THE NONPROFIT TIMES

Nonprofits Outpace Business In Pension Offerings

NPT/Flynn Research study shows most nonprofits offer retirement plans

Earned Income Streams Are Coming Of Age

Executive Session

FLYNN RESEARCH

P.O. Box 726, Harpers Ferry, WV 25425

Phone: 304-728-9499

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THE NPT 2002 PENSION SURVEY:
KEY FINDINGS AND IMPLICATIONS

Patrice Flynn[1]
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Shock waves riveted through Wall Street in 2002 in the wake of corporate accounting scandals and record size bankruptcies. The impact is far reaching. Significant is the renewed interest in the security of private sector pension plans, which motivated *The Nonprofit Times* to field the **NPT 2002 Pension Survey**. The central question examined is whether or not the nonprofit sector is following the lead of the for-profit sector and replacing defined benefit pension plans with defined contribution plans. The findings will be of interest to nonprofit sector practitioners and leaders alike.

This article is organized in four parts. Part I provides background information on the state of pensions in the United States, including trends in coverage over the past 20 years. Part II describes the research methodology for the **NPT 2002 Pension Survey**. Part III presents the findings, ranging from incidence of pensions in the nonprofit sector, to types of plans offered, financing, and general plan characteristics. Part IV discusses the key implications of the findings as they relate to national trends in pension plan coverage.

I. PENSIONS IN THE U.S.

For most Americans, retirement income derives from three sources: monthly Social Security payments, employer-sponsored defined benefit pensions, and/or individual defined contribution pensions (e.g., 401(k) or 403(b) plans). While all of us are entitled to Social Security benefits, the U.S. Department of Labor reports that only about 22 percent of the workforce participates in a defined benefit plan (down from 38 percent in 1980) and 27 percent are covered by defined contribution plans (up from 9 percent in 1980).

Retirement plans developed in a rather disjointed manner in the United States over the course of the 20th century. The well-known Social Security Act of 1935 was enacted under the leadership of Secretary of Labor Frances Perkins during the Roosevelt Administration to provide a safety net for every American as an antedote to the financial insecurity experienced by millions of people during the Great Depression.

Defined benefit plans were introduced in the 1920s as of means of deterring job mobility. Large electrical firms such as Westinghouse and General Electric were providing on-the-job training of skilled and semi-skilled immigrant labor with the expectation that the costs associated with human capital investments would be recouped over time. However, when competing factories

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[1] Patrice Flynn, PhD is an economist and chief executive officer of FLYNN RESEARCH in Harpers Ferry, WV. She can be reached at 304-728-9499 and FLYNN RESEARCH.com.

began offering higher wages to lure trained workers, Westinghouse and GE introduced pension plans to those who would agree to stay a set number of years with the firm.

Initially, defined benefit plans were only available to white, male workers with 20 years tenure; later the entire workforce was allowed to join such plans (Schatz 1983). For workers, the advantage of a defined benefit plan is that after an agreed upon number of years of employment, a set monthly payout is paid from retirement until death. The risk and responsibility associated with retirement investments are assumed by the employer.

The stability of traditional pension plans was questioned in 1964 when the Studebaker auto company went bankrupt. Workers learned that if an employer declared bankruptcy without sufficient reserves to pay pensioners, retirement payments ended. The case prompted passage of the Employment Retirement Income Security Act of 1974 and the establishment of the Pension Benefit Guaranty Corporation (PBGC) to federally insure private defined benefit pension plans. Today, PBGC insures 44 million workers who receive, on average, 94 percent of their promised retirement payouts.

Since the mid-1970s, the percent of private sector workers with some type of non-government pension plan has remained at about 50 percent. However, employers have begun shifting away from guaranteed pension plans in favor of defined contribution plans, a relatively new form of savings for old-age. According to the U.S. Department of Labor, the number of people in defined contribution plans surpassed those in defined benefit plans in 1984 (at 30 million people). Coverage through defined benefit plans has been falling ever since. Six years ago, assets held in defined contribution plans surpassed those in defined benefit plans (at $1.6 trillion).

