care expenses in retirement. They would need \$277,000 to have a 75 percent chance of covering their expenses, and \$338,000 to have a 90 percent chance of covering their expenses.

Savings Needed for a 65-Year-Old in 2009 (Currently Age 55)

While the estimates in Figures 2 and 3 are useful, individuals who have already reached age 65 generally do not have time to save for health care expenses in retirement if they have not already done so. The general rule of thumb has always been the earlier an individual starts saving for retirement, the easier it will be to meet his or her goals. Previous EBRI research has shown that during the decade ending 2030, retirees will face a shortfall of at least \$400 billion between expected retirement income compared with what they will need to cover basic expenditures and any expense associated with an episode of care in a nursing home or from a home health provider (VanDerhei and Copeland, 2003). The remainder of this section focuses on the amount of money an individual will need to save to cover health insurance premiums and out-of-pocket expenses in retirement for a person 55 years old in 2009 who will not retire until age 65 in 2019.

Employment-Based Retiree Health Benefits

Figure 4 provides estimates of savings needed for health insurance premiums, Medicare Part B premiums, and out-of-pocket expenses during retirement for a person with employment-based retiree health benefits. The estimates in this figure are for an individual who is 55 years old in 2009 and does not retire until age 65 in 2019. In one column, estimates are presented for a retiree whose premiums are subsidized by his or her former employer. In the second column, estimates are presented based on the assumption that the individual will have access to retiree health benefits through a former employer but that the plan is an access-only plan, such that the individual is responsible for paying the entire premium.

Figure 4 shows that, at the median, a 65-year-old man retiring in 2019 will need \$114,000 in savings at age 65 to pay for his portion of premiums and out-of-pocket expenses each year, and a woman would need \$164,000, assuming they have subsidized employment-based retiree health benefits. In contrast, a man at the median who pays the entire premium for health benefit through a former employer will need \$186,000 in savings while a woman would need \$266,000. If a retiree wants a 90 percent chance of having enough savings to cover health insurance premiums and out-of-pocket health care expenses in retirement, a man would need \$225,000 and a woman would need \$275,000 if premiums are subsidized by a former employer, and \$364,000 for a man and \$446,000 for a woman if premiums are not subsidized and the retiree pays the entire premium. As mentioned above, employers increasingly are moving to access-only plans. Married couples would need \$694,000 if premiums are not subsidized and they want a 90 percent chance of having enough money to cover health insurance premiums and out-of-pocket expenses in retirement.

Medigap and Medicare Part D

Figure 5 shows the level of savings required for a 55-year-old retiring at age 65 in 2019 to cover Medigap premiums, Medicare Part D premiums, and out-of-pocket prescription drug expenses. The three columns contain estimates that vary with prescription drug expenses during retirement.

According to Figure 5, a man with median drug expenditures would need \$144,000 and a woman would need \$210,000 in savings if he or she wants a 50 percent chance of having enough money to cover health care expenses in retirement. For a 90 percent chance of having enough savings, a man would need \$297,000 while a woman would need \$370,000.

Among individuals with drug expenditures at the 75th percentile, needed savings would be \$169,000 for a man and \$235,000 for a woman for a 50–50 chance of having enough savings to cover health care expenses in retirement. This same person would need \$355,000 (man) and \$419,000 (woman) in savings to have a 90 percent chance of having enough money for this purpose.

Figure 4
Savings Needed for Employment-Based Health Premiums, Medicare Part B Premiums, and Out-of-Pocket Costs for Retirement at Age 65 in 2019

	Employer Subsidizes Premiums	No Employer Subsidy of Premiums
Men		
Median	\$114,000	\$186,000
75th percentile	174,000	282,000
90th percentile	225,000	364,000
Women		
Median	164,000	266,000
75th percentile	216,000	350,000
90th percentile	275,000	446,000
Married Couple		
Median	277,000	449,000
75th percentile	359,000	580,000
90th percentile	429,000	694,000

Source: *EBRI Notes*, June 2009, authors' simulations based on assumptions described in the text.

