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## COMMENTARY:

### IS IT TIME TO TAKE THE BROOM AND REALLY CLEAN HOUSE?: A NEW PARADIGM FOR EMPLOYEE BENEFITS

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When I graduated from law school, ERISA had just recently become effective. Commentators were touting it as providing great protection for workers' retirement security. Indeed, ERISA has fulfilled its expectation of helping workers obtain the benefits they were promised—from traditional defined benefit plans.

But as the workplace and the mechanisms for the delivery of health care have changed, ERISA has not been amended to provide protections for workers who receive their health care from managed care organizations and who obtain more and more of their potential retirement income from salary deferred plans. In her Article, Professor Hylton has made suggestions for dealing with some of the issues arising from these changes.<sup>1</sup> However, her suggestions play around the margins by dealing only with the current set of problems. My purpose here is to provide a broad look at the problems in the health care and retirement systems and to suggest some proposals for more sweeping reforms.

#### I. WE'RE IN NOWHERE LAND

You cannot talk about retirement policy until you talk about health policy. Unfortunately, we have neither in this country. Instead, what we have is a voluntary employment-based system with tax incentives to induce both employers to offer employee benefits and employees to participate in these programs. Over the years, Congress has conflated tax policy with theoretical health and retirement policies, frequently with less than successful results. For example, al-

\* Senior Staff Attorney, AARP Foundation Litigation (employee benefits). The views expressed herein are the author's own and do not represent the views of AARP, AARP Foundation, or its members.

1. Maria O'Brien Hylton, *The Changing World of Employee Benefits*, 79 CHI.-KENT L. REV. 625 (2004).

though Congress has provided increased opportunities for tax-free savings, the national savings rate has not increased.<sup>2</sup>

The huge demographic shift caused by the aging of the baby boomers has exacerbated the necessity of looking at health and retirement policies together. As the population ages, this country will be looking at providing care for more chronically ill patients and determining how this care will be delivered. There is also the matter of cost. A recent study by the Employee Benefits Research Institute ("EBRI") found that an individual without access to retiree health benefits who purchases Medigap insurance will need to save approximately \$50,000 to \$1.5 million to adequately provide for his or her health care costs if he or she retires at age sixty-five in 2003.<sup>3</sup> This figure does not include the costs for providing long-term care. Even without these substantial health care costs, studies indicate that a large number of the aging population may not have enough money to provide for a comfortable retirement.<sup>4</sup>

On a practical note, there is only so much money to go around. Employers will pay, in both wages and benefits, whatever the market demands for workers' labor. Where a worker is located in the labor force hierarchy will determine how rich a benefit package he or she will have, if any. It is still the case that employees of larger employers have the richest benefit packages, while employees of smaller employers have minimal benefits, if any. For those employers that provide benefits, they are spending more on health care and less on retirement. Indeed, during the most recent downturn, more than one employer reduced its 401(k) match and put that money toward increased health care costs. Significantly, if given a choice between health care and retirement savings, most employees will choose health care over retirement savings. This is a rational choice given that uncovered health costs lead many families toward bankruptcy,

2. See UNITED STATES GENERAL ACCOUNTING OFFICE, NATIONAL SAVING: ANSWERS TO KEY QUESTIONS 5 (GAO-01-591SP, June 2001) (stating that "[t]he personal saving rate has plunged, with American households spending virtually all of their current income"), available at <http://www.gao.gov/new.items/d01591sp.pdf>.

3. Paul Fronstin & Dallas Salisbury, *Retiree Health Benefits: Savings Needed to Fund Health Care in Retirement*, EBRI ISSUE BRIEF NO. 254 (Employee Benefit Research Institute), Feb. 2003, at 1, 14-16, available at <http://www.ebri.org/pdfs/0203ib.pdf>.

4. See, e.g., Jack VanDerhei & Craig Copeland, *Can America Afford Tomorrow's Retirees: Results from the EBRI-ERF Retirement Security Projection Model*, EBRI ISSUE BRIEF NO. 263 (Employee Benefit Research Institute), Nov. 2003, at 1, available at <http://www.ebri.org/pdfs/1103ib.pdf> ("American retirees will have at least \$45 billion less in retirement income in 2030 than what they will need to cover basic expenditures and any expense associated with an episode of care in a nursing home.").

and that health care is an immediate need, rather than a long-term goal.

Given the demographic shift and the discrete money within the health and retirement systems, the issue becomes what kind of systems make sense.

## II. HOW ARE THE CURRENT SYSTEMS WORKING?

### A. Introduction

The two major leaps of faith we took as a country are the establishment of Social Security and the establishment of Medicare. These two programs have formed the underpinning of our retirement security safety net, but they are in distress. The first decision we must make as a country is whether we want to save these systems. That question is crucial because these systems can be saved, but we must decide if we have the political will to do so. In so doing, we must be mindful that there are consequences to both action and inaction.