Moreover, PBGC-insured defined benefit plans have dropped from a peak of 114,000 in 1985 to 35,000 plans in 2001, a decline of almost 70 percent (Kandarian 2002). PBGC further reports that the percentage of private sector workers with defined benefit plans declined from 38 percent in 1980 to 22 percent in 1998, the most recent year of IRS data. In 1980, over 80 percent of workers with a pension plan had a defined benefit plan. By 1998, the percentage was less than 50 percent.

Government statistics on private pension plans include activities in both for-profit and nonprofit entities. A limited amount of information is available on pension plans in tax-exempt organizations. For example, PBGC reports that the percentage of tax-exempt organizations that offered defined benefit plans dropped from 32 percent in 1993 to 26 percent in 1998. During the same period, the percentage of tax-exempt firms offering defined contribution plans rose from 68 percent to 74 percent (U.S. Department of Labor 2002).

II. RESEARCH METHODOLOGY

The **NPT 2002 Pension Survey** was developed to collect more detailed information on pension plan coverage in the nonprofit sector. A one-page survey was designed by FLYNN RESEARCH to

collect basic information on the incidence of pension plans among nonprofit organizations, the types of plans offered, and selected characteristics of the plans. Demographic information was also collected to identify organizational size, location, and primary activity. The survey was designed to collect baseline data in 2002 for possible replication in the future to monitor trends in coverage.

The Internal Revenue Service (IRS) has granted tax-exempt status to some 1.2 million organizations in the United States, approximately 20 percent of which are considered public charities. The scope of this project did not allow us to survey all public charities. Rather, the universe of survey participants was *The Nonprofit Times* subscribers in August of 2002.

The survey was fielded electronically by *The Nonprofit Times*. Respondents were asked to fax back the completed one-page survey. The data were edited to correct for response and logic errors. Transcription errors were caught through a double data entry process. If an organization did not specify its primary purpose, imputations were made only if the name of the organization clearly identified its function. Information from 100 percent of respondents was suitable for use in the following statistical analysis.

III. RESEARCH FINDINGS

Characteristics of Respondents

Of the 239 nonprofit organizations that completed the **NPT 2002 Pension Survey**, 59 percent were small organizations with annual revenues under $5 million. One quarter of respondents were medium sized organizations with revenues between $5 and 25 million. Ten percent of respondents had revenues of over $50 million annually (Table 1).

The primary purpose of organizations surveyed ranged from social welfare (44 percent), to education (13 percent), health (13 percent), culture (5 percent), associations (5 percent), religion (4 percent), foundations (4 percent) and civic groups (1 percent), representing the wide spectrum of 501(c)(3) organizations in the United States. Every geographic region of the country was represented in the survey with the largest concentration of respondents operating in California, New York, Minnesota, Illinois, District of Columbia, Virginia, and North Carolina.

Incidence of Pension Plans

A full 87 percent of respondents reported that their organization sponsored some type of pension plan for employees, well above the national average of 50 percent. The percent of nonprofit organizations offering traditional defined benefit plans was 18 percent. Ninety-four percent of respondents offered defined contribution plans. Thirteen percent offered both defined benefit and contribution plans (Table 2).

Table 1
Characteristics of Responding Organizations
(percent)

Size	
<$5 million	59
$5-10 million	14
$10-25 million	13
$25-50 million	4
>$50 million	10
Total	**100 %**
Primary Purpose	
Social Welfare	44
Education	13
Health	13
Culture	5
Association	5
Religion	4
Foundation	4
Civic	1
Other	11
Total	**100 %**

Source: NPT 2002 Pension Survey.

Table 2
Type of Pension Plans Offered in 2002
(percent)

Defined benefit only	5
Defined contribution only	81
Both	13
Total	**100 %**

Source: NPT 2002 Pension Survey. Column does not sum to 100 due to rounding.

Characteristics of Nonprofit Sector Pension Plans

Forty-one percent of the pension plans offered by respondents required mandatory employee participation; 57 percent offered voluntary participation. The remaining 2 percent had both mandatory and voluntary enrollment policies by virtue of an organization offering both defined

benefit and contribution plans (Table 3). Seventy-nine percent of plans were fully funded in 2002, and 16 percent were underfunded. The remaining 5 percent of respondents did not answer the funding question (Table 4).

