THE DEATH KNELL OF TRADITIONAL DEFINED BENEFIT PLANS: AVOIDING A RACE TO THE 401(K) BOTTOM

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I. INTRODUCTION

In August of 2006, President Bush signed into law what he characterized as "the most sweeping reform of America's pension laws in over 30 years."[1] Touted as "one of the most important pieces of legislation" that passed Congress in 2006 and the cure-all to pension funding ills and Enron-type scandals,[2] the Pension Protection Act of 2006 ("Act")[3] responded to a federally regulated pension system in crisis.

There were numerous factors contributing to the pension crisis. Corporate bankruptcies and growing reports of defined benefit plan underfunding raised serious concerns about the Pension Benefit Guaranty Corporation's ("PBGC") financial viability.[4] Created under the Employee Retirement Income Security Act of 1974 ("ERISA"),[5] the PBGC is a federal corporation that provides insurance for employer-sponsored defined benefit plans.[6] The PBGC receives

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1. President George W. Bush's Statement Before Signing Pension Protection Act of 2006 (Aug. 17, 2006) (transcript available at http://www.whitehouse.gov/news/releases/2006/08/20060817-1.html).

2. Press Release, Senator Chuck Grassley, Chairman, U.S. Senate Comm. on Fin., Memorandum re: Signing of the Pension Protection Act of 2006 (Aug. 17, 2006), *available at* http://grassley.senate.gov/public/index.cfm?FuseAction=PressReleases.Detail&PressRelease_id=dcce5613-8fc4-485f-982d-4910cd82c19b&Month=8&Year=2006 (touting importance of Pension Protection Act of 2006 and predicting that its new requirements will help curb abuses, including abuses associated with Enron scandal).

3. Pension Protection Act of 2006, Pub. L. No. 109-280, 120 Stat. 780 (codified in scattered sections of the I.R.C. and 29 U.S.C.).

4. Alex J. Pollock, *Addressing the Insolvency of the Pension Benefit Guaranty Corporation*, FIN. SERVICES OUTLOOK (Am. Enter. Inst. for Pub. Policy Research, Washington, D.C.), June 2006, at 1, 2, *available at* http://www.aei.org/docLib/20060614_FSOJune3Final_g.pdf; Ron Bigler, *Stock Market Slump Bleeding Traditional Pension Funds; Unions Can Expect Battles over Pension Costs at the Bargaining Table*, LRA ONLINE, Oct. 17, 2002, http://www.laborresearch.org/print.php?id=238.

5. Employee Retirement Income Security Act of 1974, Pub. L. No. 93-406, § 4002, 88 Stat. 829, 1002 (codified as amended at 29 U.S.C.A. § 1302(a) (West 1999 & Supp. 2007).

6. Pension Benefit Guar. Corp., Who We Are, http://pbgc.gov/about/about.html (last visited May

premium payments from sponsoring employers,[7] and, in turn, the PBGC guarantees benefit payments to almost forty-four million active workers and retirees in more than 30,000 active plans.[8] If an employer is unable to meet its obligations under the terms of a plan, the PBGC takes on plan administration and liabilities and makes annual benefit payments to plan participants.[9]

By the end of 2005, the PBGC's administration of terminated plans left it with a projected $23 billion deficit.[10] PBGC's reported deficit included then-recent plan terminations, including the United Airlines and US Airways terminations, which discharged $9.6 billion in pension liabilities.[11] The deficit did not, however, reflect the magnitude of defined benefit plan underfunding in plans not currently administered by the PBGC. Some of these underfunded plans are sponsored by employers that have filed for bankruptcy protection,[12] and, in all likelihood, these employers will turn over plan administration and

19, 2008) (describing goals of PBGC, including encouragement of private employer-sponsored defined benefit plans, protection of pension benefits to plan participants, and maintenance of low-cost premiums for sponsoring employers).

7. *See* NEELA K. RANADE & PAUL J. GRANEY, CRS REPORT FOR CONGRESS, DEFINED BENEFIT PENSION REFORM FOR SINGLE-EMPLOYER PLANS 1 n.1 (2005), *available at* http://www.opencrs.com/rpts/RL32991_20050714.pdf ("The PBGC's assets consist of revenues from premiums charged on pension plans that it insures, assets of terminated pension plans, and any asset recoveries from plan sponsors of terminated pension plans. The PBGC assets also include investment income on PBGC revenues. The PBGC's liabilities consist of the present value of the benefits payable by the PBGC for participants in terminated pension plans, plans whose termination is pending, and probable terminations.").

8. See *supra* note 6 and accompanying text for a discussion of the Pension Benefit Guaranty Corporation.

9. Marilyn Geewax, *Retirement Fund Worries: Boomers See Clouds on Horizon, Congress Has Failed to Act on Problems Facing Private Pension Plans, Social Security*, ATLANTA J. & CONST., June 26, 2005, at C1.

10. *See* DELOITTE, SECURING THE FUTURE: DEFINED BENEFIT PLANS AND THE PENSION PROTECTION ACT OF 2006 2 (2006), *available at* http://www.deloitte.com/dtt/cda/doc/content/us_consulting_hc_securingfuturepension_010507.pdf ("The [Pension Protection Act's] origins can be traced to a sudden reversal of fortunes for the PBGC's Single-Employer Program (the Program). The Program posted six consecutive surpluses beginning in 1996, including a record $9.7 billion surplus in 2000. Then, the 'perfect storm' of low interest rates and declining stock prices hit. This, combined with the termination of several large, underfunded plans, returned the Program to deficits beginning in 2002. The Program's deficit stood at $22.7 billion in 2005, a slight improvement over the record-setting $23.3 billion deficit recorded in 2004."); *cf.* OPTIMAL BENEFITS STRATEGIES, LLC, PROMISES TO KEEP: THE TRUE NATURE OF THE RISKS TO THE DEFINED BENEFIT PENSION SYSTEM, A REPORT PREPARED FOR THE AMERICAN BENEFITS COUNCIL 1, 5-6 (2005), *available at* http://www.americanbenefitscouncil.org/documents/pbgcdraft092205.pdf (explaining that estimated deficit is function of low interest rates used to calculate future liabilities, poor investment performance, recent plan terminations, and changes in PBGC mortality assumption, and observing that "this deficit could be reduced to $14.3 billion (and, under one scenario, could be as low as $4.6 billion)"); PENSION BENEFIT GUAR. CORP., PERFORMANCE AND ACCOUNTABILITY REPORT, FISCAL YEAR 2005, at 3 (2005), *available at* http://pbgc.gov/docs/2005par.pdf (discussing problems created for PBGC by employers freezing pension benefits).

11. Marcy Gordon, *Pension Agency Reports Deficit: Airlines Dumping Liabilities Contributed to $23B Shortfall*, MONTEREY COUNTY HERALD (Cal.), Nov. 16, 2005, Bus. Sec.

12. PENSION BENEFIT GUAR. CORP., *supra* note 10, at 3 (noting that Delta Airlines and Northwest Airlines filed for bankruptcy protection in 2005).

liabilities to the PBGC.[13] Other underfunded plans are sponsored by employers that are facing various levels of financial crisis. For example, General Motors ("GM") sponsors the largest defined benefit plan in the United States, covering more than 600,000 workers.[14] In December of 2005, around the time the PBGC estimated that GM's plan was underfunded by $31 billion,[15] GM announced several plant closings and 30,000 job cuts as part of a global restructuring plan.[16] If GM's financial picture does not improve, bankruptcy reorganization could become a reality. Such a reality, back in 2005, would have more than doubled the PBGC's deficit.

Collectively, in 2005, over 1,100 active plans reported underfunding of more than $353 billion.[17] Under its own calculations, the PBGC estimated that active defined benefit plans were underfunded by a total of $450 billion.[18] These potentially staggering liabilities fueled talk of a taxpayer bailout, resurrecting memories of the $124 billion bailout of the Federal Savings and Loan Insurance Corporation in the early 1990s.[19]

The defined contribution plan front illustrated another part of the crisis in the five years predating the Act, as thousands of workers and retirees lost all or a major portion of their retirement savings through poor investment selection, including large losses stemming from company stock investments in bankrupt companies. For example, the corporate scandals at Enron Corporation ("Enron") and WorldCom Corporation ("WorldCom") left their employees with over $2 billion in 401(k) plan losses attributable to company stock holdings.[20]

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13. Gordon, *supra* note 11 (observing that Delta's and Northwest Airlines' plans are collectively underfunded by approximately $16 billion).

14. Editorial, *The $800 Billion Question*, N.Y. SUN, May 15, 2006, at 8.

15. *Full or Empty? GM Pension Dispute*, CNNMONEY.COM, Oct. 3, 2005, http://money.cnn.com/2005/10/03/news/fortune500/gm_pensions/index.htm.

16. Stephanie Armour, Marilyn Adams & Kathy Chu, *Even Healthy Firms Freeze or Cut Loose Traditional Pensions*, USA TODAY, Dec. 7, 2005, at B1.

17. Press Release, Pension Benefit Guar. Corp., Companies Report a Record $353.7 Billion Pension Shortfall in Latest Filings with PBGC (June 7, 2005), *available at* http://pbgc.gov/media/news-archive/news-releases/2005/pr05-48.html.

18. Armour, Adams & Chu, *supra* note 16.

19. *Strengthening Pension Security and Defined Benefit Plans: Examining the Financial Health of the Pension Benefit Guaranty Corporation: Hearing Before the H. Comm. on Education and the Workforce*, 108th Cong. 2 (2003) (statement of Honorable John A. Boehner, Chairman, H. Comm. on Education and the Workforce); *see also* PATRICK PURCELL, CRS REPORT FOR CONGRESS, SUMMARY OF THE PENSION PROTECTION ACT OF 2006, at 2 (2006), *available at* http://www.opencrs.com/rpts/RL33703_20061023.pdf (noting strong likelihood that Congress would step in to bail out PBGC if it were to become financially insolvent, because retirement income of forty-four million Americans who earned benefits under defined benefit plans would be threatened); Press Release, The White House, Fact Sheet: The Pension Protection Act of 2006: Ensuring Greater Retirement Security for American Workers (Aug. 17, 2006), *available at* http://www.whitehouse.gov/news/releases/2006/08/20060817.html (explaining that if employers are unable to fund employees' pension plans, American taxpayers may be called on to fund difference).

