WHAT DOES RETIREMENT SECURITY LOOK LIKE IN AMERICA?
A Retirement Security Initiative by the
Office of the PBGC Participant and Plan Sponsor Advocate
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Short Summary

Pension plans are a highly effective means of ensuring retirement security for American workers and their families, while also supporting the larger economy. Despite its important economic role, the U.S. defined benefit system is currently in decline. The Pension Benefit Guaranty Corporation (PBGC) is a federal agency that insures pension plans sponsored by private employers, and its mission statement includes the protection, promotion, and preservation of these pension plans.

PBGC's Office of the Participant and Plan Sponsor Advocate (Office of the Advocate) is launching a new initiative bringing various pension industry groups, government staff, retirees, and other stakeholders together in a dialogue to address challenges to the preservation of America's private-sector defined benefit pensions, and to explore how PBGC can protect and promote the continuance of these plans for future generations of Americans.

The 2022 Advocate Annual Report to Congress first raised the question of retirement security in America given the changing defined benefit landscape. The Office of the Advocate is examining this question and exploring what PBGC can do in accordance with its statutory mission to preserve, promote, and protect the private-sector defined benefit system. There are many proposals and areas worth addressing as we review these important issues.

Background

The United States has a voluntary employee benefits system, allowing employers to choose whether to offer retirement and other benefits to their employees. One form of retirement benefit, defined benefit pension plans, can be an effective employee recruitment and retention tool for employers, while offering employees the prospect of lifetime income, which far increases the likelihood of financial comfort and security in retirement compared to a single lump sum payout. The steady stream of income for life provided by pension plans also decreases the degree to which a retiree will need to lean on family members or public assistance in old age.

Defined benefit plans – as part of a proverbial *three-legged stool* along with Social Security and personal savings – have a long track record of ensuring retirement security for significant numbers of American workers. Additionally, when retirees spend their pension income in the communities where they live, that pension income has the power to shore up local economies, particularly at times of economic difficulty. Retirees with pensions feel secure in their spending, whereas retirees relying on 401(k) income are reluctant to spend those funds during a market downturn. In fact, retiree income from defined benefit pension plans played an important role in stabilizing the U.S. economy during the COVID-19 pandemic.

America's pensions are worth preserving. Unfortunately, in recent decades, the private pension system has been in decline. PBGC's most recent Pension Insurance Data Tables indicate that the number of covered participants in defined benefit plans has decreased by 30% over the past decade, while the overall number of plans has modestly declined. Escalating PBGC premiums, funding volatility, and administrative burdens, such as reporting and disclosure, are often cited as reasons for this shift away from traditional pension plans. Employers prefer defined contribution plans, such as 401(k) plans, despite research showing that defined benefit plans are a more cost-efficient way to provide retirement benefits to employees. Many plan sponsors have begun to terminate, freeze, and/or de-risk all or part of their pension plans, posing questions about the long-term effects on the defined benefit system when employers exit entirely, extinguishing PBGC's guarantee of the benefits.

Defined contribution plans are often viewed as easier and more affordable for employers to administer. Many plan sponsors have cited burdensome administrative requirements and escalating administration costs, including PBGC premiums, as impediments to maintaining a defined benefit plan. Defined contribution plans are also more attractive to employees who favor portability over traditional defined benefit plans. Given the shift from defined benefit to defined contribution plans, it is common for many stakeholders to view the decline of the defined benefit system as inevitable. However, current research suggests that pensions are more cost-efficient for employers than defined contribution plans, and that many of the economic factors that motivated employers to move away from defined benefit plans in decades past are no longer present.

Research shows that 401(k) plans and other defined contribution plans are nowhere near as effective as defined benefit plans at providing retirement security because they are not designed to offer lifetime income. Rather, they allow employees access to an individual account with a balance that changes depending on investment performance, rendering employees' retirement savings susceptible to market volatility, with the employee bearing the entire financial risk. By contrast, the lifetime income provided by defined benefit plans protects employees (and their surviving spouses) against the possibility of outliving their retirement savings, particularly as this lifetime income is insured by PBGC.

Additionally, the defined contribution system places greater general responsibility on employees to fund their own retirements at least partially, whereas most private sector defined benefit pension plans are fully employer-funded. Employees must also figure out how best to decumulate their defined contribution plan savings to make them last throughout retirement, a responsibility that is not present in defined benefit plans since the employer pays the benefit for life.

