

# ISSUE BRIEF

## Pension Reform and 401(k) Account Protections

**Employment-based pensions are an essential component of a strong national retirement system.** Defined-benefit plans remain the soundest vehicles for building and safeguarding retirement income security, as they are federally insured and provide a guaranteed monthly lifetime benefit. According to the Pension Benefit Guaranty Corp., however, employers have been shifting from secure defined-benefit plans to riskier defined-contribution plans, like 401(k) plans, where benefits at retirement depend on workers' own contributions and investment gains or losses. Moreover, established defined-benefit plans are now facing excessive funding pressures, unnecessarily jeopardizing their stability. With workers' retirement security at stake, Congress should consider tax and other incentives to encourage employers to offer and to help maintain defined-benefit plans and should further pass meaningful 401(k) plan reform.

According to the U.S. Department of Labor, only 19 percent of American workers in the private sector today have defined-benefit plans, compared with 37 percent of workers in 1979. And, during this economic downturn, these plans are facing tremendous funding demands, with the temporary funding measure enacted last year due to expire. Last year's House-passed 401(k) "reform" bill failed to include the key protections needed to help prevent the tremendous 401(k) losses suffered by workers at Enron and WorldCom from reoccurring. The bill further would have rolled back protections that exist under current law.

**Employers should be encouraged to provide defined-benefit plans.** Seventy percent of union workers enjoy defined-benefit retirement coverage, compared with 16 percent of nonunion workers. Low- and middle-income workers often receive few, if any, benefits from 401(k) accounts because they are able to make few, if any, contributions to their accounts. Enron's collapse brutally illustrated the inherent risk in defined contribution plans. When the value of Enron stock plummeted, so did its workers' retirement savings. Congress should enact tax and other incentives to encourage employers to offer defined-benefit plans.

**Pension rules should promote the long-term stability of defined-benefit plans.** The Employee Retirement Income Security Act (ERISA) sets specific funding requirements for defined-benefit plans aimed at ensuring plans have sufficient assets to meet promised benefits over the long run. Tax code restrictions on employers' funding of pensions in good times and a rare combination of historically low interest rates and three consecutive years of stock market losses have exposed flaws in the existing funding rules and created significant short term funding pressures. Furthermore, the Treasury Department's decision to stop selling 30-year Treasury bonds—a benchmark interest rate for measuring defined benefit plan benefit obligations—means that Congress must determine a replacement rate. Any pension plan funding changes adopted must reflect the current economic pressures facing defined-benefit plans while ensuring plans' stability and continuity.

**Workers should have representation on 401(k) plan boards.** When it comes to the management of 401(k) and other defined-contribution plans, workers are on the outside looking in. Management trustees are free to decide the menu of investment options offered, how much workers have to

pay in fees and expenses and what kinds of financial services are provided. Although these decisions are supposed to be in workers' best interests, workers themselves have no input into how these decisions are made, though their money is at stake and they bear all the risk. Workers must have a voice in how these plans are run. Congress should enact legislation ensuring worker representation on 401(k) plan boards.

**Diversification is needed to protect savings.** While WorldCom was collapsing into the biggest bankruptcy in U.S. history, thousands of workers were losing not only their jobs but also their life savings and retirement security. Enron and WorldCom workers combined lost more than \$2 billion in 401(k) retirement accounts because the accounts were invested primarily in company stock. Unfortunately, 401(k) plans are not subject to the 10 percent cap on the amount that can be invested in employer stock; a cap imposed by ERISA on defined benefit plans.

**Practices at Enron illustrate how contribution matches, slanted pension plan materials, e-mails and employee meetings can be used to pressure workers into investing unlimited amounts of their life savings in unsecured company stock.** Congress should enact legislation that addresses improper employer efforts to overload employees' 401(k) plans with company stock and, at a minimum, gives workers a broad right to sell the company stock held in their accounts.

**Workers must have conflict-free investment advice.** Workers need and want honest, reliable investment advice for their 401(k) account investments. Although many 401(k) plan providers already offer access to independent investment advice, Congress should enact legislation to encourage more employers to offer it. Congress should oppose efforts to eliminate current law provisions that bar companies that manage 401(k) money (including banks, mutual funds and insurance companies) from recommending their own investment products to 401(k) participants. The reason for the ban is simple: A company should not have a profit incentive to steer workers to funds with the highest fees. The securities industry now under scrutiny because investment analysts routinely misled investors in order to win or keep lucrative investment banking business for their firms—is trying to legalize similar conflicts of interest in federal pension law, which would jeopardize workers' retirement security.