20. Yuki Noguchi, *Workers' 401(k)s Lost $1.1 Billion*, WASH. POST, July 10, 2002, at E1; *see also The Enron Collapse and Its Implications for Worker Retirement Security: Hearings Before the H. Comm. on Education and the Workforce*, 107th Cong. 25 (2002) [hereinafter *Hearings*] (statement of Rep. Rush D. Holt, Member, H. Comm. on Education and the Workforce) (discussing Enron

The Act responded to a federally regulated pension system in crisis by purportedly shoring up defined benefit plan funding, reducing the PBGC's financial exposure, and providing additional incentives for defined contribution plan sponsorship. According to White House press releases, the Act strengthens the PBGC's position by enacting numerous requirements.[21] First, the Act raises defined benefit plan funding requirements by instituting a new system for determining required minimum funding contributions, including plan funding of one hundred percent of plan liabilities and amortization of underfunded liabilities over a seven-year period versus the old thirty-year time frame.[22] Second, the Act imposes additional funding requirements on "at-risk" plans.[23] Third, the Act accelerates and increases funding requirements on plan terminations.[24] Fourth, the Act raises tax deduction limitations on employer contributions to encourage full funding.[25] And fifth, the Act restricts underfunded plan sponsors' ability to amend plans and provide additional benefits.[26]

Purportedly, the Act also strengthens defined contribution plans through various requirements. Addressing the abuses raised by the Enron and WorldCom scandals, the Act prohibits employers from making employer contributions in the form of company stock and then restricting participants' ability to diversify those investments.[27] Also aimed at promoting plan asset diversification, the Act encourages employer-facilitated investment advice by providing a prohibited transaction exemption that partially insulates plan sponsors from liability for investment advice rendered by qualified financial advisers.[28] To encourage asset accumulation, the Act allows employers to automatically enroll plan participants in the salary deferral feature of a 401(k) plan, essentially forcing participants to opt out of making contributions, and then provides for annual increases in the automatic salary deferral contribution percentage.[29]

This Article maintains that the death knell for traditional defined benefit plans has already rung, and that the Act does not provide sufficient protection for retirement plan participants. Even before the increased legislative requirements, traditional defined benefit plans were dying.[30] Imposing additional

scandal's harm to employees).

21. President George W. Bush's Statement, *supra* note 1.

22. Pension Protection Act of 2006, Pub. L. No. 109-280, §§ 102, 111, 120 Stat. 780, 789-809, 820-26 (to be codified at IRC § 412 and 29 U.S.C. § 1083).

23. *Id.* §§ 102, 112.

24. *Id.* § 103.

25. *Id.* §§ 102, 111.

26. *Id.* §§ 103, 113.

27. Pension Protection Act § 901.

28. *Id.* § 601.

29. *Id.* § 902.

30. *See Retirement Security: Strengthening Pension Protections: Hearing Before the Subcomm. on Health, Employment, Labor and Pensions of the H. Comm. on Labor and Education* 2-3 (2007) (statement of Scott Macey, American Benefits Council), *available at*

burdensome and costly requirements on defined benefit plan sponsorship will almost certainly accelerate what now seems inevitable—employers' abandonment of defined benefit plan sponsorship. Additional incentives for defined contribution plan sponsorship will also fuel the shift away from defined benefit plan sponsorship and toward defined contribution plan sponsorship.[31] With the abandonment of defined benefit plans, employees are left with defined contribution plan coverage that provides minimal benefit accruals during working years and no fixed benefit in postretirement years.[32]

Part II of this Article looks at the changing landscape of private employer-sponsored retirement plans, including recent defined benefit plan terminations, conversions, freezes, and the growing dominance of defined contribution plans, particularly 401(k) plans. Part III discusses some of the economic, social, and political factors that led to the shift away from defined benefit plan sponsorship and the embracement of 401(k) plan sponsorship, including a series of legislative and regulatory initiatives that made defined benefit plan sponsorship more burdensome and costly and defined contribution plan sponsorship more attractive. Part IV discusses how defined contribution plans fail to provide the level of benefits once offered under traditional defined benefit plans. Part V analyzes how the Act fails to encourage continuing defined benefit plan sponsorship and does little to shore up the retirement security offered under defined contribution plans. And Part VI recommends additional legislative changes that promote a higher level of retirement security for retirement plan participants.

II. THE SHIFT AWAY FROM TRADITIONAL RETIREMENT PLAN SPONSORSHIP

For the last twenty-five years, a small majority of Americans has supplemented its personal savings and social security benefits with private employer-sponsored retirement plans, often referred to as the third leg of retirement security.[33] The level of retirement security provided under these plans

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http://edlabor.house.gov/testimony/050307ScottMaceytestimony.pdf (testifying that "the defined benefit plan system has been in significant decline in recent years"). *But see* Armour, Adams & Chu, *supra* note 16 ("But while traditional pensions are suffering, they're not dead. Nearly two-thirds of Fortune 1000 companies (63%) still sponsor a defined-benefit plan, such as traditional pensions, according to Watson Wyatt Worldwide, a human resources consulting firm.").

31. Michael W. Wyand, *DuPont Shift to Defined Contribution Plan Consistent with Trends*, BNA PENSION PROTECTION ACT CENTER, Sept. 1, 2006, http://subscript.bna.com/pic2/ppa.nsf/id/BNAP-6T7RFG?OpenDocument (quoting James A. Klein, president of the American Benefits Council as stating that "'[i]n general, [the Pension Protection Act] is going to accelerate movement to defined contribution plans from defined benefit plans'").

32. Pamela Yip, *Companies Warm to Idea of Freezing Pension Plans*, DALLAS MORNING NEWS, Jan. 11, 2006, at 1A.

33. *See* PATRICK PURCELL, CRS REPORT FOR CONGRESS, RETIREMENT SAVINGS AND HOUSEHOLD WEALTH: TRENDS FROM 2001 TO 2004, at iii (2006), *available at* http://opencrs.cdt.org/rpts/RL30922_20060522.pdf (citing Federal Reserve Board Survey of Consumer Finances, which indicated that "47.9% of workers under age 65 participated in employer-sponsored retirement plans — both [defined benefit] and [defined contribution] — in 2004, down from 49.6% in 2001"). Historically, the other two legs of retirement security have been social security and private

has, however, evolved over time. In the early 1970s, the "traditional retirement plan" landscape consisted of employers' sponsorship of defined benefit plans as the dominant retirement vehicle and sponsorship of defined contribution plans for providing supplemental retirement income.[34] Defined benefit plans offer the highest level of retirement security by requiring annual employer contributions sufficient to provide participants with a fixed benefit annually during postretirement years.[35] In contrast, defined contribution plans were historically designed as supplemental profit sharing or stock bonus plans.[36] These plans promise no fixed benefit in retirement. Instead, participants receive their account balance, which consists of past contributions, adjusted for earnings, losses, and prior distributions.[37]

Beginning in the early 1980s, a fundamental shift occurred in this scheme of traditional retirement plan sponsorship. The 1980s and 1990s evidence a mass exodus from defined benefit plan sponsorship.[38] While there were once approximately 112,000 private employer-sponsored defined benefit plans,[39] at the end of 2005, there were only about 30,000.[40] This decline in sponsorship translates into a corresponding decline in the percentage of the American workforce covered under these plans. In 2006, a mere eighteen percent of the U.S. workforce was covered under defined benefit plans, compared to the sixty-two percent of the workforce covered in the 1970s.[41]

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savings. Stephen F. Befort, *The Perfect Storm of Retirement Insecurity: Fixing the Three-Legged Stool of Social Security, Pensions, and Personal Savings*, 91 MINN. L. REV. 938, 939 (2007).

34. *See* Leon E. Irish, *Twenty Years of Employee Benefit*, 57 TAX NOTES 915, 915-16 (1992) (noting that rising numbers of private pensions established before 1970 followed growth of labor movement, typically characterized by large defined benefit plans).

35. 29 U.S.C. § 1002(35) (2000) (defining "defined benefit plan").

36. *Id.* § 1002(34) and (defining "defined contribution plan"); *see also* Olivia S. Mitchell & Stephen P. Utkus, *The Role of Company Stock in Defined Contribution Plans* 3-4 (Nat'l Bureau of Econ. Research, Working Paper No. 9250, 2002), *available at* http://papers.nber.org/papers/w9250.pdf ("[Defined contribution] plans consisted mainly of profit-sharing plans to which employers made variable plan contributions based on company earnings, and Employee Stock Ownership Plans (ESOPs) which by design encouraged employers to make employer stock contributions in an effort to foster employee ownership. [Defined contribution] plans were thus not widely used as a [sic] retirement income vehicles and at many large firms, they were supplemental to [defined benefit] programs.").

37. 29 U.S.C. § 1002(34).

38. *See* PENSION BENEFIT GUAR. CORP., AN ANALYSIS OF FROZEN DEFINED BENEFIT PLANS 2 (2005), *available at* http://www.pbgc.gov/docs/frozen_plans_1205.pdf (noting that while in 1985, twenty-two million workers participated in defined benefit plans, that number decreased to seventeen million by 2002); U.S. DEP'T OF LABOR, PENSION & WELFARE BENEFITS ADMIN., PRIVATE PENSION PLAN BULL., ABSTRACT OF 1998 FORM 5500 ANNUAL REPORTS tbl.E1 (2001-2002), *available at* http://www.dol.gov/ebsa/pdf/1998pensionplanbulletin.pdf (reporting that in 1979, employers sponsored 139,489 defined benefit plans and 331,432 individual account plans, and, in 1998, employers sponsored 56,405 defined benefit plans and 673,626 defined contribution plans).

39. PENSION BENEFIT GUAR. CORP., *supra* note 38, at 1.

40. *Id.*

41. Jason Gertzen & Diane Stafford, *Sprint Puts Pension Plan on Ice*, KAN. CITY STAR, Jan. 20, 2006, at A1.

Defined contribution plans with an employee elective deferral feature, often referred to as "401(k) plans," now dominate the retirement plan landscape.[42] Forty-one percent of all plans are designed as 401(k) plans; collectively these plans cover fifty-one percent of all active retirement plan participants.[43] These figures translate into over forty-two million American workers participating in over 300,000 employer-sponsored 401(k) plans.[44]

Even with respect to the remaining defined benefit plans, they do not provide the historical level of benefits offered under traditional defined benefit plans. Over the past two decades, hundreds of employers, including IBM, Xerox, Lucent Technologies, SBC Communications, BellSouth, and Eastman Kodak have either converted their traditional defined benefit plans into cash balance plans or now offer cash balance plans as one of their retirement plan options.[45] While these plans are classified as defined benefit plans for purposes of ERISA and Internal Revenue Code ("Code") requirements,[46] their benefit accruals and liabilities differ significantly from traditional plan accruals. Cash balance plan benefits are front-loaded. Retirement benefits are calculated yearly based on a percentage of each participant's then-current pay plus an interest credit (cumulatively looking at career average compensation and not final average compensation).[47] The retirement benefits are then communicated to participants in terms of a hypothetical account available at retirement, which reflects past contributions, future contributions based on assumed compensation increases, and the plan's assumed interest rate.[48]

42. Alicia H. Munnell & Pamela Perun, *An Update on Private Pensions*, AN ISSUE IN BRIEF (Center for Ret. Research at Boston C., Chestnut Hill, Mass.), Aug. 2006, at 1, 4, *available at* http://crr.bc.edu/images/stories/Briefs/ib_50.pdf (noting dramatic rise in popularity of 401(k) plans within world of defined contributions).