Leakage resulting from participants withdrawing funds from their defined contribution plans prior to retirement as a means of funding pre-retirement expenses, particularly common in times of financial distress, is another challenge. This trend may be accelerating, as data shows that a third more people took hardship withdrawals from their defined contribution plans in the second quarter of 2023 than in the second quarter of 2022. As a result of all these factors, the shift away from defined benefit plans has coincided with a significant retirement savings gap for individuals with lower incomes.

Stakeholders throughout the retirement space are aware of the potential impacts of a shrinking defined benefit system on Americans' overall retirement security, which include declines in older Americans' ability to afford housing, healthcare, and long-term care, and to pass on intergenerational wealth. Much of the existing dialogue among retirement industry professionals focuses on improving the defined contribution system by incorporating more pension-like features. However, missing from the national conversation is robust discussion around transforming, and thus preserving and protecting, America's defined benefit pension system.

The Office of the Advocate is undertaking this project to encourage greater discussion around how PBGC can promote, preserve, and protect the defined benefit system, in accordance with its mission. This discussion is especially relevant given the upcoming 50th anniversary of the Employee Retirement Income Security Act of 1974 (ERISA). The retirement landscape has evolved over the past fifty years and consideration must be given to how PBGC can ensure and promote retirement security for all future generations.

Proposed Solutions

There are numerous reports, publications, and proposals highlighting the importance of retirement security and offering suggestions to strengthen the defined benefit system (see *Recommended Reading* section in Appendix I). In addition to reviewing this literature and attending public presentations, the Office of the Advocate engaged in informal discussions with interested industry stakeholders, including plan sponsor organizations, participant advocacy groups, pension plan professionals and service providers, and academics, regarding the decline of the defined benefit system and PBGC's role in its preservation.

During these discussions, the Office of the Advocate learned that, while some stakeholders believe that the key to stronger retirement security among Americans is a focus on improving the defined contribution system, many others continue to support reinvesting in the defined benefit system through a variety of potential approaches. The following considerations and approaches raised during the discussions warrant further consideration. Note that these proposals relate specifically to PBGC's Single Employer Program.

Reform PBGC Premiums

Single-employer PBGC premiums have grown exponentially over the last fifteen years. These increases coupled with low interest rates have made annuity purchases attractive and cost-effective options for plan sponsors seeking to manage liabilities. Premiums are frequently cited as a major driver of plan sponsors freezing, de-risking, and/or terminating their defined benefit plans.

Unsurprisingly, many stakeholders raise reducing PBGC premiums or considering alternative structures as necessary solutions, particularly considering the significant funding surplus currently enjoyed by PBGC's Single Employer Program. Current premium levels are viewed as burdensome, arbitrary, and unrelated to any rational measure of the agency's need, not to mention antiquated since they are insuring for risks that no longer exist. While any changes to the premium structure must be made by Congress through legislation, PBGC provides technical advice to Congress, and the agency should have a vested interest since its mission also includes keeping pension insurance premiums at a minimum.

There are numerous approaches to reforming the PBGC single-employer premium structure, such as:

- *Premium Holidays.* Suspending plan sponsors' obligation to pay premiums in light of surplus PBGC funding is one means of addressing PBGC premiums as a disincentive to continued sponsorship of defined benefit plans. When, for how long, and the conditions under which a plan sponsor may qualify for a premium holiday are variables that merit further examination.

- *Alternative premium structures, such as automatically adjusting PBGC premium levels based on PBGC's average funded status.* Single-employer plans must pay a flat rate per-participant premium and, if a plan is underfunded, it is required to pay a variable-rate premium (VRP) based on the plan's unfunded vested benefits (subject to a cap based on number of participants).

  This structure not only renders PBGC premiums more costly for even well-funded plans that are simply not 100% funded – when there is no expectation that plans must be 100% funded to be healthy – but also creates an even greater cost burden for those plans and sponsors facing the most financial difficulty. SECURE Act 2.0 improved the burden by eliminating the indexing on the VRP, a change that was well-received by the plan sponsor community.

  One proposal by the American Benefits Council suggests automatic premium decreases or increases when PBGC funding climbs above or dips below certain levels. Under this proposal, current premium levels would apply if PBGC's funding level falls below 90%, with lower flat rate and variable premiums if funding is between 90% and 100%, and further reductions in both flat rate and variable premiums if funding exceeds 110%, with $500 per-participant caps on variable rate premiums for all scenarios when funding is above 90% and not above 125%. The proposal recommends a premium holiday if funding exceeds 125%.

  Tying premiums to the funded status of PBGC's Single Employer Program would provide a rational basis on which to hinge premiums, while also creating opportunities to reduce sponsor costs when PBGC enjoys a significant surplus and can afford lower or no premium revenue. This creative solution merits further consideration and discussion.