Table 3
Enrollment in Pension Plans
(percent)

Mandatory	41
Voluntary	57
Combination	2
Total	**100 %**

Source: NPT 2002 Pension Survey.

Table 4
Funding of Pension Plans
(percent)

Fully funded	79
Underfunded	16
No response	5
Total	**100 %**

Source: NPT 2002 Pension Survey.

Defined Benefit Plans
Out of the nonprofit organizations surveyed with pension plans in 2002, 5 percent sponsored only traditional defined benefit plans, and the remaining 13 percent sponsored both types. Respondents indicated that workers qualified to join the defined benefit plan after an average of 1.9 years of employment. A full 92 percent of the plans are insured.

Defined Contribution Plans
Ninety-four percent of respondents to the **NPT 2002 Pension Survey** offer defined contribution plans. Eighty percent of these organizations make employer contributions to the plans. On average, workers acquire full rights to employer contributions after 5.7 years, the range being from immediate to 8 years vesting (Table 5).

Table 5
Characteristics of Pension Plans

Percentage of organizations offering pension plans	87 %
Average number of years before employee qualifies to join plan	1.9 years
Average number of years before employee is fully vested	5.7 years
Percentage of plans that are insured	92 %

Source: NPT 2002 Pension Survey.

Over two-thirds of defined contribution plans were 403(b) plans, which were created in 1958 specifically for public educational institutions and tax-exempt 501(c)(3) organizations (Table 6). Twenty-two percent of plans were 401(k) plans. The remaining 10 percent of plans included 457, 457(b), and simple IRA plans. (See Appendix 1 for definitions of pensions plans by type.)

Table 6
Types of Defined Contribution Plans Offered
(percent)

403(b)	68
401(k)	22
457	3
Other	7
Total	**100 %**

Source: NPT 2002 Pension Survey.

There are two common ways to finance pension plans: pay-as-you-go systems and funded systems. With pay-as-you-go (PAYG) pensions, pensioners are paid through contributions made by today's workers who, in turn, rely on future workers to keep the system afloat. The main risk associated with this type of financing is political, specifically, the Congress may change the level of pension benefits over time through the legislative process.

Funded pension systems, on the other hand, are paid for from savings that are invested in financial assets. The risk here is economic, whereby equities and bonds are subject to market

forces. The bursting of the dot com bubble in 2000 and the subsequent recession have reminded firms and workers of the powers of investment risk, largely minimized during the bull market of the 1990s.

Organizations that completed the **NPT 2002 Pension Survey** provided information on how their pension plans were financed. As noted in Table 7, 59 percent were funded systems and 23 percent were pay-as-you-go systems. The remaining 17 percent did not indicate how the plans were financed.

The survey further revealed that over half of the pension plans offered by responding nonprofits are funded externally through a separate pension fund (55 percent) and one-quarter are funded internally through book reserves. Nineteen percent of respondents did not indicate the funding scheme for their pension plans.

Table 7
Financing Systems for Pension Plans
(percent)

Plan Financing	
Funded system	59
Pay-as-you-go system	23
Both	<1
No response	17
Total	**100 %**
Plan Funding	
External	55
Internal	26
No response	19
Total	**100 %**

Source: NPT 2002 Pension Survey.

The **NPT 2002 Pension Survey** also asked respondents what types of funds were included in their pension portfolio, which determines the election options of workers. The findings indicate that over three-quarters of organizations included equities, 70 percent included bonds, and 39 percent included socially screened investment funds.

Cash Balance Plans

The latest trend in pension plan coverage is the cash balance plan in which employers establish an account containing a percentage of a worker's salary plus interest accrued each year. Upon separation with the firm, an employee receives either a lump sum or annuity payout. The employer assumes the investment risk of cash balance plans. Over one-third of respondents to the **NPT 2002 Pension Survey** offered cash balance plans.

IV. IMPLICATIONS

According to the U.S. Department of Labor, out of the 730,031 organizations in the U.S. with pension plans in 1998, eight percent offered defined benefit plans and 92 percent offered defined contribution plans. Industry break-outs reveal that 22,850 tax-exempt organizations offered pension plans in 1998, 26 percent of which sponsored defined benefit plans and 74 percent sponsored defined contribution plans. In contrast, 32 percent of tax-exempt organizations provided defined benefit plans in 1993 and 68 percent provided defined contribution pension plans.