43. *Id.* at 4 ("Within the defined contribution world, 401(k) plans are the 800-pound gorilla. And they have experienced a meteoric rise to prominence since their introduction in the early 1980s. . . . [A]ll dimensions of 401(k) plans — assets, benefits, participants, and contributions — have increased between 30 and 50 percent of total defined contribution plans to about 90 percent.").

44. U.S. DEP'T OF LABOR, *supra* note 38, at tbl.D3; *see also* Jonathan Peterson, *U.S. Plans Stronger Oversight of 401(k)s*, L.A. TIMES, Jan. 30, 2007, at C1 (reporting on growth of 401(k) plans, which now cover forty-seven million Americans, even as employers abandon traditional pension plans).

45. Ari Weinberg, *Pension Plans Wade into Murky Water*, FORBES.COM, Aug. 6, 2003, http://www.forbes.com/2003/08/06/cx_aw_0806pensions.html; *see also A Pension Double Header: Reforming Hybrid and Multi-Employer Pension Plans: Hearing Before the Subcomm. on Retirement Security and Aging of the S. Comm. on Health, Education, Labor and Pensions*, 109th Cong. 56 n.43 (2005) (statement of James M. Delaplane, Jr., Special Counsel, American Benefits Council) ("A majority of companies have [sic] made it clear that if hybrid plans become untenable, they [sic] will be offering only a 401(k)/defined contribution plan going forward. They will not be reverting to a traditional defined benefit plan design.").

46. I.R.C. § 414(i)-(j) (2000).

47. *See* I.R.S. Notice 96-8, 1996-1 C.B. 359 (noting that to be tax qualified, cash balance plans must be front-loaded, and providing that accrued benefits payable at retirement is partly function of compounded yearly interest credits made to participants' hypothetical accounts).

48. *Id.*; PATRICK J. PURCELL, CRS REP. FOR CONG., PENSION ISSUES: LUMP-SUM DISTRIBUTIONS AND RETIREMENT INCOME SECURITY (2003), *available at* http://www.benefitslink.com/articles/RL30496.pdf; U.S. Department of Labor, Frequently Asked Questions About Cash Balance

By front-loading, cash balance plans offer sponsors savings and predictability components, as well as significant reductions in pension liabilities. Retirement benefits are no longer linked to final average compensation or another benchmark that bases benefits primarily on compensation levels earned immediately prior to retirement. Because of the benefit of front-loading, IBM originally projected that its cash balance plan conversion "would produce annual savings of almost $500 million by 2009."[49] With significant cost savings and relatively fixed liabilities, by 2003, approximately twenty-five percent of all participants in defined benefit plans were covered by "hybrid plans" such as cash balance plans.[50]

Short of plan termination or conversion, other employers implemented plan freezes. While there are several different variations of plan freezes, in general, an employer can implement either a hard freeze or a soft freeze.[51] Under a hard freeze, the plan is closed to new and existing employees and "grandfathered" participants receive no additional credit for subsequent years of service or compensation increases.[52] Plan providers implement soft freezes under various methods. Under one method, the plan can be closed to new employees (they will never become eligible for plan participation) but grandfathered plan participants will continue to accrue benefits for additional years of service and compensation increases.[53] Under another method, the plan can be frozen for only some of the participants. Such a soft freeze could be based on age, tenure, job classification, or plant location. Under yet another method, plan participants will not accrue additional benefits for subsequent years of service, but increased compensation growth will be factored into the benefit determined at retirement.[54]

Pension Plans, How Do Cash Balance Plans Work?, http://www.dol.gov/ebsa/faqs/faq_consumer_cashbalanceplans.html (last visited May 19, 2008).

49. Cooper v. IBM Pers. Pension Plan, 274 F. Supp 2d. 1010, 1020 (S.D. Ill. 2003) (explaining that savings would be the result of reduced benefits paid to older employees).

50. CHRISTIAN E. WELLER, CTR. FOR AM. PROGRESS, ENSURING RETIREMENT INCOME WITH CASH BALANCE PLANS 4 (2005), *available at* http://www.americanprogress.org/atf/cf/{E9245FE4-9A2B-43C7-A521-5D6FF2E06E03}/ARECASHPLANS.PDF; *see also* Jason Hamersley, *Future in the Balance: Cash Balance Plans*, 22 J. COMPENSATION & BENEFITS 28, 28 (2006) (noting that in 2006, over eight million American workers participated in hybrid plans such as cash balance plans).

51. WILLIAM MOST, MILLIMAN CONSULTANTS AND ACTUARIES, WHITE PAPER: WALKING THE LINE: FACTORS FOR EVALUATING POTENTIAL FREEZES OF DEFINED BENEFIT PLANS 1 (2007), *available at* http://www.milliman.com/expertise/employee-benefits/publications/wp/PDFs/walking-the-line-WP03-08-07.pdf; *see also* Alicia H. Munnell et al., *Why Are Healthy Employers Freezing Their Pensions?*, AN ISSUE IN BRIEF (Center for Ret. Research at Boston C., Chestnut Hill, Mass.), Mar. 2006, at 1, 1-3, *available at* http://crr.bc.edu/images/stories/Briefs/ib_44.pdf (describing various types of pension freezes).

52. MOST, *supra* note 51, at 1.

53. *Id.*; Munnell et al., *supra* note 51, at 1-3.

54. *Id.*; *see also* Pension Rights Center, Pension Freezes, http://www.pensionrights.org/pubs/facts/pension_freezes.html (last visted May 19, 2008) (explaining different types of pension freezes and observing that freezes may permit benefits calculation based on pay when employee leaves plan rather than date of freeze).

Initially, plan freezes occurred in financially distressed industries.[55] This trend is primarily attributable to the fact that a freeze is a significantly less expensive process than a plan termination.[56] Except in the case of a distress termination, where a financially distressed employer sponsoring an underfunded defined benefit plan turns the plan over to the PBGC, an employer can only terminate a plan by fully funding it on a termination basis and purchasing annuities for all plan participants.[57] With underfunded plans, a plan termination could result in an immediate multimillion dollar cost to the employer.[58] By freezing a plan, an employer can reduce future benefit accrual costs without triggering plan termination rules and any corresponding additional cash infusion.[59]

In recent years, however, an "'entirely new phenomenon'" has emerged where financially stable companies are freezing their defined benefit plans.[60] With the only economic downside to either a hard or soft freeze being continuing liability for annual PBGC insurance premiums and minimum funding requirements,[61] numerous financially viable companies have implemented plan freezes.[62] In March 2006, Alicia H. Munnell, an expert on retirement security, reported that over the last several years, seventeen large, financially healthy companies at least partially froze their defined benefit plans.[63] Verizon Communications ("Verizon"), IBM Corporation ("IBM"), and Coca-Cola Bottling Company ("Coca-Cola") are among the corporate giants that recently implemented freezes.[64] After reporting $1.9 billion in third-quarter earnings and

55. Watson Wyatt Worldwide, *More Fortune 1000 Plan Sponsors Freezing Their Defined Benefit Plans*, INSIDER, July 2006, http://www.watsonwyatt.com/us/pubs/Insider/showarticle.asp?ArticleID=16298 (explaining that plan freezes and terminations were historically linked to pension plans that were in financial distress).

56. *See* PENSION BENEFIT GUAR. CORP., *supra* note 38, at 8 (finding that lower funding levels of frozen plans suggests that plan sponsors would like, but cannot afford, to terminate the plans); *see also* Munnell et al., *supra* note 51, at 2 (observing that sponsors terminating plans must pay out benefits immediately).

57. 29 U.S.C. § 1341(b)(2)(D)(ii) (2000).

58. *Id.* (requiring sufficient plan assets to satisfy plan liabilities to terminate defined benefit plan).

59. PENSION BENEFIT GUAR. CORP., *supra* note 38, at 8-9.

60. Daniel Gross, *The Big Freeze: As Companies End Their Traditional Pensions, Workers Are Left out in the Cold*, AARP BULL., Mar. 2006, http://www.aarp.org/bulletin/yourmoney/big_freeze.html (quoting Alicia Munnell, Director of Center for Retirement Research at Boston College).

61. *See* PENSION BENEFIT GUAR. CORP., *supra* note 38, at 12 (noting requirement that frozen plans must continue to pay PBCG insurance premiums and make minimum contributions).

62. Watson Wyatt Worldwide, *supra* note 55 (noting that between 2003 and 2006, seventy Fortune 1000 firms froze at least one of their defined benefit plans); *Plan Administration, Close Up: Employers Change Retirement Plans*, 16 NO. 7 THOMPSON'S 401(K) HANDBOOK NEWSL. 10 (Thompson Publ'g Group, Inc.), June 2007, at 10 (observing that freezes and terminations are spread over multiple industries).

63. Munnell et al., *supra* note 51, at 2.

64. *Id.* at 2 tbl.1*; see also* Stephanie Armour, *Verizon Freezing Managers' Pensions; Firms Phase Out Plans*, USATODAY.COM, Dec. 6, 2005, *available at* http://www.usatoday.com/money/perfi/

"sustained overall revenue and customer growth,"[65] in December 2005, Verizon announced that it would be freezing benefit accruals in one of its pension plans established for managers.[66] The change took effect in June 2006 and impacted over 50,000 management and other salaried nonunion employees,[67] about one-quarter of Verizon's workforce.[68] With a fully funded pension plan with over $48 billion in assets, in January 2006, IBM announced that it would hard freeze one of its defined benefit plans for plan years beginning after December 31, 2007.[69] The freeze impacts about 117,000 U.S. employees.[70] In February 2006, Coca-Cola announced a hard freeze on all future accruals under its defined benefit plan, effective as of June 30, 2006.[71] Collectively, nine percent of all PBGC-insured defined benefit plans are now frozen.[72]

Empirical evidence suggests that this new phenomenon of "healthy" defined benefit plan freezes will continue for the foreseeable future. In its 2006 annual review of human resources professionals, Hewitt Associates, a human resource consultancy organization, asked traditional defined benefit plan and cash balance plan sponsors about anticipated changes to plan design.[73] Thirty-two percent of responding employers indicated that they were either very likely

retirement/2005-12-06-pension-changes_x.htm (describing Verizon's plan to restructure retirement benefits for managers, including freezing defined-benefit plans); Stephen Taub, *IBM Freezes Its Defined-Benefit Plan*, CFO.COM, Jan. 6, 2006, http://www.cfo.com/printable/article.cfm/5376867?f=options (discussing IBM's freeze of its defined benefit plan while it aggressively expands 401(k) benefits).

65. Armour, Adams & Chu, *supra* note 16 (internal quotation marks omitted).

66. Ken Belson & Matt Richtel, *Verizon to Halt Pension Outlay for Managers*, N.Y. TIMES, Dec. 6, 2005, at A1.

67. Brian Tumulty, *Pension Freezes Force Workers to Seek Alternatives*, USA TODAY.COM, Mar. 24, 2006, available at http://www.usatoday.com/news/washington/2006-03-24-frozenpensions_x.htm.