- *Taking PBGC premiums "off-budget."* Even though PBGC premiums are earmarked for PBGC programs and cannot be used for other purposes, they are still counted as revenue for the purposes of the federal budget. Ceasing to treat PBGC premium increases or decreases as revenue for federal budget purposes is an important consideration because it eliminates misleading information about both PBGC financing and the federal budget.

Encouraging and Promoting Defined Benefit Plans

The decades-long and accelerating trend of shifting away from defined benefit plans in favor of defined contribution plans has made it culturally and logistically challenging for plan sponsors to turn back. While investment officers and plan administrators closely familiar with the retirement space may see the value of giving defined benefit plans a second chance, it is other corporate executives, such as a CFO, who have ultimate decision-making authority. For many key decision-makers, a retirement plan is just one measure on a corporate balance sheet, and they have long been told that defined benefit plans are an outsized liability.

Increased outreach and education in the plan sponsor community among key decision-makers such as CFOs and chief executive officers have the potential to soften the current culture of pessimism toward defined benefit plans. It is important to understand what incentives may encourage CFOs with ongoing plans to maintain such plans, and for companies who maintain frozen plans, what triggers may prompt leadership to reopen or "unfreeze" the plans. PBGC is in a prime position to lead such dialogue with the executive community, as well as encourage the significant economic benefits of defined benefit plans.

Education For Participants, Beneficiaries, and the General Public

Likewise, the general workforce may not be aware of the benefits of defined benefit plans, as these plans have diminished in popularity and availability over the years. Stakeholders noted that plan sponsors do not view defined benefit plans as offering a strong value proposition because, in addition to seeing them as costly and administratively burdensome, they do not see a significant demand for defined benefit plans among their employees.

Additionally, stakeholders noted that workers, who switch jobs more frequently today than in the past, value the portability offered by defined contribution plans. Meanwhile, the vesting requirements of defined benefit plans generally require workers to stay with one employer for five years to collect a benefit, removing flexibility. Greater education among the public of the significant economic value of defined benefit plans could increase employee demand, in addition to examining the factors that prevent employees from vesting. PBGC has an important role to play in increasing public awareness of defined benefit plans, particularly since it holds unclaimed retirement benefits for over 80,000 people.

Hybrid Structures and New Platforms That Reduce Sponsor Risk and Offer Greater Portability

Multiple stakeholders have suggested that defined benefit plans should continue to be adopted but in a modernized form that makes them more palatable to plan sponsors and more appealing to employees. Risk sharing among all parties is a common theme, suggesting that hybrid and alternative defined benefit structures offering adjustable benefits features may be attractive to employers while also providing lifetime income to participants who often cannot afford to bear risk during retirement and need the stability of a defined benefit.

There are numerous hybrid plan structures worth exploring further. For example, the hybrid structure offered by cash balance plans is currently seeing a resurgence in popularity and adoption. Over the years, while other types of defined benefit plans have declined in number, cash balance plans have grown. IBM, a benefits bellwether that led the shift from defined benefit to defined contribution plans, recently announced that it is ending its 401(k) matching and replacing it with a cash balance component in the company's previously frozen defined benefit plan. This change is prompting renewed interest in the cash balance structure and defined benefit plans in general.

Cash balance plans are attractive vehicles for retirement since they offer a more institutionalized plan structure than defined contribution plans while reducing employer risk and providing greater clarity and portability to plan participants. However, stakeholders indicate that legislative and regulatory changes are needed to help facilitate administration of these plans. While SECURE Act 2.0 provided helpful legislative changes to address "backloading" test concerns and bring certainty to how the test works, further changes could help promote adoption of the structure. A 2023 proposal from the American Benefits Council suggests updating the cash balance plan accounting rules to more accurately reflect plans sponsors' future benefit obligations.

A different hybrid plan type proposed in a 2007 report by the Pension Rights Center's Conversation on Coverage, called the Guaranteed Account Plan (GAP), works much like defined contribution plans but would require the plan sponsor to guarantee a minimum return on investment. Benefits would be paid out as an annuity with a guaranteed survivor benefit. This plan type could be insured by PBGC at a reduced premium. The Conversation on Coverage report also proposed other potential simplifications and features that could be used to modernize traditional defined benefit plans – suggestions that are worth further evaluation and consideration. A link to the report is in the Recommended Reading section in Appendix I.