Figure 5
Savings Needed for Medigap Premiums, Medicare Part B Premiums, Medicare Part D Premiums and Out-of-Pocket Drug Expenses for Retirement at Age 65 in 2019

	Median Prescription Drug Expenses Throughout Retirement	75th Percentile of Prescription Drug Expenses Throughout Retirement	90th Percentile of Prescription Drug Expenses Throughout Retirement
Men			
Median	\$144,000	\$169,000	\$290,000
75th percentile	225,000	266,000	468,000
90th percentile	297,000	355,000	634,000
Women			
Median	210,000	235,000	406,000
75th percentile	282,000	318,000	563,000
90th percentile	370,000	419,000	754,000
Married Couple			
Median	352,000	404,000	697,000
75th percentile	464,000	585,000	1,029,000
90th percentile	567,000	756,000	1,353,000

Source: *EBRI Notes*, June 2009, authors' simulations based on assumptions described in the text.

Men at the 90th percentile in drug spending would need \$634,000 and women would need \$754,000 to have a 90 percent chance of having enough money to cover health care expenses in retirement.

Conclusion

This report provides estimates for savings needed to cover health insurance to supplement Medicare and out-of-pocket expenses for health care services in retirement. It was found that men retiring at age 65 in 2009 will need anywhere from \$68,000 to \$173,000 in savings to cover health insurance premiums and out-of-pocket expenses in retirement if they want a 50–50 chance of being able to have enough money, and \$134,000 to \$378,000 if they prefer a 90 percent chance. Other findings:

Men:

- Men with *subsidized* retiree health benefits will need \$68,000, if comfortable with a 50 percent chance of having enough savings to cover health care expenses in retirement.
- Those with *unsubsidized* retiree health benefits who want a 90 percent chance of having enough savings will need \$217,000.
- Men who supplement traditional Medicare with Medigap and Medicare Part D and who have relatively high prescription drug expenses will need \$173,000 if comfortable with a 50 percent chance of having enough savings; to increase their odds to 90 percent, they would need \$378,000.

Women:

- Women retiring at age 65 in 2009 will need anywhere from \$98,000–\$242,000 in savings to cover health insurance premiums and out-of-pocket expenses in retirement if they are comfortable with a 50 percent chance of having enough money, and \$164,000–\$450,000 if they prefer a 90 percent chance.
- Women with *subsidized* retiree health benefits will need \$98,000 if comfortable with a 50 percent chance of having enough savings to cover health care expenses in retirement.
- Women with *unsubsidized* retiree health benefits who want a 90 percent chance of having enough savings will need \$266,000.
- Women who supplement traditional Medicare with Medigap and Medicare Part D and who have relatively high prescription drug expenses will need \$242,000 if comfortable with a 50 percent chance of having enough savings, while those who prefer a 90 percent chance of having enough savings would need \$450,000.

Persons currently age 55 will need even greater savings when they turn 65 in 2019. Needed savings for men range from \$114,000–\$634,000, while needed savings for women range from \$164,000–\$754,000 depending on their source of health insurance coverage to supplement Medicare, any employer subsidies, prescription drug use, and their savings goal related to their comfort level with having a 50 percent, 75 percent, or 90 percent chance of having enough savings to cover health insurance premiums and out-of-pocket health care expenses in retirement.

Most workers have always had the responsibility for their health care in retirement. The fact that the elderly had greater financial needs but less financial protection than younger workers is one reason leading up to the passage of Medicare (Institute of Medicine, 1993). Nearly 90 percent of Medicare beneficiaries have some form of insurance coverage to supplement Medicare Parts A and B.

This report's estimates comparing the savings needed for a person based on a 50 percent chance of having enough money to cover health insurance premiums and out-of-pocket health care costs with a 90 percent chance of having enough money highlights the impact of longevity and investment risk. While workers will have a difficult time saving enough money to cover health care expenses in retirement whether they live to average life expectancy or beyond,

many are generally unprepared for *both* health care expenses in retirement and retirement expenses. In fact, many individuals will need more money than the amounts cited in this report because this analysis does not factor in the savings needed to cover long-term care expenses,⁵ nor does it take into account the fact that many individuals retire prior to becoming eligible for Medicare. However, some workers will need to save less than what is reported if they choose to work during retirement and receive health benefits as active workers.

Finally, issues surrounding retirement income security are certain to become an even greater challenge in the future as employers continue to scale back retiree health benefits, and when policymakers begin to realistically address financial issues in the Medicare program with solutions that are likely to shift more responsibility for health care costs to Medicare beneficiaries.

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Endnotes

¹ Eugene Steuerle, personal communication.

² A technique used to estimate the likely range of outcomes from a complex process by simulating the process under randomly selected conditions a large number of times.