68. Belson & Richtel, *supra* note 66.

69. Nanette Byrnes, *The Rush to Shut Down Pensions: When a Well-Funded Giant Like IBM Joins the Move to End Defined-Benefit Plans in Favor of 401(k)s, Even More Companies Are Likely to Follow*, BUS. WEEK ONLINE, Jan. 9, 2006, http://www.businessweek.com/bwdaily/dnflash/jan2006/nf2006019_3388_db035.htm; Taub, *supra* note 64.

70. Munnell et al., *supra* note 51, at 2.

71. Pension Rights Center, Companies That Have Changed Their Defined Benefit Pension Plans, http://www.pensionrights.org/pubs/facts/company_list.html (last visited May 19, 2008) (providing link to Coca-Cola SEC Form 8-K filing).

72. PENSION BENEFIT GUAR. CORP., PENSION INSURANCE DATA BOOK 2005, at 3 (2006), *available at* http://www.pbgc.gov/docs/2005databook.pdf; *see also* Janet Novack, *The Big Chill; Just When the Baby Boomers Were About to Earn Some Nice Pension Benefits, Their Plans Are Being Frozen*, FORBES, Dec. 11, 2006, 2007 Retirement Guide ("Eighteen percent of the 1,000 big companies with defined benefit plans had, as of last December, frozen at least one of their plans, with the majority of those freezes occurring in 2004 or 2005, according to consultants Watson Wyatt Worldwide. Another survey, by SEI Global Institutional Group, recently found the freezes more extensive when midsize companies are factored in. This poll of 139 pension sponsors (both large and midsize businesses) showed that 40% had frozen or closed their plans, up from 30% in January [2006].").

73. HEWITT ASSOCS. LLC, SURVEY FINDINGS: HOT TOPICS IN RETIREMENT 2007, at 1 (2007), *available at* http://www.hewittassociates.com/_MetaBasicCMAssetCache_/Assets/Articles/Hot%20Topics%20in%20Retirement%202007.pdf.

or somewhat likely to no longer allow new employees to enter the defined benefit plan, with sixteen percent indicating they were very likely or somewhat likely to cease benefit accruals for all or a portion of plan participants.[74] Similarly, PricewaterhouseCoopers's August 2005 survey reported that nearly half of participating companies that expected to change their defined benefit plans in the next year also were evaluating the possibility of a full benefits freeze for all employees.[75]

III. FACTORS CONTRIBUTING TO THE SHIFT AWAY FROM TRADITIONAL RETIREMENT PLAN SPONSORSHIP

The shift away from defined benefit plans and toward defined contribution plans as the primary retirement security vehicle is attributable to numerous factors. This Part examines some of the major contributing factors: (1) the replacement of old-world industries with new-world industries that have no historical ties to defined benefit plan sponsorship;[76] (2) demographic shifts in the American workforce and a growing segment of the workforce that favors the portability and accessibility of defined contribution plans;[77] (3) economic considerations, including global competition and an evolving legislative and regulatory scheme that promotes defined contribution plan sponsorship and does little to shore up the solvency or impede the disintegration of the defined benefit plan system;[78] and (4) the growing presence of a two-tier compensation system that limits utilization of qualified plans as primary retirement security vehicles.[79]

A. *Industry Changes*

Probably the most important factor in the decline of defined benefit plan sponsorship is the demise of old-world industries that sponsored defined benefit plans and the birth of new-world industries with no historical ties to defined benefit plan sponsorship. In the 1950s and 1960s, old-world industries, such as the automobile, steel, textile, and coal industries, dominated the corporate landscape. Their defined benefit plan sponsorship generally was mandated under labor-negotiated, collective bargaining agreements.[80] Union officials fought for retirement plans that provided larger benefits to senior workers and retirees

74. *Id.* at 18.

75. Stephanie Armour & Kathy Chu, *Pension Problems Loom for Boomers*, USA TODAY, Dec. 28, 2005, at 1B.

76. See *infra* Part III.A for a discussion of the shift from old-world to new-world industries.

77. See *infra* notes III.B for a discussion of the demographic shifts in the American workforce.

78. See *infra* notes III.C for a discussion of the economic considerations impacting plan sponsorship. *See also* Edward N. Wolff, The Unraveling of the American Pension System, 1983-2001, at 2, 13-15 (July 20, 2004), *available at* http://www.newschool.edu/cepa/originalsite/papers/workshop/040910_Wolff.pdf (describing how shift away from defined benefit plans has negatively affected overall wealth inequalities despite enormous gains in stock market).

79. See *infra* notes III.D for a discussion of the two-tier compensation system. *See also* Munnell et al., *supra* note 51, at 7-8 (explaining emergence of two-tier system involving tax-qualified system for lower-paid employees and nonqualified system for higher-paid employees).

80. Teresa Ghilarducci, *The End of Retirement*, MONTHLY REV., May 2006, at 12, 18.

through increasing compensation and years of service credits. The old stalwarts agreed to these types of arrangements as part of employees' compensation package for numerous reasons, including a seeming correlation between long-term service and corporate productivity and lower current compensation costs.[81]

Beginning in the 1970s, old-world industries, as well as other financially distressed employers, fell on bad times.[82] Company bankruptcies went hand-in-hand with defined benefit plan terminations.[83] In recent years, numerous distressed companies received court permission to terminate their plans, including Polaroid, Kaiser Aluminum, Bethlehem Steel, and West Point Stevens.[84] Other companies avoided bankruptcy or shored up their financial viability by terminating their plans and lowering overall compensation costs.[85]

As the old stalwarts of defined benefit plan sponsorship died off, employment opportunities arose within new-world companies that had no history of defined benefit plan sponsorship. Fledging U.S. companies, such as Microsoft Corp. and, more recently, Google, never established defined benefit plans but instead offer 401(k) plans to their employees.[86]

B. Demographic Shifts in the American Workforce

The second factor contributing to the shift away from traditional retirement plan sponsorship was a demographic shift in the American workforce.[87] Historically, the American workforce was comprised of older, more stable employees, many of whom stayed with one employer throughout their careers.[88] These employees placed a high value on defined benefit plans that rewarded

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81. 29 U.S.C. § 1054 (West 1999 & Supp. 2007) (explaining that significant incentive to remain employed by defined benefit plan sponsor is plan's calculation of accruals based on percentage that factors in years of service and compensation, thus rewarding long-term employment); *see also* Befort, *supra* note 33, at 947 (attributing growth of pensions and fringe benefits during war and subsequent years to tax policy and managerial goals of attracting skilled, long-term workers).

82. John M. Berry, *Economy Is in Recession, President Acknowledges*, WASH. POST, Oct. 19, 1981, at A1 (reporting on "severely depressed" automobile industry); Joseph Kraft, *The Chrysler Portent*, WASH. POST, Nov. 8, 1979, at A19 (describing difficulties facing traditional industries and observing that industries such as steel, textiles, automobiles, and chemicals "have lost their competitive edge").

83. Gross, *supra* note 60.

84. Armour, Adams & Chu, *supra* note 16.

85. Nancy L. Ross, *Retirement Concerns Growing*, WASH. POST, Nov. 13, 1977, at G1 (considering potential negative impact of mergers, business failures, and pension plan terminations on pension benefits and noting that "[t]he defined benefit plan . . . is slowing giving way to the defined contribution plan").

86. Albert B. Crenshaw, *Make 'em Provide Pensions*, WASH. POST, Jan. 29, 2006, at F1; Novack, *supra* note 72 ("New economy companies—companies like Google or Cisco—don't offer traditional defined benefit pensions, the kind where you get your gold watch and your former employer pays you a fixed stipend for life.").

87. *See* Eric Krell, *The Changing Face of Retirement*, 23 BAYLOR BUS. REV. 26, 28 (2005) (discussing evolution of U.S. economy from manufacturing- to service-based economy and corresponding reduction in need for long-term employees as factors in emergence of defined contribution plans).

88. *Id.*

long-term service through increased credits for rising compensation and additional years of service.[89]

Beginning in the 1970s, fewer workers made a lifetime commitment to one employer.[90] Instead, workforce mobility became a common pattern,[91] with employees changing employers several times throughout their careers.[92] Women transitioned in and out of the workforce to accommodate childrearing and other family considerations.[93] Other employees worked on a part-time basis.[94]

This growing segment of mobile, transient, and part-time workers does not bring the same level of long-term employment expectations to the bargaining table. Generally, this segment places less emphasis on retirement plans that reward long-term service[95] and, instead, favors plans that provide more immediate, tangible retirement benefits, those that offer benefit front-loading, accessibility, and portability.[96] Defined contribution plans, particularly 401(k) plans, fit the bill. Benefits are front-loaded, meaning that contributions are made annually based on current compensation.[97] Employees can direct investment of account assets.[98] Employees can access plan assets in preretirement years either through plan loans, hardship distributions, in-service distributions, or distributions following termination of employment.[99] Further, former employees can roll over distributions to qualified retirement plans sponsored by subsequent employers or into individual retirement accounts established with various

89. Stephen P. McCourt, *Defined Benefit and Defined Contribution Plans: A History, Market Overview and Comparative Analysis*, 43 BENEFITS & COMPENSATION DIG. (Int'l Found. of Employee Benefit Plans, Brookfield, Wis.) Feb. 2006, at 1, 4, *available at* http://www.ifebp.org/PDF/webexclusive/06feb.pdf.

90. Olivia S. Mitchell & Janemarie Mulvey, *Possible Implications of Mandating Choice in Corporate Defined Benefit Plans* 9 (Pension Research Council, Working Paper No. 2003-25, 2004), *available at* http://rider.wharton.upenn.edu/~prc/PRC/WP/WP2003-25-revised%209-04.pdf (noting that only approximately seven percent of American workforce stays with same employer throughout their careers); Ross, *supra* note 85 ("The mobility of the American population appears to be maintained at the expense of pension right. In 1973, the Bureau of Labor Statistics reported that half of all the workers covered by private pension plans had been at their present job nine years or less.").

91. *Id.*; *see also Plan Administration*, *supra* note 62 (discussing interview with Karlyn Oberg, SureWest Director of Investor Relations, who described change in employee activity and analysis, which suggests employees change jobs every five to seven years).

92. Mitchell & Mulvey, *supra* note 90, at 10.

93. Stephanie Aaronson & Julia Coronado, *Are Firms or Workers Behind the Shift Away from DB Pension Plans?* 1-2 (Fed. Reserve Bd., Working Paper No. 2005-17, 2005), *available at* https://www.federalreserve.gov/Pubs/feds/2005/200517/200517pap.pdf.

