

The Disappearing Defined Benefit Pension and Its Potential Impact on the Retirement Incomes of Boomers

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Abstract

Over the last three decades there has been a steady shift from DB to DC pensions. The Pension Protection Act of 2006 may accelerate this trend. This paper examines the impact of an accelerated freeze on the retirement income of boomers. Simulations suggest that such a scenario would produce more losers than winners and reduce average retirement incomes. Income changes will be substantial among high-income workers, who have the highest DB coverage and pension incomes. Late boomers will experience the largest impacts, as they lose their high DB accrual years and have inadequate time to accumulate DC wealth before retirement.

Executive Summary

In recent years, the United States has seen a significant shift away from defined benefit (DB) pension plans to defined contribution (DC) plans. This shift may accelerate rapidly, as more large companies, even those with financially solvent plans, freeze their DB plans and replace them with new or enhanced DC plans.

This paper uses the Model of Income in the Near Term to simulate the effects of an accelerated shift from DB to DC pensions on boomers' incomes at age 67. We compare a scenario under which employers freeze all remaining private sector DB plans and a third of all state and local plans over the next five years with a baseline scenario that incorporates all known pension freezes as of the end of 2006. Under this baseline, future changes in DB coverage reflect only projected changes in employment patterns. We project how the accelerated decline in DB coverage affects the level, composition, and distribution of income at age 67 by sex, education, marital status, race/ethnicity, number of work years, and quintiles of lifetime earnings and retirement income. We also project numbers and characteristics of winners and losers from the change in pension coverage. To understand better the differential impact of DB pension freezes on the retirement incomes of boomers, we compare outcomes for four waves of boomer cohorts born between 1946 and 1965.

The results show that the numbers of winners and losers and net income changes are much greater for boomers born between 1961 and 1965 (last wave boomers) than for earlier boomers. Younger boomers are most likely to have their DB pensions frozen with relatively little job tenure and to lose their high accrual years for DB pension wealth, but also to have relatively more years to accumulate DC pension wealth before retirement.

Key findings include the following:

- For boomers born between 1946 and 1950 (first wave boomers), the accelerated pension freezes produce virtually no change in DB or DC pension coverage and little change in income at age 67. These individuals are near or at plan retirement age when the first new plan freezes occur in 2007. Because they are likely to have their DB pensions frozen with lengthy job tenures, they do not lose much DB pension income. They also will have relatively few years to contribute to new or enhanced DC pensions before retirement to accumulate much additional retirement wealth.
- The freezes will also produce little change in pension coverage for last wave boomers, reducing their DB coverage rates from 44 to 42 percent while increasing their DC coverage rates from 77 to 79 percent. Only workers who are projected to start new jobs with DB pensions under the baseline will lose DB coverage under the simulated pension freezes; existing workers will maintain DB coverage, but have lower benefits. The freezes will reduce average income at age 67 by \$700 per person. DB pension benefits will decline by \$1,100, but new and enhanced DC plans will raise income from retirement accounts by \$300 and delayed retirement will raise earnings at age 67 by another \$100.
- The accelerated decline in DB coverage will produce more losers than winners. The new freezes will reduce income for 26 percent of last wave boomers by an average of \$4,200 and raise income for only 11 percent of last wave boomers by an average of \$2,800.
- Boomers in high socio-economic groups, who have the highest DB coverage rates and projected pension incomes, are most likely both to lose and win from the additional DB plan freezes and will experience the

largest losses and gains. For example, 48 percent of last wave boomers in the top income quintile will lose an average of \$8,000 in income at age 67, while 12 percent will gain an average of \$5,800. In comparison, only 8 percent of last wave boomers in the lowest quintile will lose an average of \$700 in income at age 67, while 6 percent will gain an average of \$800.

- While most boomers will experience relatively modest changes in income from the additional DB freezes, some boomers (particularly those in the last wave) will experience large losses and gains. The freezes will lower average incomes by at least 5 percent for 10 percent of last wave boomers, and raise average incomes by at least 5 percent for 3 percent of them. Big losers will be concentrated in the top income quintiles. For example, 15 percent of last wave boomers in the top income quintile, but only 3 percent of those in the bottom quintile will see their incomes decline by 5 percent or more under the accelerated pension shift. In contrast, the share of large winners will be fairly evenly distributed among income quintiles.
- On average, winners will experience gains in DC retirement accounts (\$2,100) and earnings (\$1,300) that exceed their losses in DB pension benefits (\$600). In comparison, losers will have small gains in retirement accounts (\$200) that are insufficient to offset their large losses in DB benefits (\$4,300). Losers are less likely than the winners to contribute to new or enhanced DC plans and, when they do contribute, are less likely to receive high returns.
- The net decline in retirement income from an accelerated shift from DB to DC plans is to some degree a transitory phenomenon. When workers switch from DB to DC plans in mid-career, they lose the high accrual years in their DB plans and have few years to accumulate DC wealth. Compared with retirement outcomes under this scenario, most workers would be better off participating in either a DB or DC plan for their entire career. More than any other birth cohort, the boomers cohorts will suffer the repercussions of this transition; those who come later may fare better depending on participation rates, contribution rates, and market returns.

(End of excerpt. The entire [Working Paper](#) and [Social Security Bulletin](#) is available in PDF format.)

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