³ Nominal after-tax rates of return were assumed to follow a log-normal distribution with a mean of 1.078 and a standard deviation of 0.101. This provides a median nominal annual return of 7.32 percent.

⁴ See www.kff.org/medicare/med121306pkg.cfm

⁵ See VanDerhei (2006) for estimates of the impact of long-term care expenses on the amounts needed for sufficient retirement income at the 50th, 75th, and 90th percentiles.

Many 401(k) Sponsors Suspending Matching Contributions Are Funding Defined Benefit Pension Plans

By Dallas Salisbury and Liz Buser, EBRI

A review by the Employee Benefit Research Institute of 251 401(k) plan sponsors that have suspended matching contributions for their approximately 4.4 million workers finds that those employing 50 percent of the workers also maintained an open defined benefit plan. An additional 16 percent of workers were with employers that were still obligated to fund a frozen defined benefit plan. Further, 8 percent of the workers were with an employer that had both an open and a frozen defined benefit plan that carried funding obligations.¹

The effect that the economic downturn has had on the funded status of private-sector defined benefit pension plans has gained a great deal of attention. Employers like General Motors and General Electric have seen their plans go from being "over-funded" (in excess of 125 percent of liabilities) before the downturn to 84 percent and 97 percent funded, respectively, as of year-end 2008. Separate reports from Mercer and Milliman consultants have reported asset losses for private-sector defined benefit plans of more than \$350 billion since the market high in the fall of 2007. Employers seeking relief from provisions of the Pension Protection Act of 2006 have stated that they will have to contribute unanticipated billions to their pension plans in the years ahead unless the equity markets fully recover quickly.

One of the reasons many employers have replaced traditional defined benefit plans with cash balance plans and 401(k) retirement plans is to achieve predictability of expenses by reducing contributions costs (in the case of cash balance plans) or allowing them to be budgeted as a fixed percentage of pay (in the case of the 401(k)-type plan). Of the approximate total of 4.4 million workers in the 251 surveyed firms, 20 percent are with an employer with an open traditional defined benefit plan, and 30 percent are with an employer with an open cash balance plan. An additional group of workers, which could be as high as 730,000, work for firms that have some union workers and may be required to contribute to multi-employer defined benefit plans. Were this the case for all of these workers, it would raise the total percentage of those working for a firm contributing to some defined benefit plan to 73 percent of the approximately 4.4 million workers in this group of 251 companies.

As noted above, most of these workers are with firms that have both types of retirement plans. Because of the current economic conditions, many of these employers must make what are unexpected contributions to the defined benefit plan as a result of asset losses and liability growth, but they can eliminate what are discretionary matching contributions to a 401(k)-type plan. For the 50 percent of the workers in this group of 251 employers, the 401(k)-type retirement plan is an additional benefit to the open defined benefit pension plan; thus, retirement benefits are still being provided by the employer, in spite of the suspended 401(k) matching contribution. For the 16 percent of workers employed by a firm where the only defined benefit plan is frozen (as opposed to those employers that have both an open defined benefit plan and a frozen defined benefit plan), the loss of the 401(k) match is most serious for those who do not have a frozen benefit in the frozen plan because they were hired after the date of the freeze. For the 20 percent to 30 percent who are with an employer where the only retirement plan appears to be a 401(k) plan, suspension of the matching contribution likely means no employer contribution to retirement for workers unless and until the match is resumed.

Having detailed information on these firms would allow for a more detailed analysis and firmer findings, but the information gleaned from what is available suggests that most 401(k)-type matching contribution suspensions for this group of companies are taking place at employers that also have other retirement plan obligations, specifically for a defined benefit pension. Following the last recession at the turn of this century, there were also reports by employers of match suspensions, and subsequent reinstatements when the economy recovered. Hopefully, that will be true when the economy recovers from this recession as well. However, data are not yet available to know whether these findings hold true across the full spectrum of 401(k)-type plans that are suspending their matches.

This review was based upon information from several sources, including the Web site of The Pension Rights Center in Washington, DC (www.pensionrightscenter.org), which maintains what appears to be the most complete list of retirement plan sponsors that have made their match suspension actions public. A second information set on the PRC Web site lists firms that have publicly disclosed their pension freezes and conversions to cash balance plans. Also, public records at freeERISA.com, the U.S. Securities and Exchange Commission (<http://sec.gov>), and the U.S. Department of Labor (www.dol.gov), and lists published by various consulting firms, allowed determination of whether these sponsors also have open traditional defined benefit pension plans. In addition, company Web sites provided information on the number of workers.