94. *Id.*

95. *Id.*

96. *Id.*

97. I.R.C. § 415(c) (2000 & Supp. V 2005); 29 U.S.C. §§ 1002(34) (2000), 29 U.S.C.A. § 1025 (West 1999 & Supp. 2007).

98. 29 U.S.C.A. § 1104(c) (West 1999 & Supp. 2007).

99. I.R.C § 401(k)(2) (2000 & Supp. V 2005) (authorizing elective deferrals distributions upon separation of service and hardship); 29 U.S.C. § 1108(b)(1) (2000) (providing prohibited transaction exemption for loans to participants).

financial institutions.[100]

C. Economic Considerations

The third factor contributing to the shift away from traditional retirement plans involves economic considerations faced by all companies, including global competition and the relative costs of defined benefit plan versus defined contribution plan sponsorship. Competition comes from an increasingly global marketplace, which includes both foreign and domestic corporations. U.S. companies face increasing competition from companies operating in such countries as China, where less than twenty percent of the Chinese workforce receives pension benefits[101] and production costs are generally half of the costs incurred in U.S. operations.[102] Even domestically, many competitors have never sponsored a defined benefit plan for their employee workforce or offered an equivalent compensation structure.[103]

To compete in this environment, many U.S. companies restructured their employee workforce and redesigned compensation packages for their remaining workforce. For example, in 2004, over 239,000 private-sector workers were affected by mass layoffs.[104] Some of the jobs were outsourced to foreign workers, while others were outsourced to domestic workers.[105] With outsourcing, companies reduce compensation, employee benefits, and overhead costs.[106]

Restructuring remaining employee workforce compensation also dramatically decreases costs and provides employers with a competitive advantage. For example, defined benefit plan terminations and freezes dramatically decrease the total compensation costs spent on retirement plans.

100. I.R.C. § 402(f)(2)(A) (Supp. V 2005).

101. Nicholas Eberstadt, *Growing Old the Hard Way: China, Russia, India*, POL'Y REV., Apr. & May 2006, *available at* http://www.hoover.org/publications/policyreview/2912391.html.

102. Jacqueline Thorpe, *They Will Buy More*, FINANCIAL POST (Can.), Sept. 18, 2003, at 8.

103. *See* Press Release, Am. Benefits Council, Council Available to Comment on Pension System Developments After IBM Announcement (Jan. 5, 2006), *available at* http://www.americanbenefitscouncil.org/newsroom/pr06-01.cfm (linking defined benefit plan terminations and freezes, in part, to global competition from employers that do not sponsor defined benefit plans).

104. Press Release, Bureau of Labor Statistics, U.S. Dep't of Labor, Extended Mass Layoffs Associated with Domestic and Overseas Relocations, First Quarter 2004, at 2 (June 10, 2004), *available at* http://www.bls.gov/news.release/pdf/reloc.pdf.

105. *Id.* See U.S. GOV'T ACCOUNTABILITY OFFICE, INTERNATIONAL TRADE: CURRENT GOVERNMENT DATA PROVIDE LIMITED INSIGHT INTO OFFSHORING OF SERVICES 32-46 (2004), *available at* http://www.gao.gov/new.items/d04932.pdf, for a discussion of the Government Accountability Office's most recent examination of outsourcing's effects on the U.S. economy, and Joseph R. Meisenheimer II, *The Services Industry in the "Good" Verses "Bad" Jobs Debate*, MONTHLY LAB. REV., Feb. 1998, at 22, 22, *available at* http://www.bls.gov/opub/mlr/1998/02/art3full.pdf, for a discussion of the transformation of the U.S. labor market from a manufacturing-based economy to a service-based economy.

106. Frank J. Spanitz, Comment, Inter-Modal Rail*: Will ERISA's Newly Defined Welfare Benefit Noninterference Clause Curb Outsourcing?*, 23 DEL. J. CORP. L. 589, 589 (1998); *see also* Bureau of Labor Statistics, *supra* note 104, at 1 (noting domestic outsourcing of almost 10,000 jobs in 2004).

IBM's recent defined benefit plan freeze is projected to save that company $2.5 to $3 billion over the next five years.[107] Similarly, Verizon's defined benefit plan freeze will purportedly save about $3 billion over the next decade.[108] By transitioning to at least a temporarily "beefed-up" 401(k) plan, employers can reduce their retirement plan costs by almost one-third.[109]

Even in the absence of further legislative and regulatory requirements that increase defined benefit plan sponsorship and funding costs, the continuing unpredictability of costs associated with defined benefit plans also affects employers' decisions to continue plan sponsorship. Employers are faced with such variables as market volatility and the inability to project future contributions accurately.[110] For example, the decline in the equities markets and long-term interest rates at the start of this decade resulted in thousands of defined benefit plans becoming underfunded.[111] The bottom line for overfunded plans was also dramatically affected. From 2000 to 2002, earnings from IBM's overfunded plan boosted the company's net income by $4 billion.[112] With market volatility, however, IBM's pension liabilities became "unpredictably expensive."[113] In late 2004, IBM projected a cost of $2.7 billion for its 2006 pension contributions: that forecast represented an increase of $500 million over its projected 2005 expense. By late 2005, the 2006 projections were revised to $3.1 billion.[114]

Increased legislative and regulatory requirements add to the burden and provide another level of unpredictability.[115] Prior to the enactment of the Pension Protection Act of 2006, Congress enacted and President Bush signed into law the Deficit Reduction Act of 2005 ("Deficit Reduction Act").[116] As a stopgap measure during consideration of more comprehensive pension reform,

107. Byrnes, *supra* note 69.

108. Armour, Adams & Chu, *supra* note 16.

109. *Hearings*, *supra* note 20, at 206 (statement of Teresa Ghilarducci, Ph.D., Associate Professor, Department of Economics, University of Notre Dame).

110. MERCER HUMAN RES. CONSULTING, A CLOSER LOOK AT RECENT HIGH-PROFILE PENSION PLAN FREEZES 2-3, *available at* http://wrg.wmmercer.com/pub/ps/34336/p/5/blurb/65300/article/20066125 (last visited May 19, 2008); Jack VanDerhei, *Defined Benefit Plan Freezes: Who's Affected, How Much, and Replacing Lost Accruals*, ISSUE BRIEF (Emp. Benefit Research Inst., Washington, D.C.), March 2006, at 7-8, *available at* http://www.ebri.org/pdf/briefspdf/EBRI_IB_03-20063.pdf (citing Press Release, Aon Study: Pension Plan Freezes Moving to Forefront; More Possible Without Changes to Funding Rules (Oct. 29, 2003)).

111. Bigler, *supra* note 4.

112. Byrnes, *supra* note 69.

113. *Id.*

114. *Id.* (citing numerous factors that contributed to $400 million increase, including "rising short-term interest rates and flat long-term rates").

115. OPTIMAL BENEFITS STRATEGIES, LLC, *supra* note 10, at 1 ("Because employers enter the defined benefit pension plan system voluntarily, policymakers need to be sensitive to the possibility that certain legislative responses will drive more employers (including employers with well-funded plans) to exit the system. Predictability of funding obligations is the single most important issue for employers; legislation that increases the volatility and unpredictability of funding requirements will undoubtedly lead to increasing plan terminations and freezes.").

116. Deficit Reduction Act of 2005, Pub. L. No. 109-171, 120 Stat. 4.

the Deficit Reduction Act includes provisions increasing PBGC premiums.[117] Prior to the change, the annual flat-rate premium for single-employer defined benefit plans was $19 per participant.[118] The Deficit Reduction Act makes numerous changes to the PBGC premium structure, including raising the per-participant flat-rate premium from $19 to $30 for single-employer plans, effective for plan years beginning on or after January 1, 2006, and adjusted annually for wage inflation; granting PBGC discretion to increase premiums by an additional twenty percent per year; and adding a new plan termination premium for distress or involuntary terminations resulting in PBGC plan administration.[119] Prepassage, the House and Senate projected that the increased premium requirements would impose an additional $6.2 billion to $6.7 billion in costs to defined benefit plan sponsors over a three-year period.[120] For those employers sponsoring fully funded plans (and therefore having no significant funding liabilities upon plan termination), the increased premium costs would be another nail in the defined benefit plan coffin.

Additionally, in September 2006, the Financial Accounting Standards Board ("FASB"), as phase one of a two-phase reform agenda,[121] issued a new standard that requires employers to fully recognize obligations associated with defined benefit plans in their annual financial statements.[122] Unlike past standards that "only required an employer to disclose the complete funded status of its plans in the notes to the financial statements" and "allowed employers to delay recognition of certain changes in plan assets and obligations,"[123] under new

117. *Id.* § 8101.

118. PENSION BENEFIT GUAR. CORP., *supra* note 10, at 8.

119. Deficit Reduction Act sec. 8101, § 1306 (stating that new bankruptcy exit premium of $1250 per participant applies for distress terminations and PBGC-initiated terminations occurring while plan sponsor is in bankruptcy).

120. NEELA K. RANADE, CRS REPORT FOR CONGRESS, BUDGET RECONCILIATION AND THE PBGC 1 (2005), *available at* http://digital.library.unt.edu/govdocs/crs/data/2005/upl-meta-crs-8307/RS22315_2005Nov10.pdf.

121. *See* Paul B.W. Miller & Paul R. Bahnson, *Perfect Storm Prompts Changes in Pension Accounting*, J. ACCOUNTANCY, May 2007, at 36, 36, *available at* www.aicpa.org/PUBS/JOFA/may2007/miller.htm (describing goal of first phase of reform as moving "off-balance-sheet items onto the financial statements").

122. Press Release, Fin. Accounting Standards Bd., FASB Improves Employers' Accounting for Defined Benefit Pension and Other Postretirement Plans (Sept. 29, 2006), *available at* http://www.fasb.org/news/nr092906.shtml ("[FASB's new standard] require[s] employers to fully recognize the obligations associated with single-employer defined benefit pension, retiree healthcare and other postretirement plans in their financial statements. . . . The requirement to recognize the funded status of a benefit plan and the disclosure requirements are effective as of the end of the fiscal year ending after December 15, 2006, for entities with publicly traded equity securities, and at the end of the fiscal year ending after June 15, 2007, for all other entities. The requirement to measure plan assets and benefit obligations as of the date of the employer's fiscal year-end statement of financial position is effective for fiscal years ending after December 15, 2008."); *see also* Craig Schneider, *One Small Step for Pensions*, CFO.COM, Dec. 19, 2005, http://www.cfo.com./article.cfm/5325254?f=search (noting that this first phase requires overfunded or underfunded status of postretirement benefit plans to be reported on balance sheet rather than in footnotes).

