President's Report

—Dallas L. Salisbury

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The Memorial Day recess emptied Washington, as the campaign trail attracted politicians like flypaper. Policymaking has come to a virtual standstill as the election season heats up, with a growing prospect that the nation will enter 2005 with a large federal deficit and with few new laws. Mental health parity extension and new limits on executive compensation may represent the extent of employee benefits legislative action. Some added guidance from the SEC, Treasury, and Labor is likely on health savings accounts (HSAs), mutual fund practices and trading, defined contribution plan fees, and investment advice. Should it appear that President Bush is in deep trouble in the fall, the nation could see a rush to deregulate in other areas, as occurred in the last months of the Clinton administration. Clarity on cash balance plans, the PBGC, and other issues will await the next Congress, and perhaps the Congress after that, as policymaking in Washington becomes more incremental and more heavily driven by ideology. The House and Senate continue to see the retirement and departure of "moderates" in both parties, who have been advocates of making policy in the middle ground; inevitably, the art of compromise in Washington is a dwindling one.

Many issues will be left to the next Congress:

- What to do about high health-care cost growth?
- What to do about the growing population that lacks health insurance?
- What to do about the erosion of employer-sponsored health insurance?
- What to do about the individual health insurance market to assure that those who want and need insurance can get it?
- What to do about defined benefit pension funding (and underfunding)?
- What to do about cash balance plans?
- What to do about projected PBGC deficits?
- What to do about financial and medical illiteracy—especially as savings, retirement, and health programs put more responsibility on individuals?
- What to do about looming deficits in Medicare and Social Security?
- What to do about the future financial security shortfalls that will occur as individuals move away from pooled risk?

The policy list is actually much longer, and if regulatory activity were added it would go on for pages.

Discussion at EBRI's May 5 Board of Trustees meeting focused on EBRI documentation of disturbing trend lines in many of these areas (all at www.ebri.org). Discussion at the May 6 policy forum built upon the new EBRI analysis of the implications for long-term financial security and savings needs of the shift away from risk pooling and annuity payment streams. The new work tested the value of annuitization and therefore needed to simulate a significant number of future life-paths to capture the longevity risk experienced by retirees. The output metric used was the median percentage of additional compensation that must be saved annually until retirement for a 75 percent chance of covering simulated expenses. If one assumes that all defined benefit participants take lump-sum distributions at retirement, the average annual increase in needed savings is 14.9 percent, whereas assuming that all individual accounts (employer-based DB and DC plans and IRAs) are annuitized at retirement has an impact twice as large—but in the opposite direction (a 30.0 percent decrease in needed annual savings). Both sessions included discussion of how the magnitude of underfunding for retiree health insurance (including Medicare) will damage long-term financial security.

The EBRI Board discussed dramatic changes in the policy environment. Trustees involved on a daily basis with Congress noted that when ERISA was enacted in 1974, the Republican Party focused on strengthening employer provision of health and retirement plans as the best way for individuals to gain economic security protections, whereas the Republican focus today is on individual choice and responsibility and individual markets and programs. By contrast, they noted, the Democratic Party emphasized at the time of ERISA's enactment the expansion of government programs, possible mandates on employers, and "big-bang" changes rather than incremental action. The Democratic focus today was described as moving away from government-only solutions, embracing incremental policy change, and seeking to maintain employer-based programs. Both parties seem to be moving toward legislation that requires standardization of both health and retirement plans, systems, administration, etc., as opposed to individual employer or provider customization.

Discussion of the absence of clear national retirement and health policies led to the recognition of what has become a constant partisan election-year mentality in the Congress, as opposed to a long-time tradition of bipartisan cooperation in the year after each election. Now the political world is one of 24-hour posturing, with every action judged against its ultimate election impact. The number of lawmakers willing to break ranks and moderate across the partisan aisles has declined with each election, and retirements from the Senate this year will remove several more of those members.

The EBRI Board also discussed dramatic change in the environment in which human resources and employee benefit decisions are made. Trustees described the basic social contract between employer and employee as having changed drastically. Employers, they noted, now frequently focus on facilitation rather than automatic provision (a voluntary participation DC plan instead of a mandatory participation DB plan); on individual choice rather than mandatory pooling of all risk; on individual and government responsibility rather than the "paternalistic" employer; on avoiding corporate cost volatility rather than insulating employees from volatility created by risk; on segmenting the work force into multiple units, with different total rewards, due to competitive differences in different business segments, rather than pooling all workers into the same total rewards program; and on the impact of benefit program design and cost on domestic and global competitiveness and reported quarterly earnings. In addition, it was noted, when ERISA was passed many large employers still suggested that workers who wanted it could anticipate lifetime employment with the organization—whereas few organizations (be they public or private) suggest that today. One Trustee cited the rate of federal government outsourcing and federal agency job buyouts at early ages, as well as federal government defined benefit plan reductions and the introduction of the federal thrift savings plan, as evidence that the social contract changes had taken place in both sectors.

The EBRI Board reviewed a history of benefit trends since 1974 (see my background paper "ERISA at 30," contained with the policy forum information at www.ebri.org) and the success of EBRI in providing "macro disclosure" numbers on the implications of trends and policy proposals (with the May *EBRI Issue Brief* on the consequences of lump-sum and annuity trends for financial security and needed savings levels being the newest example). I recalled the central role such analysis had played in a number of congressional debates of the past, including the role our July 2003 report on employer retiree health plans and prescription drugs played in final decision-making on the Medicare modernization legislation. As before, "just the facts" was the bottom line for the Board, as they discussed how a policy process driven primarily by ideology made broad-based, fact-based disclosure of implications extremely important. The Board also concluded that quantification of the implications of moving away from risk sharing and pooling arrangements for future financial security should continue to be a central focus of EBRI's work.

The EBRI Board then discussed many changes being required in both retirement and health programs by the pressures of competition. The biggest question left open was how employees would react in terms of job loyalty and job change when the economy does turn around and labor market tightening shifts power back to the worker. How will employers and unions balance the need to attract and retain against a growing concern over the cost of benefit programs? What design actions may employers feel they have to take simply because the government fails to provide clear guidance through a process marked by both delay and incrementalism? How will employees and policymakers react if, based upon comprehensive and sweeping reviews of benefit programs, employers make radical changes? Will more and more involvement of CEOs and CFOs in benefits and HR, with more and more emphasis on the financials and costs being key, lead to additional fundamental changes in health and retirement benefits?

The databases and models that EBRI has developed provide a unique ability to undertake implications analysis for "macro disclosure" and to facilitate collaborative work with others. The breadth of our Board and our members assures a richness of insight on trends and pressures, as well as an avenue for distribution of research results. The Internet—with www.ebri.org, www.choosetosave.org, and www.asec.org —the many sites to which we link, and the power of search engines in finding our work assure national and international disclosure.

The pressures discussed at the May meetings are unlikely to abate. With your support, EBRI will continue to present the facts and inform decision-making. Enjoy the summer ahead, and don't forget to put EBRI in your 2005 budget!

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