The trends suggest a decline in tradition pension plan coverage among tax-exempt organizations. Indeed, a snap-shot of coverage among subscribers to *The Nonprofit Times* indicates a further shift away from defined benefit plans into defined contribution plans. In 2002, 18 percent of respondents offered traditional employer-sponsored retirement plans and 94 percent offered individual defined contribution plans (Table 8).

Table 8
Trends in Pension Plans Offered by Tax-Exempt Organizations: 1993-2002

	U.S. Department of Labor		NPT Pension Survey
	1993	1998	2002
Defined benefit plan	32 %	26 %	18 %
Defined contribution plan	68 %	74 %	94 %
Both	--	--	13 %

Source: U.S. Department of Labor, Private Pension Plan Bulletin (Winter 2001/2002) and NPT 2002 Pension Survey. Dash indicates data not available.

A second trend in national pension plan coverage is the growth in the number of firms reporting underfunded defined benefit plans. Steven Kandarin, the executive director of the Pension Benefit Guaranty Corporation (PBGC) reported to Congress on February 27, 2002, that the federal agency responsible for insuring traditional defined benefit pension plans could be forced to make up a shortfall of “at least $125 million” in the Enron Corporation’s plan covering 20,000 people if Enron fails to survive (Kandarian 2002). PBGC officials warned that this figure may

be the tip of the iceberg if other troubled firms declare bankruptcy without sufficient funds to pay their pensioners.

Indeed, in October of 2002, Delta Air Lines, the third-largest U.S. airline disclosed a pension fund deficit of between $700 million and $800 million. General Motors wrote off about $9.6 billion in assets in 2001 to cover a pension fund deficit.

While underfunding was not the primary focus of the **NPT 2002 Pension Survey**, the results reveal that a full 79 percent of nonprofit sector pension plans were fully funded in 2002, 16 percent were underfunded, and 5 percent did not respond. All firms—for-profit and nonprofit alike—will be impacted by heightened scrutiny of financial accounting in the wake of the Sarbanes-Oxley Act of 2002, which seeks "to protect investors by improving accuracy and reliability of corporate disclosures" [P.L. 107-204]. Enhanced accounting oversight will enable workers to better monitor the risks associated with both defined benefit and contribution plans.

Third, recent events in the marketplace have raised a red flag about the amount of retirement income investors will derive from their defined contribution plans. Since the bursting of the dot-com bubble on Wall Street in 2000, the onset of the recession in March of 2001, and the corporate accounting scandals of 2002, investors have learned—experientially—the personal risks associated with defined contribution pension plans. Information on the perceptions and experiences of nonprofit sector workers regarding the risks associated with their pension plans may be a potential focus of subsequent nonprofit sector research, especially if the U.S. government decides to privatize the Social Security program.

In the United States, pension fund assets comprise over 70 percent of gross domestic product, a non-trivial sum. The debate is ongoing as to the merits of defined benefit vs. contribution plans, pay-as-you-go vs. funded systems, and internal vs. external accounting schemes. With over 11 million people employed in the nonprofit sector, it behooves workers, board members, and managers to fully understand the structure of nonprofit pension plans, embrace the risks and responsibilities associated with retirement plans, and strive to keep abreast of the latest information on best practices to ensure a sustainable quality of life for retirees in their old age.

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APPENDIX 1:
TYPES AND DEFINITIONS OF
U.S. RETIREMENT & PENSION PLANS[2]

I. Tax-Deferred Retirement Savings Programs

Traditional IRA (Individual Retirement Arrangement)
Individual tax-deferred retirement account set-up and managed by an individual. Contributions are tax deductible if the individual does not participate in an employer-sponsored retirement plan. Employers are not allowed to match worker contributions. Maximum contribution per person is $3,000 in 2002. As of mid-2001, more than 44 million households owned IRAs, according to the Investment Company Institute.

Roth IRA
Individual retirement account set-up and managed by an individual. Allows workers to save after-tax dollars in a tax-deferred account and never pay taxes on the interest earned. Employers are not allowed to match worker contributions. Maximum contribution per person is $3,000 in 2002.