123. Press Release, Fin. Accounting Standards Bd., *supra* note 122.

FASB Standard Number 158, employers generally must report directly in their financial statements a plan's assets and its obligations as of the end of the employer's fiscal year. One of the effects of the new standard is that employers will recognize and report changes in funding status in the year in which the change occurs.[124]

According to one expert, FASB Standard No. 158 "will increase balance-sheet liabilities of the largest U.S. companies by $466 billion, reducing their net worth by 7 percent."[125] For some companies, the change will wipe out their entire net worth.[126] For other companies, the change will still have a significant impact on their value. If IBM's $50 billion defined benefit plan had a ten percent loss in a given year, it would record a $5 billion loss on its financial statements. Neither IBM nor any other publicly traded company will be receptive to including these types of fluctuations on their annual financial statements, giving them one more reason to retreat from defined benefit plan sponsorship (if they have not already done so, like IBM).[127]

Furthermore, the FASB has considered revising numerous accounting standards under phase two of its pension reform agenda. Reforms considered are designed to address common criticisms of existing postretirement benefit obligations accounting, including delayed recognition and measurement of liability.[128] Some experts believe that additional FASB reforms "could introduce tremendous volatility to corporate income statements, leading to a whole new group of companies freezing or terminating their [defined benefit] plans."[129]

D. Two-Tier Compensation System

The fourth factor contributing to the shift away from traditional retirement plan sponsorship is the growing presence of a two-tier compensation system that

124. *Id.*

125. Vineeta Anand, *Future Pension Cost Becomes a Liability*, WASH. POST, Sept. 30, 2006, at D8 (citing estimate by Howard Silverblatt, Standard & Poor's analyst).

126. *Id.* For example, "General Motors Corp. said in its 2005 annual report that putting the cost of future pension and medical benefits on the balance sheet will make its liabilities greater than its assets, erasing the company's net worth." *Id.*

127. *See* Eric Anderson, *Companies Reduce Costs, Uncertainties by Ending Defined-Benefit Plans*, TIMES UNION (Albany, N.Y.), Dec. 10, 2006, at E1 (noting that posting shortfalls on balance sheets discourages companies from creating defined benefit plans); Jeffrey Marshall, *The Calm Before a Storm?*, FIN. EXECUTIVE, May 2007, at 24 (noting that proposed changes will affect shareholder equity and may increase volatility "'if asset values do not move in tandem with liabilities'" (quoting Mary Ann DiMaggio)); Watson Wyatt Worldwide, *Marking to Market: A Second Look*, INSIDER, Feb. 2006, http://www.watsonwyatt.com/us/pubs/insider/showarticle.asp?ArticleID=15780 (noting that FASB proposal to include funding status of pensions on balance sheet would negatively impact shareholder's equity, but observing that change may not affect defined benefit plan sponsorship given that funding status is already available in footnotes of financial reports and financial relief from terminating or closing plan is not realized for several years).

128. Fin. Accounting Standards Bd., Project Updates, Phase II: Postretirement Benefit Obligations, Including Pensions, http://www.fasb.org/project/postretirement_benefits_phase2.shtml (last visited May 19, 2008).

129. Macey, *supra* note 30, at 3.

limits utilization of qualified plans as primary retirement security vehicles. Historically, traditional retirement plan sponsorship provided the added benefit of allowing companies to provide substantial retirement benefits to their highly compensated employees at the cost of providing minimum benefits to nonhighly compensated, rank-and-file employees.[130] Under a defined benefit plan, a relatively large retirement benefit can be provided to highly compensated employees by factoring in their final average compensation and years of service.[131] The benefit provided to rank-and-file employees is significantly less because of the compensation considered under the benefit formula. Similarly, under a defined contribution plan, employer contributions are generally based on a percentage of compensation,[132] so much higher contributions are made on behalf of highly compensated employees. The highly compensated employees are also more likely to make higher salary deferral contributions under a 401(k) plan and receive correspondingly higher employer matching contributions.

Further, to the extent that Code limitations disregarded higher levels of compensation in benefit calculations,[133] companies historically provided additional retirement benefits to their executives and other highly compensated employees through the establishment of nonqualified excess benefit plans.[134] As a mirror of the benefits provided under qualified plans, excess benefit plans provide for the benefits lost under qualified plans' tax qualification rules.[135]

Within the aforementioned framework, companies routinely viewed traditional retirement plan sponsorship as a cost of providing its elite with substantial retirement benefits.[136] That view has changed. Today, companies provide for their executives' and other highly compensated employees' retirement security outside of the historical combined qualified and excess benefit plan structure. For example, current executive salaries have increased dramatically. By 2003, CEO compensation was more than 400 times the wages paid to rank-and-file workers.[137] Between 1993 and 2002, the top five executives at publicly traded companies received total compensation of $260 billion.[138]

130. *See* Munnell et al., *supra* note 51, at 7 (observing that, since 1940s, highly compensated employees have embraced pension system due to tax incentives).

131. *See* I.R.C. § 415(b) (2000 & Supp. V 2005) (setting forth Code limitations on employees' benefits in defined benefit plans).

132. *See id.* § 415(c) (setting forth Code limitations on employees' benefits in defined contribution plans).

133. I.R.C. § 401(a)(17) (Supp. V 2005).

134. *See* 29 U.S.C. § 1002(36) (2000) (defining "excess benefit plan" as "a plan maintained by an employer solely for the purpose of providing benefits for certain employees in excess of the limitations on contributions and benefits imposed by [I.R.C. § 415] on plans to which that section applies without regard to whether the plan is funded").

135. *Id.*; Munnell et al., *supra* note 51, at 8.

136. *See* Munnell et al., *supra* note 51, at 7 (describing one goal of federal pension policy as gaining support for company-sponsored plans from executives and highly compensated employees).

137. *Id.* at 8.

138. Ben White & Carrie Johnson, *Executives Cash In, Regardless of Performance*, WASH. POST, Mar. 22, 2005, at E1.

Further, equity-based compensation became more prevalent.[139] Top corporate executives profited from multimillion dollar executive compensation arrangements that often included thousands or millions of nonqualified, fixed price stock options.[140] By 2001, "CEOs of the 200 largest U.S. companies took about ninety percent of their pay in some form of equity," most of which was attributable to fixed-price stock options.[141] Executive severance arrangements also became popular. For example, in the last few years, four former executives of Coca-Cola received retirement and severance packages valued from $24 million to $119 million.[142]

With increasing salaries, bonuses, equity-based compensation, and severance packages, executives' retirement security is guaranteed outside of the traditional retirement plan or excess benefit plan structure. Employers no longer need to design tax-qualified retirement plans, trading off a minimum benefit for nonhighly compensated, rank-and-file employees, for greater benefits to highly compensated employees. With the advent of this new two-tiered compensation system, highly paid workers now receive generous retirement income from sources other than qualified plans "while lower-paid workers are left with little or no coverage" under qualified plans,[143] "something that ERISA and the tax qualification rules in effect for pension trusts since the late 1930s were intended to prevent."[144]

139. Brian J. Hall, *Six Challenges in Designing Equity-Based Pay* 4 (Nat'l Bureau of Econ. Research, Working Paper No. 9887, 2003), *available at* http://www.nber.org/papers/w9887.

140. *See CEO Compensation in the Post-Enron Era: Hearing Before the S. Comm. on Commerce, Science, and Transportation*, 108th Cong. 28 (2003) (statement of Sean Harrigan, President, Board of Administration, California Public Employees' Retirement System (CalPERS)) ("In the last five years alone, CEO compensation has doubled according to compensation consultants Pearl Meyer & Partners. In 1996, the average CEO at the largest 200 companies made about $5.8 million. By 2001, that figure jumped to $11.7 million."); CONFERENCE BD., COMM'N ON PUB. TRUST & PRIVATE ENTER., EXECUTIVE COMPENSATION ISSUES: A RATIONALE 4 n.3 (2002), *available at* http://www.heidrick.com/NR/rdonlyres/FE3E3A74-3E5E-4584-8CF1-EC033E0759A2/0/TCB_PublicTrust.pdf ("S&P data show that, in 1992, median CEO total compensation was $1.8 million, however by 2000, it had reached $6.1 million.").

141. Richard A. Booth, *Executive Compensation, Corporate Governance, and the Partner-Manager*, 2005 U. ILL. L. REV. 269, 281.

142. AFL-CIO, *The Coca-Cola Co.*, http://www.aflcio.org/corporatewatch/paywatch/retirementsecurity/case_cocacola.cfm? (last visited May 19, 2008) ("As part of his severance agreement, Coca-Cola's former chairman of the board and CEO, M. Douglas Ivester, received a six-year consulting agreement worth $675,000, office space, furniture, supplies, a company car, home security service and club dues. In total, Ivester's retirement package was reportedly worth $119 million. Steven Heyer, Coca-Cola's former president and COO, received a severance package reportedly worth at least $24 million after only three years on the job. Jack Stahl, also a former president and COO of Coca-Cola, received a severance package reportedly worth more than $25 million. Douglas Daft, former chairman of the board and CEO of the company, was paid more than $36 million when he retired in 2004.").

143. Daniel I. Halperin, *Special Tax Treatment for Employer-Based Retirement Programs: Is It "Still" Viable as a Means of Increasing Retirement Income? Should It Continue?*, 49 TAX L. REV. 1, 24 (1993).

144. Patricia E. Dilley, *Hope We Die Before We Get Old: The Attack on Retirement*, 12 ELDER L.J. 245, 261 (2004).

IV. The Embracement of a Less Secure Defined Contribution Plan Retirement System

As a result of the plan terminations, conversions, freezes, and other employers' failure to enter the defined benefit plan arena, millions of employees are relying on their employers' defined contribution plans as a primary retirement security vehicle.[145] This shift from traditional retirement plans to 401(k) plans has been described as a "part of the general unraveling of the 'worker safety net.'"[146] Often left as the sole source of employer-provided retirement benefits, there are numerous reasons why today's 401(k) plans do not provide the historical level of security offered under traditional retirement plans. First, defined benefit plan participants accrue significant retirement benefits based on years of service and career average or final average compensation.[147] Defined contribution plans do not guarantee any set benefit at retirement; instead, participants receive their account balances, which consist of past contributions, adjusted for earnings, losses, and prior distributions.[148]

Second, defined contribution plan participation does not guarantee participants significant "benefit accruals." For example, in 401(k) plans, annual contributions can consist of employer contributions, participants' salary deferral contributions, and employer matching contributions (matching a portion of participants' salary deferral contributions).[149] None of these contribution sources guarantee significant benefit accruals. Employer contributions, such as profit-sharing contributions, are often discretionary. Even where a plan by its terms requires a set employer contribution, employers generally retain discretion to amend plans and can prospectively enact plan amendments that either reduce or eliminate employer contribution requirements.[150] Similarly, where employer matching contributions are required under the terms of a plan, a plan can be amended prospectively either to reduce or eliminate employer matching contribution requirements.[151]

For example, hand-in-hand with recent defined benefit plan terminations and freezes have been corporate promises of increased employer contributions and employer matching contributions under a 401(k) plan. Alcoa announced that it would implement a relatively generous 401(k) plan under which the company would make a mandatory employer contribution equal to three percent of compensation, as well as a more generous employer matching contribution.[152]

145. *See* Munnell et al., *supra* note 51, at 3-4 (providing information about replacement of traditional pensions with 401(k)s).

