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WOMEN'S PENSIONS

Recent Legislation Generally Improved Pension Entitlement and Increased Benefits

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SUMMARY

Pension benefits have long been recognized as an important source of income for many retirees, often supplementing social security and private savings. Given the importance of pensions to retirement income and the amount of federal revenue forgone through tax expenditures to encourage and maintain pension plans--$48 billion in fiscal year 1992--the Congress has acted to ensure that more participants receive benefits from pension plans. GAO studied the effects of recent changes to private pension provisions on women's pension entitlement and benefits.

GAO found that the recent changes will generally expand pension entitlement and increase benefits for working women and widows. The testimony conveys the following points:

-- Pension benefit entitlement for women will improve substantially under the Tax Reform Act of 1986 (TRA). About 75 percent of women in pension plans will be vested under TRA compared to about 50 percent under pre-TRA vesting provisions. Furthermore, almost 1 million women will gain, on average, an additional $980 in annual vested pension benefits under TRA vesting provisions.

-- TRA will improve benefit equity between men and women--particularly in pension plans sponsored by small employers. Before TRA, although the majority of participants were in large employers' plans in which men and women earned equitable benefits, most defined benefit plans sponsored by small employers favored the higher-paid, who were primarily men. Under TRA, differences in benefit allocation between men and women will be dramatically reduced.

-- Survivor pension benefit coverage for wives of private pensioners increased after implementation of the 1984 Retirement Equity Act (REA). REA required private pension sponsors to obtain a spouse's written approval when a married retiring worker chose a payout option other than a joint and survivor annuity--the benefit payment option that automatically entitles widows to survivor benefits.

-- Despite substantial gains in pension entitlement and benefit distribution for working women and widows, the private pension system alone will not markedly help to ease the economic plight facing poor widows. These women will continue to depend on social security as their major source of income in widowhood.

-- The Internal Revenue Service (IRS) recently initiated actions to improve the quality of pension forms that document a wife's decision to agree to waive survivor benefits. IRS's efforts will better ensure that wives are adequately apprised of the economic effects of their decision.

Mr. Chairman and Members of the Subcommittee:

I am pleased to be here today to discuss the results of GAO studies relevant to women's pension issues. Our work in this area largely was done in response to a mandate in the Retirement Equity Act of 1984 (REA) that we study the impact of the federal pension rules on women.

My testimony today will discuss how recent changes to the private pension rules have generally improved pension entitlement and benefits for working women and widows. I will cover four topics: (1) the impact of the vesting and benefit distribution provisions under the Tax Reform Act of 1986 (TRA), (2) widows' receipt of survivor pension income and the impact of REA on their access to these benefits, (3) the role of the private pension system in helping the economic condition of poor widows, and (4) recent IRS efforts to improve the effectiveness of pension documents important to wives of private pensioners.

BACKGROUND

Pension benefits have long been recognized as an important source of income for many retirees, often supplementing social security and private savings. Private pensions received by unmarried men and women aged 65 and over constituted, on average, roughly up to one-third of their total money income (22 percent for women and 30 percent for men) in 1990. For married couples, pension benefits comprised, on average, about 23 percent of total income.[1]

Pension receipt among the elderly has increased over the past 30 years. In 1962, 17 percent of men and 5 percent of women aged 65 or older were receiving income from private pensions or annuities. By 1990, receipt had almost doubled for men, increasing to about 35 percent, and had more than tripled for women, increasing to 17 percent.

Pensions are expected to remain an important source of retirement income. The Congressional Budget Office estimated that pension benefits will comprise about 30 percent of total income for retired singles and couples in 2019.

Given the importance of pensions to retirement income and the amount of federal revenue foregone through tax expenditures[2] to encourage and maintain pension plans--$48 billion in fiscal year 1992--the Congress has acted to ensure that participants receive some benefits from their pension plans. The Employee Retirement Income Security Act of 1974 (ERISA) was the first major legislation

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[1]In 1990, unmarried men aged 65 and over received, on average, $4,483 in annual income from private pensions compared to women's $2,364. Married couples received $5,409.