II. Defined Benefit Pension Plans

Traditional pension plan designed, sponsored, and managed by employers that guarantees a set payout upon retirement to retirees (and spouses, in some cases). Plans are guaranteed by the Pension Benefit Guaranty Corporation of the U.S. Department of Labor.

III. Defined Contribution Pension Plans

Retirement plan set-up by employers and funded by employees. The value of the balance at retirement is determined by the amount of a worker's contributions and employer matching contributions (if any), and the performance of the investments the worker chooses. No federal agency guarantees the plan.

401(k)
A defined contribution retirement plan named after section 401(k) of the 1978 Internal Revenue Code that permits employees to set aside pre-tax money into an account where it grows tax-deferred until withdrawal. Employers design the plan rules and handle the automatic payroll deductions and paperwork. Employees make contributions and assume the investment risk and responsibility. Employers may match part or all of a worker's contribution. Normally 401(k) plans are established by for-profit companies.

[2] For further details on retirement accounts, please visit www.mpowercafe.com.

Plan became effective January 1, 1980. At the end of 2000, about $1.8 trillion was invested in 401(k) plans, according to the Employee Benefit Research Institute. Maximum contribution per person is $11,000 before taxes in 2002. No federal agency guarantees 401(k) plan assets.

Roth 401(k)
Created by the Economic Growth and Tax Relief Reconciliation Act of 2001, allows workers to save after-tax dollars in a tax-deferred account and never pay taxes on the interest earned. Plan becomes effective in 2006; regulations have not yet been drafted by Congress.

403(b)
A defined contribution, tax-deferred retirement plan used by employees of public educational institutions and tax-exempt organizations who, by law, cannot participate in a 401(k) retirement plan. The plan was created by Congress in 1958 under section 403(b) of the Internal Revenue Code to include 501(c)(3) organizations; in 1961, the law was expanded to include public schools, colleges, and universities. 403(b) plans are often referred to as "tax sheltered annuities" although they can now also offer mutual funds.

Employers design the plan and handle the paperwork. Employees make pre-tax contributions through payroll deductions, assume investment risk and responsibility, and pay taxes upon withdrawal. Employers may make matching contributions. Maximum worker contribution is $11,000 in 2002. All contributions (worker and employer) may equal no more than 100 percent of compensation or $40,000, whichever is less.

Roth 403(b)
Created by the Economic Growth and Tax Relief Reconciliation Act of 2001, allows workers to save after-tax dollars in a tax-deferred account and never pay taxes on the interest earned. Plan becomes effective in 2006.

457
Created by Congress in 1978, a nonqualified, tax-deferred, defined contribution retirement plan offered to employees of state governments, local governments, and nonprofit organizations as a supplement to other defined benefit and defined contribution plans. Contributions remain assets of the employer until distributed to the participant, and are therefore vulnerable to creditors if employer goes bankrupt. Money must be held in a trust, custodial account, or annuity contract. The extra 10 percent IRS early distribution penalty tax does not apply if person withdraws money early.

Maximum contribution limit is $11,500 in 2002. As of December 31, 2001, $45.7 billion was held in 457 plans.

457(b)
Created by the Economic Growth and Tax Relief Reconciliation Act of 2001, a nonqualified, tax-deferred compensation, eligible plan, covered by Internal Revenue Code Section 457(b). Established for senior management and highly compensated employers who can defer up to 100 percent of total compensation (before deferrals) in addition to 401(k) and 403(b) deferrals.

457(f)
Same as the 457(b) plan except that it is an ineligible plan covered under Internal Revenue Code Section 457(f). Allows workers to make contributions to 403(b), 401(k), 457(b) and 457(f) plans and defer up to 100 percent of compensation.

IV. Cash Balance Pension Plans

Cash balance plans represent a relatively new and growing portion of the pension plan system in the United States. Employers establish an account containing a percentage of a worker's salary plus interest each year. Upon separation with the firm, an employee receives either a lump sum or annuity payouts. The employer assumes the investment risk. A growing number of employers with defined benefit plans are shifting to cash balance plans rather than abandoning pension plans altogether.