146. Dilley, *supra* note 144, at 255 (quoting Wolff, *supra* note 78, at 15).

147. *See* 29 U.S.C.A. § 1054(b)(1)(A) (West Supp. 2007) (using average compensation during years of service to calculate retirement benefit).

148. 29 U.S.C. § 1002(34) (2000).

149. U.S. Department of Labor, Frequently Asked Questions About Pension Plans and ERISA, http://www.dol.gov/ebsa/faqs/faq_compliance_pension.html (last visited May 19, 2008).

150. 29 U.S.C. § 1102(b)(4).

151. *Id.* § 1102(b)(3).

152. David R. Francis, *Tension over Pensions: Can They Be Saved?*, CHRISTIAN SCI. MONITOR,

IBM announced that it would amend its 401(k) plan to sweeten employer contributions and employer matching contributions, with an automatic employer contribution of one to four percent of employee compensation and a dollar-for-dollar match up to six percent of compensation.[153] Coca-Cola announced that it was increasing employer matching contributions to one hundred percent of participants' elective deferral contributions (up to a maximum of five percent of compensation).[154] These promises are not, however, guaranteed by law.[155] Prospectively, any of these employers can amend their plans to reduce or eliminate employer contribution and employer matching contribution requirements.[156] Many may do so after the sting of a defined benefit plan termination or freeze lessens.

Third, more generous employer matching contribution requirements may mean little for plan participants who make no or reduced salary deferral contributions. Employer matching contributions are based on plan participants' elective salary deferral contributions. Where a plan participant fails to make elective deferral contributions, or makes a minimal contribution as compared to the maximum allowable under law,[157] the employer will make either no employer matching contribution or a smaller employer matching contribution. Many employees, particularly rank-and-file employees, who are otherwise eligible to participate in the plan, do not elect to make annual salary deferral contributions. A recent study shows that twenty-six percent of all employees eligible to participate in 401(k) plans choose not to participate.[158] Of the remaining seventy-four percent, approximately ten percent contribute the maximum amount allowable under law,[159] with the remainder making salary deferral contributions equal to about six percent of compensation (a percentage that is significantly lower than the recommended ten to thirteen percent rate needed to provide adequate retirement security).[160] In 2004, this small percentage of salary deferral contributions translated into a median annual contribution of less than $1900 for the year.[161] Given these facts, employer matching contributions often provide little retirement security.

Fourth, the promise of a generous employer contribution or employer matching contribution may do little, if anything, for baby boomers and older

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Jan. 23, 2006, at 17.

153. Taub, *supra* note 64.

154. Pension Rights Center, *supra* note 71 (follow "Coca-Cola Bottling Co. Consolidated" hyperlink).

155. *See* 29 U.S.C. § 1102(b)(4) (providing that employers may specify basis on which payments are made to and from defined contribution plans).

156. *Id.*

157. I.R.C. § 402(h) (2000 & Supp. V 2005).

158. ALICIA H. MUNNELL & ANNIKA SUNDÉN, COMING UP SHORT: THE CHALLENGE OF 401(K) PLANS 56 (2004).

159. *Id.* at 61-62.

160. Gregory Crawford & Vineeta Anand, *Looming Pension Crisis Needs Creative Solutions: Economists, Politicians Say the Time Is Ripe for Reform*, INVESTMENT NEWS, May 9, 2005, at 27.

161. Ghilarducci, *supra* note 80, at 20.

employees who have little time to build up enough of an account balance to offset the accrual loss under a terminated or frozen defined benefit plan.[162] Hardest hit are those older workers who participated in a final average pay defined benefit plan. This result is because the workers will not receive the benefit of either the increase in compensation used to calculate final average pay or the additional years of service accrued after the plan is terminated or frozen.[163]

Fifth, even if substantial annual additions are made under the defined contribution plan, there are several reasons why the plans provide little retirement security to the vast majority of plan participants. According to numerous studies, defined contribution plan asset investments do not historically produce the same rate of returns enjoyed by defined benefit plans. Economists Alicia Munnell and Annika Sundén estimate that, between 1985 and 2001, the average defined benefit plan outperformed the average defined contribution plan by 0.8% per year.[164] Other studies estimate that defined benefit plans outperform defined contribution plans by two to four percent a year.[165] Whatever the percentage, the result on asset growth and accumulation is significant.

This disparity in return rates is primarily attributable to one factor: participant-directed investment. Defined benefit plan sponsors employ professional fiduciary investment advisors and asset managers.[166] In contrast, the vast majority of 401(k) plans are now designed as ERISA Section 404(c) plans,[167] which transfer investment decisions to plan participants and beneficiaries.[168] Under Department of Labor regulations,[169] plan fiduciaries can effectively transfer control over investment decisions to plan participants by conveying only a minimal level of investment education,[170] with no requirement that plan fiduciaries facilitate individually tailored investment advice to plan participants. In the past, the lack of such a requirement has meant that only approximately twenty-five percent of large, publicly traded companies voluntarily offer some

162. *See* VanDerhei, *supra* note 110, at 12 (noting that long-time employees have shorter period of time to accumulate balances when plan is changed from defined benefit to defined contribution).

163. Press Release, Employee Benefit Research Inst., Pension Freezes: Who's Affected and by How Much? (Mar. 8, 2006), *available at* http://www.ebri.org/pdf/PR_731_8Mar06.pdf (observing that for final average pension plans, "[w]orkers would have to save a median amount of about 8 percent of their annual salary to make up for the pension freeze (assuming an 8 percent return)," compared to seven percent needed to be saved in career-average pension plan freezes and three percent needed to be saved in cash balance pension plan freezes).

164. MUNNELL & SUNDÉN, *supra* note 158, at 77 fig.4-1.

165. Byrnes, *supra* note 69.

166. McCourt, *supra* note 89, at 4.

167. U.S. DEP'T OF LABOR, PENSION & WELFARE BENEFITS ADMIN., *supra* note 38, at xii (estimating that approximately "[s]eventy-nine percent of 401(k) type plans, covering 83% of the active participants, and holding 81% of the assets, provided for participant direction of investments of either all assets or assets based on employee contributions").

168. 29 U.S.C.A. § 1104(c) (West 1999 & Supp. 2007).

169. *Id.*; 29 C.F.R. § 2550.404c-1 (2006).

170. 29 C.F.R. § 2550.404c-1(b)(2)(B).

type of investment advice.[171] Recently, employer-facilitated investment advice has become more common, with some surveys indicating that over half of responding companies report that they now provide some type of investment advice.[172] Nevertheless, that still translates into almost half of ERISA Section 404(c) plan participants not receiving investment advice.

Lacking business acumen, ERISA Section 404(c) participants face the often daunting task of choosing between an average of eighteen fund options,[173] with an increasing number of plan sponsors offering a brokerage option with virtually unlimited investment options.[174] Most participants invest in just two or three investment alternatives,[175] with each selected investment concentration significantly more than the recommended ten to twenty percent concentration.

To complicate matters further, over twenty-three million of the nation's 401(k) plan participants, approximately forty-two percent of all defined contribution plan participants, have access to a company stock investment alternative.[176] Losses from company stock investments can be even more

171. *See* Press Release, Profit Sharing/401(k) Council of Am., PSCA Releases 45th Annual Survey of Profit Sharing and 401(k) Plans (Oct. 8, 2002), *available at* http://www.psca.org/MEDIA/PressReleases/tabid/97/ctl/Detail/mid/475/Id/89/Archive/Default.aspx (noting only 25.7% of large companies with over 5000 plan participants offer investment advice).

172. *E.g.*, Nevin Adams, *The Debate over Plan Advice*, ON WALL STREET, Apr. 2006, at 55, 56 (noting that "more than 60% of the 4,000-odd plans responding to *PLANSPONSOR*'s annual defined contribution survey" offer investment advice).

173. Patty Alman, *48th Annual Survey in Review: A Look at Current Profit Sharing/401(k) Trends and Practices*, DEFINED CONTRIBUTIONS INSIGHTS MAGAZINE, http://www.psca.org/DCIMagazineMembers/tabid/133/ctl/Detail/mid/490/Id/828/Archive/Default.aspx (describing results of Profit Sharing/401(k) Council of America's forty-eighth annual survey, which found that, on average, plans offered eighteen investment funds).

174. Craig Gunsauley, *Unlimited Options*, EMP. BENEFIT NEWS, July 1, 2002, http://www.mywire.com/pubs/EmployeeBenefitNews/2002/07/01/539151.

175. *Id.*

176. Mitchell & Utkus, *supra* note 36, at 13. Mitchell and Utkus explain why over half of 401(k) participants are affected:

> [O]nly 3 percent of 401(k) plans actually offer company stock as an investment option . Yet because these plans are mainly sponsored by large firms, they account for a substantial subset of the [defined contribution] plan participant and asset universe. Consequently, those firms offering company stock include 42 percent of all [defined contribution] plan participants and 59 percent of all [defined contribution] plan assets. To put it differently, only 3 percent of 401(k) plans offer company stock, but some 23 million [defined contribution] plan participants have access to company stock within their employer plans, and those [defined contribution] plans command assets of $1.2 trillion, in total.

Id. (citation and footnote omitted). *But see* Sara Holden & Jack VanDerhei, *401(k) Plan Asset Allocation, Account Balances, and Loan Activity in 2005*, ISSUE BRIEF (Emp. Benefit Research Inst., Washington, D.C.), Aug. 2006, at 7, *available at* http://www.ebri.org/pdf/briefspdf/EBRI_IB_08-200622.pdf ("Allocations to company stock continue to be relatively similar across age groups. Participants in their 20s have a little more than 10 percent of their 401(k) plan account balances in company stock as do participants in their 60s, while those in their 40s have close to 14 percent."); *id.* at 19 n.30 ("At year-end 2005, nearly half (or 8.3 million) of the 401(k) participants in the EBRI/ICI database were in plans that offer company stock as an investment option. Among these participants, about two-thirds hold 20 percent or less of their account balances in company stock, including 40 percent who do not hold company stock at all. In contrast, 10 percent have more than 80 percent of substantial than market losses in other investments. Enron and its 401(k) plan are illustrative. Like most large, publicly traded corporations, Enron sponsored a 401(k) plan with a company stock investment alternative.[177] Also, like most American workers who participate in 401(k) plans, Enron 401(k) plan participants did not receive independent, individually tailored investment advice.[178] What they did receive, however, was direct and indirect encouragement from Enron company executives to invest their employee elective deferral contributions in Enron company stock. Direct encouragement came in the form of executives' vigorous support of the company's future profitability.[179] Indirect encouragement came in the form of plan fiduciaries' unwavering decisions to offer company stock as an investment alternative and make employer matching contributions in the form of Enron company stock.[180] Employees responded to this encouragement by collectively investing more than sixty percent of their 401(k) plan assets in Enron company stock, with only eleven percent of the plan's Enron company stock concentration attributable to employer matching contributions.[181] With the demise of Enron, its employees suffered more than $1 billion in 401(k) losses attributable to company stock holdings.[182]

Enron is not, however, an isolated incident. The corporate scandal at WorldCom left its employees with over $1.1 billion in 401(k) plan losses attributable to company stock holdings.[183] Employees of Rite Aid, Lucent

their account balances invested in company stock." (citation omitted)).