[2]For qualified pension plans, employers' contributions for workers' pension benefits are tax deductible to the employers and are not counted as taxable income to the employee. Money in pension funds earns interest tax free, and individuals pay taxes on pension benefits only when they are received.

aimed at assuring that private pensions were delivered to a broad spectrum of the workforce. ERISA and subsequent legislation govern areas such as pension coverage, vesting periods, benefit accrual and distribution, and survivor's benefits.

TAX REFORM WILL IMPROVE PENSION ENTITLEMENT AND BENEFIT EQUITY

One of our efforts was to evaluate the effects of various pension rule changes on workers' pensions. The Tax Reform Act of 1986 was a major congressional effort to correct perceived abuses and inequities in the benefits of men and women. Among other things, TRA cut the maximum allowable period workers must wait to be fully vested. TRA also increased the prospects of benefit receipt for lower-paid workers by eliminating methods used to coordinate pension and social security benefits (a process known as integration) that could result in a total depletion of pension benefits. In addition, recently issued IRS regulations further fine-tuned TRA's integration provisions and placed limits on differences in the rate at which high- and low-paid workers accrue pension benefits throughout their careers.

TRA's vesting provisions will substantially improved benefit entitlement for shorter-tenured workers. We estimate that about 75 percent of women in pension plans will be vested under TRA compared to about 50 percent under pre-TRA vesting provisions. For virtually 1 million women in defined benefit plans, TRA vesting rules will increase the amount of vested pension benefits earned each year. The median gain for these women would be $980 (1990 dollars), or 5 percent of compensation. The gain in annual benefits under TRA for women is about half that for men.[3]

For employers, the effect of increased vesting under TRA on annual pension plan costs probably will be relatively small. The Employee Benefit Research Institute (EBRI) estimates that the additional cost of 5-year vesting (TRA's standard) would require an additional 2 to 7 percent of private pension plan contributions.

TRA will also help improve benefit equity between men and women--particularly in plans sponsored by small employers. We found that before TRA, the majority of pension plan participants were in large employers' plans in which, after accounting for differences in salary and tenure, women earned about $1.00 in benefits for each $1.00 men earned.

In contrast, most defined benefit plans sponsored by small employers favored the higher-paid, who were primarily men. In about one-third of these plans men earned over $1.50 for every $1.00 women earned, after accounting for differences in salary and tenure. The benefit distribution still favored men in many of these plans after adding social security benefits.

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[3]See Private Pensions: Impact of New Vesting Rules Similar for Women and Men (GAO/HRD-90-101, Aug. 1990).

Under TRA, the differences in the benefit allocation between high- and low-paid workers will be dramatically reduced. If social security benefits are included, few small employers' defined benefit plans will still favor the higher-paid after TRA.[4]

In light of these substantial equity gains, GAO supports IRS's regulations under TRA. However, IRS recently announced its decision to delay the effective date of its rules and may consider changes.[5] We urge IRS to consider the results of our work on benefit equity in conducting its review.

LACK OF PENSION PORTABILITY; PRE-RETIREMENT DISTRIBUTIONS OFTEN NOT USED FOR RETIREMENT

The positive effects of the Tax Reform Act on pension income may not be fully realized if participants lose pension credits and benefits when changing jobs. Our work shows that few arrangements exist for allowing workers to transfer service credits and benefits from one pension plan to another. The Department of Labor reported in 1981 that only 6 percent of all pension plans accepted assets transferred from prior plans. More important, workers receiving benefit cash-outs (or lump sum payments) are generally not using the funds for retirement savings. According to a 1990 EBRI study, roughly 90 percent of workers with cash-outs did not roll over the

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[4]See Private Pensions: 1986 Law Will Improve Benefit Equity in Many Small Employers' Plans (GAO/HRD-91-58, Mar. 1991).

[5]IRS's original effective date of February 11, 1992, was changed to January 1. 1993.

money into other retirement vehicles; only 35 percent used the funds for any kind of financial savings.

