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PENSIONS UNDER ASSAULT

House-passed ‘reform’ jeopardizes workers’ retirement plans

by Ross Eisenbrey

In response to the Enron scandal and the terrible losses its employees experienced in their 401(k) retirement plans, the House of Representatives passed H.R. 3762, the Pension Security Act of 2002. While most of the bill is of debatable merit, one provision — Section 204 — runs completely contrary to the goal of protecting employee pensions. This provision would permit employers to dump lower-paid employees from their pension plans while covering 100% of the most highly compensated executives. If Section 204 of this bill becomes law, it will put at risk the pension coverage and retirement security of millions of workers.

Pension coverage already favors the wealthy

America’s private pension system has two great problems: it covers only 44% of private sector workers (U.S. DOL 2000), and it provides its benefits disproportionately to the wealthy. In fact, two-thirds of pension benefits go to the 15% of households with more than $100,000 in income (Calabrese 2000).

The lack of coverage stems from two related problems: many employers simply do not provide pension plans, and those that do often exclude some of their employees from coverage. While 58% of private sector employees work in a firm that provides pension coverage, only 44% are actually covered. And the lower an employee’s income, the less likely he or she is to be covered. Seventy-six percent of workers earning more than $1,000 a week were covered by an employer plan in 1999, but only 33% of workers earning $300-399 a week were covered (U.S. DOL 2000). Despite $100 billion a year in federal tax subsidies to encourage employers to provide pension plans, the percent of employees covered is no higher now than it was in 1970.

Current law stipulates that, for an employer to qualify for favorable tax status, a pension or 401(k) plan must not provide an unfair share of its benefits to highly compensated employees (i.e., generally those who earn more than $90,000 a year). The basic test of fairness under current law is a requirement that at least 70% of the

non-highly compensated employees (those earning less than $90,000 a year) must be covered by a plan if it covers 100% of the highly compensated.

Alternatively, the employer can establish a "reasonable" classification for eligibility that is found not to discriminate in favor of the highly paid. Before 1986, the Treasury Department applied only a vague and subjective "facts and circumstances" test of fairness, approving pension plans that covered all of the most highly compensated employees but as few as 20-25% of the middle-income and low-income workers. In 1986, however, Congress imposed an additional requirement that the average benefit percentage for employees who are not highly compensated must be at least 70% of the average benefit percentage for highly compensated employees. Thus, if highly paid employees get on average 50% of their pay in retirement, the lower paid employees must, on average, get a benefit equal to at least 35% of their pay.

H.R. 3762 would tilt coverage even further to the wealthy

The House-passed bill would return the test of pension fairness to its pre-1986 uncertainty, giving employers the opportunity to restructure their pension plans and exclude most of their lower-paid employees. Under the guise of encouraging small employers to create pension plans, Section 204 in reality would allow plans that fail both of the 70% tests to still qualify for tax subsidies. Thus, a plan that covers 100% of the highest paid executives but only 35% of the lower-paid employees could qualify for these tax incentives even though the average benefit percentage for top executives is far more generous than for lower-paid employees. This almost certainly would lead to the creation of new pension plans, but it would skew the tax benefits of the pension system even more radically to the wealthy and do little to broaden employee coverage, which ought to be the foremost goal.

Supporters of the House bill argue that the Treasury Department can be trusted to prevent abuses of this new "flexibility." Section 204, however, provides that plans must be submitted to the treasury secretary for approval only if the secretary takes action to require it. If the treasury secretary does not act affirmatively to issue regulations and to specify conditions to "appropriately limit" this new flexibility, no limits will apply. In essence, unless the agency acts, the 70% tests are effectively repealed by the statute.

President Bush has called on Congress to make sure that the rules that apply to the "top floor" apply equally to the "shop floor." That laudable goal could be accomplished by *strengthening* the law that requires top executives and the highly compensated to get no greater or better coverage than the lower-paid employees. Instead, the House has taken a sharp turn in the opposite direction to undo the rules that maintain any semblance of fairness between the shop floor and the top floor.

References

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