Multiple stakeholders are enthusiastic about variable annuity plans, which operate like defined benefit plans but offer flexibility, portability, and limited risk-sharing between the employer and annuity. These plans insulate plan sponsors from risk by adjusting benefits based on returns on the plan's assets, but also include participant protections, such as benefit stabilization by way of an asset reserve. The American Benefits Council offers specific proposals to facilitate the growth of this type of plan, such as allowing plan sponsors more time than is currently allowed to make benefit adjustments based on assets and providing clearer regulatory guidance as to the calculation of lump sum benefits under such plans.

Additionally, many sources have noted the value of exploring multiple employer plans or other plan types or platforms that offer a defined benefit structure but tie the plan less closely to the employer-employee relationship. This type of platform offers the potential benefits of removing employer risk while increasing portability. Further discussion would be required as to the risk-sharing structure associated with such a platform and the role of services providers in administering them.

It is also worth considering successful international models that provide examples for improved defined benefit structures that enhance retirement security. For example, the CAAT Pension Plan, which was originally created to support the Ontario, Canada college system, now covers over 360 participating employers and over 91,000 active and retired members. This hybrid plan provides participants with lifetime retirement income at an affordable cost for employers in all sectors.

The United Kingdom's (UK) National Employee Savings Trust (NEST) is another example of a successful plan that provides for the accumulation of retirement funds in a UK trust for all UK citizens with or without a pension plan and offers distribution in the form of a lifetime annuity. This is an amazing form of coverage and offers retirement security to all citizens of the UK to provide some opportunity for a secure retirement.

Suggested Changes to Enhance and Preserve Defined Benefit Plans

Legislative changes providing funding relief and current economic conditions have resulted in many plans experiencing a funding surplus. Under current law, these overfunded plans can only use the surplus funds if they terminate. Many plan sponsors and their advisors have suggested that this captured surplus may result in a wave of plan terminations in the coming years. However, there are numerous suggestions for legislative changes that would allow plan sponsors to recapture value from the surplus without the need to terminate the plan by allowing use of the surplus to enhance retirement security and provide other benefits to participants.

Suggestions include legislation to allow surplus funds to be used to fund defined contribution plans. Such legislation would require participant protections to ensure that defined benefit plan benefits are preserved. There are similar proposals involving surplus amounts in 401(h) health arrangements. These proposals, which would require legislation, also involve using the 401(h) surplus to fund both defined benefit and defined contribution plans. Overall, these proposals provide strong incentives for plan sponsors to maintain well-funded plans since they could use surplus funds for other retirement security-related purposes.

Another suggestion to improve the current defined benefit system includes conforming defined benefit plan vesting rules to the defined contribution plan rules (requiring 3 years to vest or a 2-6 year graded vesting), as a means of simplifying administration and enabling portability. Coupling this provision with higher mandatory cash-out limits would likely address potential plan sponsor concerns about having to administer and paying premiums for participants with very small benefits. These changes could also prevent dramatic increases in the number of missing participants and lost plans.

Conclusion and Outlook

There are many strong suggestions and proposals to help enhance the defined benefit system and promote retirement security for Americans. The Office of the Advocate will be continuing its research into these topics in 2024. The Office of the Advocate looks forward to holding a series of roundtable discussions to explore areas of interest related to defined benefit system preservation, single-employer premiums, plan design, and future considerations for the system.

These dialogues will help identify opportunities to strengthen the existing defined benefit system, particularly regarding the actions, guidance, procedures, and policies PBGC can implement toward that end.

Appendix I - Recommended Reading

Proposals for Enhancing Retirement Security by Strengthening the Single-Employer Defined Benefit Plan System
American Benefits Council, October 31, 2023

Americans are Pulling Out of Their 401(k) Plans at an Alarming Rate
Alicia Wallace, CNN.com, August 2023.

2020 Pension Insurance Data Tables
Pension Benefit Guaranty Corporation, July 2023.

Pensionomics 2023: Measuring the Economic Impact of DB Plan Expenditures
Ilana Boivie and Dan Doonan, National Institute on Retirement Security, January 2023.

Pension Defrost: Is it Time to Reopen DB Pension Plans – or at Least Stop Closing and Freezing Them?
Jared Gross and Mike Buchenholz, J.P. Morgan Asset Management, January 2023.

Office of the PBGC Participant and Plan Sponsor Advocate De-Risking Study: Part I (2017) | Part II (2018)

Retirement for the Ages: Building Enduring Retirement-Income Systems
American Academy of Actuaries, January 2014.

Covering the Uncovered, Final Report of the Conversation on Coverage: Common Ground Proposals to Expand Retirement Savings for American Workers
Pension Rights Center, 2007.

A New Benefit Platform for Life Security
ERISA Industry Committee, May 2007.