Congress approves sweeping pension reforms

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After many months of deliberation, Congress approved groundbreaking legislation to shore up employee pensions passed in early August, with wide-ranging implications for 401(k)s, defined benefit plans and financial security for retirees. At press time, President Bush was expected to sign the bill.

"The pension reforms are the most far-reaching and comprehensive pension changes in 30 years and dramatically affect not only how plans will be funded and administered, but also whether employers will continue to sponsor them," Mark Urgoretz, president of the ERISA Industry Committee, comments.

David Speier, a senior actuary at Watson Wyatt, observes, "Having a level of certainty [about funding requirements and legal compliance] is going to make a big impact. We had an environment that was very uncertain. It's too early to tell all the challenges [employers] will face."

The bill's provisions include:

* 2008 effective date.

* Minimum funding standards with amortization of liabilities over seven years.

* Interest-rate smoothing over 24 months.

* Accelerated contribution requirements for at-risk plans

* Prohibition against benefit increases, if plan is less than 80% funded.

* Prohibition against forcing workers to invest retirement savings in company stock.

* Longer transition period for certain airlines and defense contractors.

* Allowing investment advice from firms that sell investments.

* Sanctioning hybrid pensions, but only for actions taken after June 30, 2005.

* Safe harbor for automatic enrollment.

* Permitting employers to take money out of an overfunded pension and spend it on retiree health care

* Limited use of credit balances.

* Permanent viability for Roth 401(k)s.

Concerned about freezes

Some employer groups are concerned that the bill could encourage more companies to freeze or terminate their pensions.

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The American Benefits Council considers the legislation a mixed bag for employers and workers. ABC President Jim Klein says it is "a very positive step for Americans participating in defined contribution retirement plans. However, as a result of the volatile pension funding rules enacted, I believe we will witness an unprecedented number of companies closing their well-funded defined benefit pension plans to new employees."

He adds, "The bill is flawed in its approach to the funding rules for defined benefit plans. The new funding regime for most companies will inject more unpredictability into their pension financial obligations. If well-funded pension plans leave the system because of unpredictable funding requirements, then the premium base will shrink, and the Pension Benefit Guaranty Corp. will be in worse shape."

Likewise, Karen Ferguson, director of the Pension Rights Center, criticizes the bill for containing "harmful provisions that could result in broken pension promises and conflicts of interest. The center is also concerned that the bill would give unnecessary and costly tax breaks to higher-paid employees at the expense of others, and that the bill's overarching goal to improve pension plan funding could be undercut if employers, daunted by what they perceive as onerous requirements, exit the system."

However, she likes that it "has a handful of positive provisions relating to disclosure and vesting requirements."

Ugoretz notes, "The legislation's true test will be its impact in the real world, as each employer asks, Can I sponsor a pension plan under these rules?'"

Watson Wyatt analyzed retirement plans at Fortune 100 companies and found that 37% offered a pension to new hires in 2005, down from 42% in 2004 and 50% in 2003. The proportion of private industry workers participating in a defined benefit retirement plan dropped from 32% in 1993 to 21% last year, according to the Bureau of Labor Statistics.

Bob McAree, senior vice president at The Segal Company, agrees that the legislation increases funding volatility for employers, but says that can be mitigated by better asset allocation. (See further coverage on the pension bill from The Segal Company on page 80.)

Speier says, "There will be some additional volatility. The [older] rules weren't without volatility. Now there's a little more room to manage your funding policy for those who have the cash to do so," thus potentially reducing volatility.

Dorothy Coleman, vice president of tax and domestic economic policy at the National Association of Manufacturers, observes, "The bill likely will increase costs for employers that sponsor traditional defined benefit plans."

Meanwhile, AARP CEO Bill Novelli remarks, "While this bill has shortcomings, a number of its provisions will improve retirement security. While employees may get more help with their investment decisions, they also may be at greater risk of receiving conflict-tainted investment advice from financial service firms. This bill can help make retirement more secure for many, but it leaves much work to be done to ensure retirement security for all."

Supporters

David Woods, CEO of the National Association of Insurance and Financial Advisors, lauded the bill's passage as "a giant step in the right direction."

House Majority Leader John Boehner (R-Ohio), says, "These pension reforms will help protect the retirement security of American workers and ensure their hard-earned pension benefits are there for them when they retire. This bill gives American workers the type of meaningful, personally tailored investment advice that will help them make the most of their retirement future. It will also protect the interests of taxpayers, who could be on the hook for a multibillion dollar bailout of the PBGC."

Likewise, Sen. Edward Kennedy (D-Mass.) says, "Too many Americans lie awake at night worrying about how they can afford retirement. Too many workers have seen their pensions fail in recent years. Key provisions of this bipartisan plan will help safeguard the retirement security of over 100 million Americans. They will open up important new ways for all Americans, including the middle class workers, to save more for retirement."

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