Without debating whether tax cuts are good or bad, the recent initially proposed tax cuts are an example of the consequence of certain actions. The cost of the Bush Administration's tax cuts, both enacted (the Economic Growth and Tax Relief Reconciliation Act ["EGTRRA"]) and proposed (to accelerate EGTRRA cuts, to repeal the tax on dividends, to create the new Retirement Savings and Lifetime Savings accounts, and others), over a seventy-five-year period have been estimated at a present value of between \$12.1 to \$14.2 trillion, depending on whether the issue of the alternative minimum tax is addressed.<sup>5</sup> This equals 2.3 percent to 2.7 percent of the gross domestic product.<sup>6</sup> The shortfall for Social Security and Medicare combined over the same period equals 1.84 percent of the Gross Domestic Product.<sup>7</sup> Thus, the proposed tax cuts are larger than the shortfall for Social Security and Medicare. With these budget deficits, there is significantly less discretionary money to shore up Social Security and Medicare.

5. Peter Orszag et al., *The Administration's Tax Cuts and the Long-Term Budget Outlook*, Center on Budget and Policy Priorities, Mar. 19, 2003, at <http://www.cbpp.org/3-5-03bud.htm>; John Springer, *Cost of Administration Tax Cuts Exceeds the Combined Long-Term Deficits Faced by Social Security and Medicare*, Center on Budget and Policy Priorities, Mar. 20, 2003, at <http://www.cbpp.org/3-5-03bud-fact.htm>.

6. Springer, *supra* note 5.

7. *Id.*

## B. Health Care

There are three major issues concerning health care—access to coverage; extent or scope of coverage; and quality of care provided. At last report, over forty million nonelderly Americans are uninsured, with the numbers rising.<sup>8</sup> Without a major overhaul of the health care system, this lack of access to coverage will only increase.<sup>9</sup>

Even for those workers who are covered, at least forty million are underinsured. The market has tried different approaches to this problem, none of which has been particularly successful. The first approach is to provide comprehensive coverage with a limited set of choices. The second approach is to provide less coverage with more choice. The third approach is to use tiered arrangements for pharmacies, hospitals, and physicians. For example, the costs of generic drugs are less than the costs of formulary drugs, which are in turn less than the costs of non-formulary drugs.

Finally, there is a real question concerning the quality of health care provided in this country. Many people think that choice equals good care, but this country has some of the worst statistics on health care, such as infant mortality rates. Moreover, RAND Corporation recently reported that only 55 percent of patients receive care consistent with best practice guidelines.<sup>10</sup>

In the health care arena, there are many issues that affect cost, and there are real disagreements over how they should play into the system. Among these issues are questions such as: does it make sense to pay for preventive care versus catastrophic care; how do you reduce overuse and over-insurance; do you let consumers drive the system; how do you manage large claims; how, if at all, do you manage health risks like obesity, diabetes, and high blood pressure to reduce costs; and how do you manage behavior which adversely (or positively) affects health care costs (*e.g.*, tobacco use, exercise, seat belt use)?

If this country had a comprehensive national health policy dealing with access, scope of coverage, and quality of care, we would not

8. Paul Fronstin, *Sources of Health Insurance and Characteristics of the Uninsured: Analysis of the March 2002 Current Population Survey*, EBRI ISSUE BRIEF NO. 252 (Employee Benefit Research Institute), Dec. 2002, at 3 (executive summary available at <http://www.ebri.org/ibex/ib252.htm>).

9. *Id.* at 19.

10. See Elizabeth A. McGlynn et al., *The Quality of Health Care Delivered to Adults in the United States*, 348 NEW ENG. J. MED. 2635 (2003).

need the legal system to deal with the open issues that surround the provision of health care.

### C. *Social Security*

There are three things we know about dealing with the Social Security system. The first is that there are methods that will bring the system into balance: increase the money going into the system (generally by increasing taxes); increase the investment income derived from the money already in the system; and lower the amount of money coming out of the system (by cutting benefits). The second thing we know is that the longer we wait to do something, the more drastic the action that will be needed to bring the system into balance. Finally, the third thing that seems certain is that no one will be happy with either of the scenarios—raising taxes or lowering benefits. Consequently, being a proponent of the theory that the only way legislation gets passed is if no one is really happy or unhappy, a combination of raising taxes and lowering benefits will be the most politically viable to achieving balance in the system.

### D. *The Pension System*

The American pension system is the single largest pool of capital in the United States, with \$4 trillion in net assets (depending on how the economy is doing). It is a voluntary employment-based system, which depends on tax incentives and the marketplace to determine whether workers will be covered by a pension plan and how generous the plan is.

When ERISA was enacted in 1974, about half of the American workforce was covered by a pension. This has remained relatively consistent. In 2001, 43 percent of all workers participated in an employment-based retirement plan, and 58.3 percent of full-time regular wage earners ages 21–64 participated. Thus, overall coverage is still poor, with large segments of the population uncovered. Not surprisingly, coverage directly correlates with income rather than gender or race. Coverage also correlates directly with employer size, with larger employers offering pension plans with more generous benefits.<sup>11</sup> Moreover, with the exception of some persons covered by pension

11. Craig Copeland, *Employment-Based Retirement and Pension Plan Participation: Geographic Differences and Trends*, EBRI ISSUE BRIEF NO. 256 (Employee Benefit Research Institute), Apr. 2003, at 22 (executive summary available at <http://www.ebri.org/ibex/ib256.htm>).

plans sponsored through labor organizations, pension portability has been virtually nil. Even in those pension plans which permit lump sum distributions prior to retirement age, many workers do not keep this money; it "leaks" from the system.