It must be emphasized that it is not known how many workers of the totals reported are actually *active* participants or *vested* participants in the various open and frozen plans. It must also be noted that it is not known how many out of the universe beyond this group of 251 employers have suspended matching contributions, covering how many additional workers.

Endnotes

¹ Public data sources were used for this assessment that are not maintained by EBRI, such that their accuracy cannot be assured. It was also found that the Web sites of many of the companies reviewed contained internal contradictions, and contradicted information on Web sites such as www.freeERISA.com. It is unknowable which source is accurate or which conflicted fact is accurate, but this analysis chose to use the data that appeared the most reasonable. In spite of these issues, the authors felt this review was worthwhile given frequent questions from the news media and policymakers seeking any form of additional understanding of the suspension of 401(k) matches, what might explain them, and what their consequences might be.

New Publications and Internet Sites

Employee Benefits

Employee Benefit Research Institute. *Fundamentals of Employee Benefit Programs*. Sixth Edition. \$19.95 (EBRI members get a 55 percent discount) plus shipping. EBRI member organizations, or those interested in bulk purchases of *Fundamentals*, should contact Alicia Willis at (202) 659-0670 or e-mail: publications@ebri.org. To place individual orders online, contact publications@ebri.org or go to www.brightdoc.com/ebri

Health Care

Watson Wyatt Worldwide. *Closing the Gap: 2008/2009 Employee Perspectives on Health Care*. \$45. Watson Wyatt Worldwide, 901 N. Glebe Rd., Arlington, VA 22203, (703) 258-8000, fax: (703) 258-8585, www.watsonwyatt.com

U.S. Government Accountability Office. *State Children's Health Insurance Program: CMS Should Improve Efforts to Assess Whether SCHIP Is Substituting for Private Insurance*. Order from GAO.

Pension Plans/Retirement

Chatham Partners, LLC. *The Long March: Strategies to Accelerate Growth in the Retirement Outsourcing Market*. \$10,000. Andrew McCollum, Managing Director, Chatham Partners, 275 Wyman Street, Ste. 120, Waltham, MA 02451, (781) 314-0607, e-mail: amccollum@chathampartners.net

Orenstein, Mitchell A. *Pensions, Social Security, and the Privatization of Risk*. \$15 + S&H. Columbia University Press, 136 S. Broadway, Irvington, NY 10533, (800) 944-8648, fax: (800) 944-1844, <http://cup.columbia.edu/>

U.S. Government Accountability Office. *Defined Benefit Pensions: Survey Results of the Nation's Largest Private Defined Benefit Plan Sponsors*. Order from GAO.

COBRA Continuation Coverage Assistance Under the American Recovery and Reinvestment Act of 2009: Web Sites

Centers for Medicare & Medicaid Services, www.cms.hhs.gov/cobracontinuationofcov/

Hewitt Associates

www.hewittassociates.com/Intl/NA/en-S/KnowledgeCenter/LegislativeUpdates/LegislativeUpdatesDetail.aspx?cid=6541

Internal Revenue Service, www.irs.gov/newsroom/article/0,,id=204708,00.html

International Foundation of Employee Benefit Plans

www.ifebp.org/Resources/News/Regulatory+Updates/AmericanRecoveryandReinvestmentBillIncludesCOBRACHanges.htm

The Segal Company, www.segalco.com/uploads/9b156b028b0bd867a1bb2e025d4d268b.pdf

U.S. Department of Labor, www.dol.gov/ebsa/COBRA.html

Web Documents

America's Health Insurance Plans: "January 2009 Census Shows 8 Million People Covered by HSA/High-Deductible Health Plans" [May 2009] www.ahipresearch.org/pdfs/2009hsacensus.pdf

BlueCross BlueShield Association: "Healthcare Trends in America: A Reference Guide from BCBSA, 2009 Edition" www.bcbs.com/blueresources/healthcare-trends-report/pdfs/2009-healthcare-trends-in-america.pdf