The Congress has considered several proposals aimed at enhancing the portability or preservation of pension benefits. Unfortunately, the proposals that would give workers better benefits would also increase employers' costs. And because most employer pension expenses are tax deductible, the federal government could lose tax revenues with increased portability.

SURVIVOR PENSIONS IMPORTANT TO MANY ELDERLY WIDOWS; ACCESS INCREASING

The first group of GAO studies I have discussed has focused on assuring pensions for workers. A second group will deal with issues related to survivor pension benefits for widows.

Although the economic status of the population aged 65 and over has improved substantially in the past 30 years, elderly widows continue to have a high risk of being poor. In 1990, 22 percent of unmarried women aged 65 and over were poor compared to 5 percent of married women. About one-third of unmarried women had incomes that were less than 125 percent of the poverty line.[6] The large number of poor widows--about 2 million in 1990--makes this group of

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[6]In 1990, the poverty line was $6,268 for a single person aged 65 or over.

special concern. In fact, widows constitute over half of the poverty population age 65 and over.

Research has shown that nearly 80 percent of widows in poverty were not poor before their husbands died. According to a 1987 study, women generally had less income after widowhood than before because they received less in social security benefits than they had as a couple. In some cases widows also lost the income from their husbands' pensions.[7]

Survivor benefits generally provide lifetime pension income to spouses of deceased pension retirees. Widows become eligible to receive lifetime survivor benefits only if their retiring spouse has a joint and survivor (J&S) type of pension benefit payment. Generally, this arrangement provides a pension annuity[8] to the retiree during his or her lifetime and a portion of that reduced annuity to the surviving spouse if the retiree dies first.

Improving the economic status of the elderly by increasing their access to survivor benefits has been a continuing goal of federal pension legislation. Beginning with ERISA, most private pension

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[7]See Michael D. Hurd and David A. Wise, The Wealth and Poverty of Widows: Assets Before and After the Husband's Death. National Bureau of Economic Research, Working Paper No. 2325, 1987.

[8]The J&S annuity is usually lower than the amount the married retiree would have received from an annuity that spans only his or her lifetime. Reduction for the J&S annuity is usually based on actuarial calculations that take into account the probability that the spouse will outlive the retiree.

plan sponsors offering annuities were required to provide automatically, at a minimum, a 50-percent J&S annuity to their retiring married workers. However, ERISA originally allowed married retirees to choose another type of benefit payment, such as an annuity spanning only the retiree's lifetime, without the spouse's approval. As a result, many widows were financially unprepared for their husbands' death because they were unaware of the choice not to receive the J&S annuity.

To address this problem the Congress sought through the Retirement Equity Act of 1984 to bring the retiring worker's spouse directly into the decision process concerning benefit payment options. REA required private pension sponsors to obtain a spouse's written approval when a married retiring worker chose a payout option other than the J&S annuity. Through the spousal consent requirement, the Congress envisioned that, among other things, a greater proportion of married men would retain the J&S annuity, thus providing their spouses the opportunity to receive survivor benefits.

Our analysis shows that in 1989, an estimated 2.6 million elderly widows of public- and private-sector pension retirees (or about 1 in 3) received survivor benefits. The median annual survivor benefits for widowed women aged 65 and over was an estimated $4,404 as compared to $2,292 for widowed men. Median survivor benefits did not vary much between different age categories for widows aged 65 and over.

Many widows with survivor benefits also receive social security benefits, but far fewer receive a pension based on their own employment (83 percent versus 27 percent). About one in five widows received income from all three sources of employment-based retirement income.

Survivor benefits comprised, on average, about 40 percent of income for all widows receiving survivor benefits and social security only. Their median monthly income from employment-based sources was $800.

Survivor benefits made up on average about one-fifth of employment-based retirement income for widows receiving all three sources of such income. The related median monthly income was about $1,200.

