From the Editor

Rethinking Employee Benefits, Part 3: Should Pensions Be Voluntary?

What would the ideal retirement system look like? It would be simple, funded, easy to use and hard to misuse—in a nut shell, idiotproof and bulletproof. It would look nothing like the rickety, three-legged stool on which baby boomers' financial future is precariously perched. Defined benefit plans are close to extinction, 401(k) and other defined contribution arrangements are ineffective as retirement vehicles, and Social Security, a more-than-six-decade success story, is showing its age.

Typical for every new life issue confronted by the self-absorbed baby boomer generation (of which I'm a not-too-proud member), the media, politicians, and pundits have relentlessly examined the state of the nation's retirement system and concluded that boomers and their progeny are in for a rough ride.

Since nobody finds the current situation satisfactory—not employers, not employees, not even the federal government—is it time to scrap Social Security and employer-sponsored retirement system and shift to a universal program based on mandated contributions by employees and employers, with the sole purpose of providing retirement income? Radical, to be sure. But a quick survey of what is not working suggests that the current problems may have gotten too big to fix.

Retirement Plans

While wonderful for most workers, traditional defined benefit plans are viewed by most businesses as a threat to their success and even survival. Not only have they become a financial and regulatory minefield, but DBs also are expensive and, worst of all, unpredictable. Any benefit in which annual costs can fluctuate wildly based on investment markets and interest rates—unpredictable and largely uncontrollable factors—mean trouble for the executive suite. As the head of bankrupt auto parts maker Delphi put it: "It's not wise for a company to make a financial promise for 40 or 50 years down the road."

Adding insult to injury, federal pension funding rules make it difficult for employers to sock away extra money in good years or to recapture excess assets. Recent attempts by employers to make plans more user-friendly through the introduction of cash balance plans have been attacked on multiple fronts, from the plaintiff's bar and the EEOC to the AARP and the media. Meanwhile, the SEC and other regulators—who years ago insisted the companies put pension costs and liabilities on the books—are now investigating whether companies have manipulated those costs to smooth out or pad profits. The PBGC, reeling from the bankruptcy of the steel, airline, and auto parts industries, and facing the once unthinkable collapse of GM and Ford, is clamoring for increased premiums. And Congress is set to tighten funding rules and generally "reform" DB plan rules, driving the last nail into the pension coffin.

Not surprisingly, there is a major move by employers to switch to defined contribution plans. DC plans shift some of the expense and most of the investment responsibility from the company to its workers and makes it possible to more easily budget plan costs. They also are governed by far more simple regulations.

Unfortunately, there is a slew of data showing that most employees are poor money managers of their nest eggs—overly conservative, overly aggressive, or simply clueless. Even those who prudently contribute to their company's 401(k) tend to spend those benefits at the first opportunity by making hardship withdrawals, taking loans they don't repay, or spending rather than rolling over lump sum distributions. Many of those who do accumulate a seemingly comfortable nest egg find the challenge of making it last through retirement overwhelming. (See "Cracking the Nest Egg," *Benefits Law Journal*, Vol. 18, No. 2.)

Some organization have responded by trying to better educate their employees about the basics of asset allocation, financial planning, and the like. As the shortcomings of worker-managed retirement accounts become clear, other employers are reducing workers' responsibilities, without increasing the corporate burden, by introducing negative elections, automatic 401(k) contribution increases, asset allocation/life cycle funds, and third-party investment advice.

Congress, having created the statutory framework governing retirement plans, is not pleased with the results. Because Washington believes that the tax loss caused by retirement plans (which is really just a deferral of tax revenues) is expensive, successive administrations have exacted a regulatory toll on employers wishing to maintain qualified plans. A hornet's nest of nondiscrimination rules, benefit limits, and compensation ceilings have been imposed with the supposed goal of making company plans more "fair." Nevertheless, the tax advantages of retirement plans still tilt toward upper income high-bracket participants, even as plans become more complicated to design and administer and less personally valuable to the executives charged with how much to spend on the company retirement plan. The net result is more regulation and lower company-paid retirement benefits.

Social Security

There is good reason that Social Security is a political sacred cow: from an employee view; it is simple to understand and participate in, promising an inflation-protected lifetime pension for basically everyone who ever worked. Yet, as retired Federal Reserve Chairman

Alan Greenspan reported to Congress late last year, while we are in a "demographic lull," the Nation has committed "more physical resources to the baby-boom generation's [retirement] than the economy can deliver." Translation: Social Security is currently running a surplus but as boomers begin to retire *en masse* it will go broke. Compounding the problem, the President and Congress have used that surplus to help offset the federal budget deficit. It is a virtual certainty that at some point, the post-baby boom generations will say "Thanks for all the great music, but we're through supporting your profligate ways" and vote to cut back Social Security benefits.

The Ideal Program

A retirement program should be built around the principle that the fewer financial decisions employees must make, the better. Employers should have little, if any, fiduciary exposure, and predictable costs and administrative expenses should be low. Employers, employees, and the government should be absolutely prohibited from accessing program funds for anything other than retirement benefits. All benefits would be paid through an inflation-adjusted annuity that covers spouses and dependents. Similarly, retirement accounts must be temptation-proof—unavailable to employees to tap into for buying a house, putting kids through college, paying off credit card bills, or any other purpose regardless of how worthy, and safeguarded from the employee's creditors. Retirement accounts could not be used by the employer, ever, to finance operations or even save jobs, nor could they ever be tapped by Congress.

Clearly, nothing in the current system fits the bill. Recently, a few insurance companies have been pitching "mini annuities," which are basically DC plans in which each contribution buys a tiny lifetime pension, based on prevailing interest rates at the time of each purchase. Essentially, they convert a DC plan to a DB plan. This would be a good start, except that prohibitive fees of as much as 75 basis points offset any investment or planning advantage. Not surprisingly, relatively few workers have signed up despite increasing media attention.

But what if the government scrapped the entire Social Security and retirement program system in favor of a mandatory mini-annuity type program run by the government or outsourced to a semi-public or private entity[ies]? Employers and employees could be required to contribute a fixed annual percentage of total pay, say 10 percent without any compensation cap, to purchase a deferred annuity-type product. Investments could be a simple, predetermined mix, perhaps of long-term bonds. Distributions would begin at retirement, death, or disability. Retirement age would reflect the demographic realities of twenty-first century longevity and the reduced physical strain of most occupations.

The new program would not be designed to build wealth. The Bush proposal to freeze Social Security and create an "ownership society" is doomed to failure, in part because you cannot build wealth and pay a pension at the same time.

Instead, the ideal program *would* fulfill the basic requirements of a workable, financially realistic retirement program: simple, automatic and fully funded. With global coverage and few bells and whistles, fees and expenses would be low. Think of it as a combination DC plan and Social Security, but on steroids.

Obviously, a change of this magnitude would be a massive and complicated transition. But once implemented, it would put benefit lawyers like myself out of business, and allow American workers to look forward to a truly secure retirement.

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