Families USA: "Too Great a Burden: Americans Face Rising Health Care Costs"

www.familiesusa.org/assets/pdfs/too-great-a-burden-2009.pdf

Investment Company Institute: "Defined Contribution/401(k) Fee Study: Inside the Structure of Defined Contribution/401(k) Plan Fees: A Study Assessing the Mechanics of What Drives the 'All-In' Fee" [conducted by Deloitte for the Investment Company Institute, Spring 2009] www.ici.org/pdf/rpt_09_dc_401k_fee_study.pdf

Mathematica Policy Research: "State Policies to Encourage High-Deductible and Limited-Benefit Health Plans: Costs, Constituents, and Concerns" [*Policy Brief*] www.mathematica-mpr.com/pdfs/health/statepolicyencourage09.pdf

MetLife: "Managing Global Benefits: Challenges and Opportunities"

www.metlife.com/assets/institutional/products/benefits-products/ManagingGlobalBenefits.pdf

Milliman: "Preparing for Parity: Investing in Mental Health" [White Paper]

www.milliman.com/expertise/healthcare/publications/rr/pdfs/preparing-parity-investing-mental-WP05-01-09.pdf

NPR/Kaiser Family Foundation/Harvard School of Public Health: "The Public and the Health Care Delivery System"

www.kff.org/kaiserpolls/posr042209pkg.cfm

The Sloan Center on Aging & Work at Boston College: "Engaging the 21st Century Multi-Generational Workforce: Findings from the Age & Generations Study" http://agingandwork.bc.edu/documents/IB20_Engagement_2009-02-10.pdf

Towers Perrin: Value-Based Strategies: "Driving Down Costs by Improving Quality of Care"

www.towersperrin.com/tp/getwebcachedoc?country=global&webc=USA/2009/200904/perspectives_valuebased_strategies.pdf

Transamerica Center for Retirement Studies: "10th Annual Transamerica Retirement Survey: Strengthening Retirement Savings in a Weak Economy"

www.transamericacenter.org/resources/TCRS%2010th%20Annual%20Survey%20-%20Strengthening%20Savings.pdf

The Vanguard Group: "Inertia and Retirement Savings: Participant Behavior in 2008"

<https://institutional.vanguard.com/iam/pdf/CRRPB.pdf>

Wilshire Consulting: "2009 Wilshire Consulting Report on Corporate Pension Funding Levels"

www.wilshire.com/BusinessUnits/Consulting/Investment/2009_Corporate_Funding_Report.pdf

Washington Watch

Congressional Hearings of Note

Pensions Committee: *Delivery Reform: The Roles of Primary and Specialty Care in Innovative New Delivery Models* (May 14): http://help.senate.gov/Hearings/2009_05_14/2009_05_14.html

Senate Special Committee on Aging: *No Guarantees: As Pension Plans Crumble, Can PBGC Deliver?* (May 20) http://aging.senate.gov/hearing_detail.cfm?id=313310&

Joint Economic Committee: *Equal Pay for Equal Work? New Evidence on the Persistence of the Gender Pay Gap* (April 28): http://jec.senate.gov/index.cfm?FuseAction=Press.PressReleases&ContentRecord_id=cf433c8d-5056-8059-76c9-af59a1aa3b35

EBRI Activities

EBRI President and CEO Dallas Salisbury was appointed June 3 by the Securities and Exchange Commission to an Investor Advisory Committee to give investors a greater voice in the commission's work. SEC Commissioner Luis A. Aguilar will serve as the Commission's primary sponsor of the Committee. SEC press release on the panel is online at <http://www.sec.gov/news/press/2009/2009-126.htm>

Dallas Salisbury testified April 29 in his capacity as chairman of the American Savings Education Council before the Senate Committee on Homeland Security and Government Affairs, Subcommittee on Oversight of Government Management, the Federal Workforce and the District of Columbia. The topic of the hearing was "The Federal Government's Role in Empowering Americans to Make Informed Financial Decisions." <http://www.ebri.org/pdf/publications/testimony/t158.pdf>

On May 20, Salisbury testified as EBRI president and CEO at a hearing of the Senate Special Committee on Aging. The hearing focused on the financial situation of the PBGC. Salisbury's testimony was titled "The Pension Benefit Guaranty Corporation," and is available at <http://www.ebri.org/pdf/publications/testimony/t-159.pdf>

Also on May 20, EBRI Research Director Jack VanDerhei presented EBRI data in a meeting of the President's Economic Recovery Advisory Board Retirement and Savings Working Group.

