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How Political Correctness Affects Pensions – Fall 2019

Vocabulary.com defines *Political Correctness* (PC) as the "... avoidance of expressions or actions that can be perceived to exclude or marginalize or insult groups of people who are socially disadvantaged or discriminated against ....". Defined benefit pension plans can be seen as not-PC for several reasons:

- Compensation programs that allocate proportionately more pension benefits to higher-paid, productive employees are somehow perceived as exploiting lower-paid, less-productive employees.

- IRS permits Social Security integration benefitting higher-paid employees on a nondiscriminatory basis to restore proportionately less working-life income replaced by Social Security.

- PC condemns the proportionately higher retirement benefits a defined benefit plan provides higher-paid employees in a fair value exchange for their greater productivity that builds an organization.

- PC-ers see savings account plans as a form of social equality because the employer contributes about same percentage of Form W-2 Wages each year for each employee's retirement benefits.

- The employer's sponsored pension trust fund imposes an element of control over employees depriving them of the instant gratification from some control of "their" money through account balance plans.

- The PC community rejects the notion that an employee's total compensation package should be restricted to the economic value of his production, perceived as Politically Incorrect.

Many decision makers do not apply the following very basic concepts:

Compare each employee's total compensation cost to his value of production – see our Newsletter titled *Efficient Compensation Design – Fall 2016*. The value of an employee's production should exceed his total compensation cost to yield the employer a profit. Our Newsletters are available on the Internet.

Recognize whom to benefit - pension benefits accrue more rapidly with more value in a defined benefit plan for older, higher-paid employees because they have less remaining work-life expectancy. This is a fair value exchange for their greater commercial value and contribution to building the organization.

Exchange Some Form W-2 Wages for pension benefits - responsible employees will recognize that shifting compensation dollars from taxable Form W-2 Wages to pension benefits will advantage them long term. Annual Benefit Statements showing compensation sources help sell this concept.

Control plan provisions and investment management through a self-administered plan – the IRA-type and Section 401(k) savings account plans do not permit designs that advantage older, longer-service employees. Their retail consumer investment products may be limited to mutual funds.

Understand pension cost dynamics - defined benefit pension plan retirement income is directly proportional to compensation and service. This allocates the greater portion of pension funding costs to the higher-paid, longer-service employees. Retirement costs are not wasted on short-term employees.

Avoid a path of least resistance – enabled by IRA and Section 401(k) arrangements.

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Estimates are that single employer pension coverage declined to about 20% of private sector working Americans through 2018. Congress intended to strengthen the private pension system through the Employee Retirement Income Security Act of 1974 (ERISA) signed by President Ford during September 1974; but, the private pension system is weakening, being replaced by retail consumer savings products marketed by commissioned salesmen. Workers are left with little more than a small savings account at retirement age to help pay their medical bills if not already misspent for nonessentials. See our Newsletter titled *Write to Your Senators - Winter 2018 and 2019* for a discussion of declining pension coverage in the United States that leaves current and future retirees with insufficient retirement income to maintain a reasonable standard of living in most localities.

The availability of Section 401(k) provisions as an add-on to tax qualified profit sharing plans beginning in 1980, and the introduction of IRA-type arrangements in 1981 brought at least two negative consequences: (a) employees see less need for their employer's funded pension plans; and, (b) employers see less need to sponsor tax qualified retirement plans if employees fund their own IRAs. These arrangements promote the idea that employers can pass retirement plan funding costs to employees with small employer matching contributions. Most workers lack the discretionary income to voluntarily contribute enough to IRA and Section 401(k) arrangements to accumulate any meaningful savings for retirement. Very few employees have the discipline to voluntarily save for retirement, and most do not preserve their accounts for future retirement income needs. IRA and Section 401(k) arrangements were never intended to replace employer funded private pension plans for which they are poor substitutes.

` The fill-in-the-blank prototype plan documents flourishing after ERISA provide an inexpensive way to implement and administer account balance plans under the guidance of commissioned sales agents having only minimal bookkeeping skills. Prototype plan documents are preapproved by IRS with limited design options, and usually without a required IRS filing for a Favorable Determination Letter. Investment product sources seized upon prototype plan documents after ERISA to arm their sales forces with another sales tool. IRS contributed substantially to the decline in the private pension system when it made retirement plan implementation a commodity thorough prototype documents and IRA-type arrangements rather than a formal procedure requiring the assistance of attorneys and actuaries. One result is the growing number of retirees dependent on public assistance. Employers forfeit the possibly greater long-term investment returns and control available through self-administered pension trusts.

Our Newsletter titled *Another Freedom Endangered - Fall 2014* addresses the imposition of the Affordable Care Act and the prospects of a mandated employer-paid defined contribution plan arrangement through the USA Retirement Funds. We noted in a memo to employers during May 2019 the emerging requirements of the Illinois Secure Choice Retirement Savings Program that requires employers of over 25 employees to enroll employees in an employee paid voluntary payroll deduction defined contribution program unless they privately sponsor a retirement plan. The point is private sector employers are losing the freedom to sponsor individually designed pension programs that meet their specific objectives at the least cost. PC-ers do not understand that IRS regulations permitting greater benefits for higher-paid employees with less IRS meddling enable greater benefits for all employees.

The mollification of the public educational system in the United States has depleted critical thinking skills. Workers having no investment management skills have apathetically accepted the investment risk for pension savings from their employers. Most workers not covered under public and collective bargained plans have lost sight of what constitutes pension benefits.

Please call or e-mail any questions or comments.