MORE WIDOWS COULD RECEIVE SURVIVOR BENEFITS IN THE FUTURE

Looking to the future of widows' entitlement to survivor benefits, our analysis shows that 2.5 million wives of retired private pensioners (or 3 in 5) could receive survivor benefits because their husbands retained the J&S form of pension annuity.
Wives of retired men with the highest pension amounts have the greatest chance of receiving survivor benefit coverage. In 1989, about 3 out of 4 married men in the top pension income group retained the J&S annuity; their median monthly pension amount was $1,000. By contrast, about 45 percent of men in the lowest pension

income group, with a median monthly pension amount of $135, retained a J&S annuity.

Survivor benefit coverage for wives of private pensions has been on the rise since REA's spousal consent requirement took effect. The percentage of retired married men retaining the J&S annuity rose from 65 percent in 1985 to 80 percent in 1988-89, a 15-percentage-point increase.

Some of the new pension rules discussed earlier may contribute to increased entitlement to survivor pension income for widows in the longer term. Changes such as the Tax Reform Act of 1986 will be instrumental in increasing husbands' entitlement to private pensions. In particular, TRA's accelerated vesting requirements will allow more shorter-tenured men to gain entitlement to pension benefits. Moreover, TRA's integration rules and the associated nondiscrimination rules will heighten the prospects of benefit receipt for lower-paid husbands.

In the future, elderly widows may be less dependent on survivor benefits. As women with longer work records and higher earnings move into retirement, the percentage receiving pensions from their own employment should increase. For most widows, however, at least for the near term, any income they receive from employer-sponsored pension plans will come from survivor benefits.

LITTLE HELP FOR THE POOREST WIDOWS

Any increased access to survivor benefits for widows in the future will help the economic situation of many widows but will not provide major change for the poorest widows. Our previous work has shown that increased access to survivor pensions would have little impact in reducing the overall poverty rate for widows. Most wives who potentially would become poor had husbands who lacked pensions because they worked in industries and occupations where pension coverage has traditionally been low. Also, if husbands had private pension benefits, the amounts would tend to be very low.[9]

EFFORTS ONGOING TO IMPROVE PENSION SPOUSAL CONSENT FORMS

Wives whose husbands do not want to keep the J&S form of benefit (about 20 percent in 1988-89) are confronted with the sometimes difficult decision of consenting to waive survivor benefits. In such instances, the spousal consent form becomes a vital component in the wife's decisionmaking, particularly since it is the only pension document that spouses must receive when consenting to waive survivor benefits.

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[9] Retirement Income: 1984 Pension Law Will Help Some Widows But Not the Poorest (GAO/HRD-88-77, July 1988).

Responding to your request for a follow-up study to our 1989 report,[10] we evaluated IRS efforts to ensure that spousal consent forms were informative and understandable. In 1989, we recommended that IRS require that certain important information be disclosed on these forms. We also recommended that IRS issue guidance to employers on ways to convey this information clearly.

Our recent efforts revealed that IRS has initiated programs to improve the substance and readability of spousal consent forms.[11] The agency's actions are consistent with what we recommended in our 1989 study. Moreover, responding to additional input from GAO, IRS is also considering requiring that other information, such as a statement about the revocability of the consent decision, be disclosed on consent forms. We and IRS agree that these efforts will better ensure that spouses possesses sufficient knowledge about the economic effect of their decisions.

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In conclusion, recent changes to private pension rules have generally improved pension entitlement and benefits for working women and widows. However, as our work indicates, the private pension system alone will not markedly help to ease the economic

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[10]See Private Pensions: Spousal Consent Forms Hard to Read and Lack Important Information (GAO/HRD-90-20, Dec. 1989).

[11]Private Pensions: IRS Efforts Underway to Improve Spousal Consent Forms (GAO/HRD-92-31, Dec. 1991).

plight facing poor widows, particularly those whose husbands lacked pension coverage or earned low benefits. These widows will continue to depend on social security as their major source of income in widowhood.

This concludes my testimony, Mr. Chairman. I would be happy to answer any questions.