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Treasury May Help Workers On Details of Pension Choices

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The Treasury Department is proposing new regulations that would give workers more information about their pension choices, a change that could benefit millions of employees by spelling out which option would pay them the most money after they leave a company.

The proposal, issued last week and scheduled to take effect in little over a year, would require employers to provide details about pension payouts, in particular the effects on employees of taking a lump sum, a monthly payment in retirement or a combination when they retire or quit a job.

Typically, pensions are structured so lump sums are worth far less to most workers than when the pension is taken as a monthly payment -- as much as 50% less. However, 90% or more of departing employees choose the lump sum, rarely realizing it has a far lower value because they lack adequate information to compare the choices, according to lawmakers who have studied the issue.

Employees as a result often receive 20% to 50% less from their pensions than they otherwise would. Those most likely to be affected are long-term employees in their 40s to mid-50s.

The Treasury proposal would require employers to provide the relative values of the payouts; in other words, employers can't simply say the lump sum is $200,000 and the monthly payment is $1,000. They would have to say what the lump sum would be if it were paid out monthly in retirement, and vice versa.

"This may prove to be one of the more important retirement security measures this year," says David Certner, director of federal affairs at AARP, formerly known as the American Association of Retired Persons.

Employer groups have in the past opposed the proposed changes, which they say would burden employers with more paperwork. The American Benefits Counsel, an organization that represents employers, declined to comment, though a spokeswoman says the group is studying the matter.

Ron Gebhardtsbauer, senior pension fellow at the American Academy of Actuaries, says his group is neutral. "It's important to disclose this information, but I'm not sure it will be helpful to everybody," he says. In general, he adds, people are better off taking monthly pensions rather than lump sum payments, though that isn't always the case. People may be better off taking a lump sum if they have a short life expectancy, which means they might not collect monthly pension payments long enough to equal the amount of the lump sum they could collect, he notes. In addition, some people will be attracted to the lump sums if they think they can invest it for a higher return, he adds.

Employees have complained for years that they can't get their employers to provide apples-to-apples comparisons of the pension payout choices. Employers save money when employees choose the less-valuable lump sums, which critics say is one of the reasons employers began offering lump sums in the 1990s.

The law requires companies to tell employees about the relative values of the payout options. But, because this requirement is vaguely worded, employers still could avoid providing details showing a direct comparison of the value of the pension options. The Treasury's proposal has been in development for more than two years, and was prompted by a January 2000 letter from Sen. Tom Harkin, a Democrat from Iowa, that complained that companies were intentionally failing to provide adequate information to employees about which payout options were more valuable.

The letter cited an industry publication that encouraged employers to "Ask a few employees, 'At age 65, would you rather have $100,000 or $1,200 a month for life?' You'll likely find far more takers for the lump sum" even though the lump sum is 50% less valuable than the monthly payment. The industry publication also noted that "most American workers are clueless about the financial aspects of retirement," and that "given this massive naivete, it's little surprise that [most] employees who had a choice took lump sum payouts."

While current law forbids employers from cutting a pension that has already been earned, if an employee chooses a less valuable payout -- in effect choosing to cut his or her own pension -- then the so-called anti-cutback rule hasn't been violated.

In April, Sen. Harkin added an amendment calling for greater disclosure of payouts onto a broader Senate pension bill, and Sen. Max Baucus, a Montana Democrat, chairman of the Senate Finance Committee, added a similar provision to a bill introduced by the Senate Finance Committee.

"Making the pension decision between one immediate payment or annual payments is one of the largest financial decisions someone makes in his or her life -- folks should be able to do so with good-faith information from their employer," says Mr. Harkin.

These legislative initiatives will become moot if the Treasury proposal, which doesn't require congressional approval, is adopted. A hearing on the Treasury proposal is scheduled in January, and employers and interested parties have until Jan. 1, 2003, to file comments. "Senate interest in this issue clearly helped move the Treasury along," says Mr. Certner of AARP.

Mark Iwry, former benefits tax counsel at the Treasury, under whose tenure this project was launched, says, "The proposed regulation strikes a reasonable balance. It gives employees information they need to make informed decisions while giving employers flexibility."

Employees most likely to have a large gap between the value of the lump sum and monthly payments are those who leave their jobs in their early 50s, because they have built up a pension and can lose the value of any "early retirement" subsidy their pension may provide. People in their 40s who have worked many years at a company can also see a steep pension cut if they choose a lump sum when they leave and forgo an option to wait for a monthly payment to commence at age 55, when a subsidy would be locked in.

The Treasury proposal wouldn't erode the funding level of pensions, because companies have already funded the promised benefits. It could, however, make companies less likely to benefit when employees inadvertently give up some of their pensions.

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