Recent Fast Facts

Fast Facts from EBRI #120, April 23, 2009: *What Are Workers' Expected Major Sources of Retirement Income?* <http://www.ebri.org/pdf/FFE120.23April09.Final.pdf>

Fast Facts from EBRI #121, April 29, 2009: *What Are Key Characteristics Indicating Likely Retirement Savers?* <http://www.ebri.org/pdf/FFE121.29April09.Final.pdf>

Fast Facts from EBRI #122, May 13, 2009: *Paying for Retiree Medical Costs, I: Workers Views:* <http://www.ebri.org/pdf/FFE122.13May09.Final1.pdf>

Fast Facts from EBRI #123, May 14, 2009: *Paying for Retiree Medical Costs, II: Retirees Views:* <http://www.ebri.org/pdf/FFE123.14May09.Final.pdf>

Fast Facts from EBRI #124, May 20, 2009: *Social Security: How Much Confidence Among Workers, Retirees?* <http://www.ebri.org/pdf/FFE124.20May09.Final.pdf>

Social Media Sites

EBRI's Twitter page is @EBRI (if on Twitter) or can be found on the Web at <http://twitter.com/EBRI>

Choose to Save[®] is now on Facebook (<http://www.facebook.com/home.php?#/pages/Choose-to-Save/56756038533?ref=ts>), Twitter (<http://twitter.com/choosetosave>), and YouTube (www.youtube.com/ctspsas)

Notable Government Documents Available Online

Congressional Budget Office:

- *The State of the Economy*: http://cbo.gov/ftpdocs/100xx/doc10086/05-21-State_of_Economy_Testimony.pdf
- *Data on the Distribution of Federal Taxes and Household Income*: <http://cbo.gov/publications/collections/taxdistribution.cfm>

Congressional Research Service:

- *Setting and Valuing Health Insurance Benefits*: http://assets.opencrs.com/rpts/R40491_20090406.pdf
- *Retirement Savings and Household Wealth in 2007*: <http://opencrs.com/document/RL30922/>
- *State Children's Health Insurance Program (CHIP): A Brief Overview*: <http://opencrs.com/document/R40444/>
- *Health Care Reform: An Introduction*: <http://opencrs.com/document/R40517/>
- *State Health Reform Strategies*: <http://opencrs.com/document/R40513/>
- *Unemployment and Health Insurance: Current Legislation and Issues*: <http://opencrs.com/document/R40165/>
- *Health Insurance Premium Assistance for the Unemployed: The American Recovery and Reinvestment Act of 2009*: <http://opencrs.com/document/R40420/>

Department of Labor Bureau of Labor Statistics:

- *Consumer Expenditures in 2007* [includes data on spending for health care, life and other personal insurance, and pensions and Social Security]: <http://www.bls.gov/cex/csxann07.pdf>
- *Access to Wellness and Employee Assistance Programs in the United States*: <http://www.bls.gov/opub/cwc/cm20090416ar01p1.htm>

Department of the Treasury: *General Explanations of the Administration's Fiscal Year 2010 Revenue Proposals*: <http://www.treas.gov/offices/tax-policy/library/grnbk09.pdf>

Government Accountability Office:

- *The Nation's Long-Term Fiscal Outlook: March 2009 Update*: <http://www.gao.gov/cgi-bin/getrpt?GAO-09-405SP>
- *Auto Industry: Summary of Government Efforts and Automakers' Restructuring to Date* [This report includes a discussion, on pages 20–22, of the federal government's potential financial exposure if the Pension Benefit Guaranty Corporation had to take over the Chrysler or GM pension plans.] <http://www.gao.gov/new.items/d09553.pdf>

U.S. House of Representatives:

- *The 401(k) Fair Disclosure for Retirement Security Act of 2009* [text of bill introduced by Reps. Miller, Andrews]: <http://edlabor.house.gov/documents/111/pdf/legislation/401kFairDisclosureforRetirementSecurityAct2009.pdf>
- *Savings Recovery Act of 2009* [text of bill introduced by Rep. Boehner, others]: http://www.americanbenefitscouncil.org/documents/savings_recovery_act2009.pdf

Internal Revenue Service: *Retirement News for Employers*: http://www.irs.gov/pub/irs-tege/rne_spr09.pdf

U.S. Senate Finance Committee: *Information on the Finance Committee Policy Options for Health Care Reform*: <http://finance.senate.gov/sitepages/Policy%20option%20report.html>

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