Even if you have pension coverage, it is clear that pension income alone will not be adequate for retirement. In 2001, the median annual annuity payment for those older than age sixty-five was \$8,136.<sup>12</sup> "Younger recipients generally received higher payments."<sup>13</sup> Over the years, the type of pension plan offered to workers has changed. As employers have tried to reduce costs and reduce administrative burdens, more workers have become covered by salary deferral plans like 401(k) or 403(b) plans, instead of traditional defined benefit plans. Some commentators have said that this change is good for the retirement system because it forces workers to take responsibility for their own retirement. Like many things, it is only good if you earn enough money and take advantage of the opportunity to save. Higher wage earners save more; those workers who save more also roll over more of their monies more frequently than those who save less. Not surprisingly, these workers tend to be older.<sup>14</sup>

If this country is not going to adopt mandatory universal pensions, then within this system we need to increase opportunities for coverage, adequacy, and portability. Mandatory rollovers, reverse matches where an employer must make a certain contribution to which the employee then contributes, reduction of the use of employer stock for matching contributions, and independent unconflicted investment advice allowing people to make smart investment choices all would be steps to improve the current system.

The pension system has evolved into a savings system, so that the traditional three-legged retirement stool now has two legs and is very wobbly.

12. See News Release, Employee Benefit Research Institute, *Pension Payments Track Employment Compensation Patterns* (Jan. 15, 2003), at <http://www.ebri.org/prrel/pr619.htm>.

13. *Id.*

14. See Sarah Holden & Jack VanDerhei, *401(k) Plan Asset Allocation, Account Balances, and Loan Activity in 2001*, EBRI ISSUE BRIEF NO. 255 (Employee Benefit Research Institute), Mar. 2002, at 5-7 (executive summary available at <http://www.ebri.org/ibex/ib255.htm>); David Rajnes, *An Evolving Pension System: Trends in Defined Benefit and Defined Contribution Plans*, EBRI ISSUE BRIEF NO. 249 (Employee Benefit Research Institute), Sept. 2002, at 4-7 (executive summary available at <http://www.ebri.org/ibex/ib249.htm>).

### E. Savings

In 2002, the American Savings Education Council conducted a Retirement Confidence Survey, and revealed the following results:

Most workers have not saved enough for retirement. Almost half have saved less than \$50,000 (46 percent), and 15 percent say they have saved nothing. The majority of workers expect to spend at least 20 years in retirement, so even with \$100,000 saved, that would mean they would only have \$5,000 per year to spend.<sup>15</sup>

American culture is certainly not conducive to saving, especially when the message is to spend to help the economy. There is also the tendency to ignore long-term goals and focus on the immediate, whether it is health care costs or college. Savings frequently correlates to income; an obvious suggestion is to raise the minimum wage as well as to increase financial literacy.

### CONCLUSION

As Professor Hylton's suggestions demonstrate, this country has preferred incremental changes over a substantial overhaul of major systems. Unfortunately, major change may be the only way to solve these crucial issues, but such change may be unlikely in the long term. If we just tinker around the edges of our health and retirement systems, there is the problem of unintended consequences (the current pension funding crisis is a case in point). If we do nothing, we should at least consciously decide that this is the course we choose and be willing to accept the social implications of our inaction.

My suggestion is that this country should develop a comprehensive health and retirement policy. One suggestion is to divorce these systems from the employment relationship. In this manner, we would also achieve some tax reform because we would not be using the tax code to create incentives to employers to provide coverage. It would also simplify benefits administration and permit employees to receive promised benefits. Of course, one obvious disincentive for making this change is that employees who have worked for large employers have been able to amass personal wealth by using the employer-provided retirement and other benefit-related vehicles.

15. News Release, American Savings Education Council, *Americans More Confident About Their Financial Future Yet Fewer Are Saving and Planning* (June 6, 2002), at <http://www.asec.org/media/pr143.htm>.



Such a divorce would require a new paradigm. Some commentators have suggested a super-Social Security system. Others have suggested using workers' crafts or careers as the focal point for benefits, not dissimilar to the multi-employer plan concept used by labor organizations in the construction industry. For the health care system, some have argued for a single payer system or a "pay-or-play" system like that recently enacted in California. Others have suggested using a method similar to car insurance—all individuals must have basic health insurance, with deductibles and additional coverage available at a price. Many have analyzed the systems in foreign countries to see what systems have been successful.

Without question major overhaul is traumatic, but it will be necessary if we desire to minimize human suffering in the future. The discussion needs to start now!