177. *See* PATRICK J. PURCELL, CRS REPORT FOR CONGRESS, THE ENRON BANKRUPTCY AND EMPLOYER STOCK IN RETIREMENT PLANS 3 (2002), *available at* http://fpc.state.gov/documents/organization/9102.pdf (noting that "62% of the assets in Enron Corporation's 401(k) plan consisted of shares of Enron stock").

178. *Cf. Hearings*, *supra* note 20, at 8 (statement of Elaine L. Chao, Secretary, U.S. Department of Labor) (discussing Retirement Security Advice Act, H.R. 2269, 107th Cong. (2001), which would encourage employers to offer investment assistance to their employees).

179. *Id.* at 182 (statement of Thomas O. Padgett, senior lab analyst at EOTT, an Enron subsidiary) ("Throughout my time with Enron, the top management of the company constantly encouraged us to invest our savings in Enron stock. I took the fact that the Company matched our savings only with Enron stock as a further endorsement of the stock as a safe retirement investment. More recent statements made by Enron's top management, including e-mails from Ken Lay, about the Company's stock also caused me to keep investing my savings into the stock. I remember, in the Fall of 2000, Enron's top executives telling us at an employee meeting and by Company e-mail that Enron's stock price was going to increase to at least $120 per share. When Mr. Skilling resigned last August [2001], Mr. Lay told us that the Company was stronger than it had ever been."); *see also* STAFF OF JOINT COMM. ON TAXATION, 108TH CONG., REPORT OF INVESTIGATION OF ENRON CORPORATION AND RELATED ENTITIES REGARDING FEDERAL TAX AND COMPENSATION ISSUES, AND POLICY RECOMMENDATIONS 537 (Comm. Print 2003) ("Even as the price of Enron stock declined during 2001, management told employees of a bright future for Enron.").

180. *See Hearings*, *supra* note 20, app. G at 226, 235 (containing text of Enron Corporation Savings Plan, which permitted employees to invest in Enron stock and outlined company matching policy).

181. PURCELL, *supra* note 177, at 3. These numbers are accurate as of December 31, 2000. *Id.*

182. *Hearings*, *supra* note 20, at 25 (statement of Rep. Rush D. Holt, Member, H. Comm. on Education and the Workforce).

183. Noguchi, *supra* note 20.

Technologies, Nortel Networks, Qwest Communications, the Williams Companies, Providian Financial Corporation, IKON Office Solutions, and Global Crossing, to name only a few, have suffered similar fates.[184]

Another offshoot of participant-directed investment is that plan fiduciaries do not retain fiduciary duties with regard to any investment decisions made by plan participants. ERISA's fiduciary protections apply only to the extent that plan fiduciaries continue to make investment decisions, such as where plan fiduciaries make employer contributions and employer matching contributions in the form of company stock[185] or where participants fail to direct account investments.[186]

Within this context, holding plan sponsors and other plan fiduciaries liable for plan losses associated with participant-directed investment is difficult. Since the Enron debacle, there have been more than 100 lawsuits filed over ERISA Section 404(c) plan investment in company stock.[187] Successful claims have, however, generally included allegations of active fraud or misrepresentation by high-ranking company executives or plan administrators.[188]

Another reason why defined contribution plans fail to provide an adequate level of retirement security is that account balances are generally distributable preretirement. Given their supplemental status at the time of ERISA's enactment, these plans are not subject to the same distribution restrictions imposed on defined benefit plans.[189] Loans and hardship distributions are commonly available to defined contribution plan participants during their employment terms.[190] Seventy-two percent of workers participate in 401(k) plans that allow for loans.[191] Indeed, one study found that approximately nineteen percent of participants borrow from their plans.[192] Further, defined contribution

184. PATRICK J. PURCELL, CRS REPORT FOR CONGRESS, EMPLOYER STOCK IN RETIREMENT PLANS: INVESTMENT RISK AND RETIREMENT SECURITY 1 (2002), *available at* http://www.benefitslink.com/articles/crs_empstock2002.pdf.

185. *See* Gretchen Morgenson, *Insurance Scandal Jolts Industry but Devastates Workers*: *Drop in Marsh Shares Hurts Employee Plans*, N.Y. TIMES, Oct. 20, 2004, at C1 (citing study showing that eighty-four percent of companies still invest employer contributions to 401(k) plans in company stock investment alternatives).

186. For example, see 29 C.F.R. § 2550.404c-1(c)(1) (2006), noting that ERISA Section 404(c), 29 U.S.C.A. § 1104(c) (West 1999 & Supp. 2007), applies "only with respect to a transaction where a participant or beneficiary has exercised independent control in fact with respect to the investment of assets in his individual account." Compare this to defined benefit plans, where the employer bears the risk of plan losses. *See* 29 U.S.C. § 1104(a)(1)(B)-(C) (2000) (describing fiduciary obligations).

187. Karen Alexander, *The Perils of Your Company's Stock*, N.Y. TIMES, Apr. 12, 2005, at G8.

188. *See, e.g.*, *In re* WorldCom, Inc., 354 F. Supp. 2d 423, 426 (S.D.N.Y. 2005) (describing earlier litigation where company and high-ranking executives were found liable for breach of fiduciary duty to plan participants); *In re* Xcel Energy, 312 F. Supp. 2d 1165, 1181-82 (D. Minn. 2004) (finding that defendants breached fiduciary duty in failing to disclose risks to Xcel stock price to plaintiffs).

189. *See* 29 U.S.C. § 1107(a)-(b) (2000) (describing plan limitations).

190. I.R.C. § 4975(d)(1) (2000); 29 U.S.C. § 1108(b)(1).

191. Ghilarducci, *supra* note 80, at 21; *see also* Alman, *supra* note 173 (noting that 86.6% of 401(k) plans studied permitted loans).

192. Holden & VanDerhei, *supra* note 176, at 11 ("[A]s has been the case for the 10 years that the EBRI/ICI database has tracked 401(k) plan participants' loan activity, relatively few participants

plan assets are distributable to participants prior to their attainment of the plan's normal retirement age. For example, employer profit-sharing contributions can be distributed after being held in the plan for a number of years and 401(k) salary deferral contributions are distributable upon termination of employment or attainment of fifty-nine and one-half years.[193] Rank-and-file employees, those employees who are likely to make little, if any, elective deferral contributions, are also the most likely group to take in-service distributions, reducing the account balance available for postretirement years.[194] Also, upon employment termination, over half of employees who change jobs spend distributions from their 401(k) plans instead of rolling them over to another tax-deferred vehicle.[195]

The confluence of all of these factors is borne out in the relatively meager account balances maintained by most defined contribution plan participants. Studies show that the average 401(k) account balance was $58,328 at the end of 2005.[196] Also in 2005, participants near retirement held an average 401(k) account balance of approximately $141,000.[197]

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make use of borrowing privileges. At year-end 2005, only 19 percent of those eligible for loans have loans outstanding. As in previous years, loan activity varies with age, tenure, salary, account balance, and plan size. Among 401(k) participants nearing retirement age, only 10 percent have a loan outstanding at year-end 2005." (citation and footnote omitted)); *see also* Ghilarducci, *supra* note 80, at 21 (noting that ten percent of participants borrowed from their 401(k)s). For examples of employee practices of taking out loans against 401(k) balances, see Press Release, Watson Wyatt Worldwide, Pension Act Regulations Could Mean Significant Changes for 401(k) Sponsors, Watson Wyatt Says (Jan. 29, 2007), *available at* http://www.earthtimes.org/articles/printpressstory.php?news=51374.

193. I.R.C. § 401(k)(2)(B)(i)(III).

194. *See* MUNNELL & SUNDÉN, *supra* note 158, at 129 (finding participants with relatively weak financial positions outside plan more likely to take out loans).

195. Ghilarducci, *supra* note 80, at 21; *see also* MUNNELL & SUNDÉN, *supra* note 158, at 133 (observing that penalties to encourage rollover have increased rollover rates, but noting that less than fifty percent of participants completed rollovers).

196. Holden & VanDerhei, *supra* note 176, at 5 ("The average account balance for 401(k) plan participants at year-end 2005 is $58,328. Half of the participants in the database have account balances less than $19,398 (the median account balance), while half hold more. . . . Most importantly, these aggregate averages are based on accounts held by participants of varying ages and job tenures . . . ."); Sarah Holden & Jack VanDerhei, *401(k) Plan Asset Allocation, Account Balances, and Loan Activity in 2003*, INVESTMENT COMPANY INST. PERSP. (Investment Co. Inst., Washington, D.C.), Aug. 2004, at 1, 5 fig.1, *available at* http://www.ici.org/pdf/per10-02.pdf (showing that for plans with fewer participants, average balance is significantly lower).

197. Sarah Holden & Jack VanDerhei, *Appendix: Additional Figures for the EBRI/ICI Participant-Directed Retirement Plan Data Collection Project for Year-End 2005*, RESEARCH PERSP. (Investment Co. Inst., Washington, D.C.), Aug. 2006, at 1, 7 fig.A6, http://www.ici.org/pdf/per12-01_appendix.pdf; U.S. Department of Labor, Employee Benefits Security Administration, Frequently Asked Questions About Cash Balance Plans, http://www.dol.gov/ebsa/faqs/faq_consumer_cashbalanceplans.html (last visited May 19, 2008).

V. THE PENSION PROTECTION ACT OF 2006: FUELING THE SHIFT AWAY FROM DEFINED BENEFIT PLAN SPONSORSHIP WITHOUT INCREASING RETIREMENT SECURITY

Adding to the economic considerations discussed in Part III, the vast majority of the Act's requirements fuel the shift away from defined benefit plans by making plan sponsorship more burdensome and costly.[198] The Act increases defined benefit plan funding requirements in numerous ways. First, it increases plan funding targets.[199] Prior to the change, employers were required to fund up to ninety percent of a plan's total liabilities.[200] Beginning in 2008, the Act phases in full funding requirements (a pension funding target of one hundred percent).[201] Second, the Act accelerates amortization of funding shortfalls from the prior thirty-year period to as short as a seven-year period.[202] Third, the Act requires more conservative funding assumptions, including a difference in the effective rate used by plans (a three-segment, rate-simplified yield curve). The new, conservative assumptions will generally "increase measured liability values for mature plans, while reducing liability values for plans covering younger populations."[203]

Fourth, as part of the increased funding target, the Act reins in employers' ability to average over time the interest rates used to calculate assets and liabilities. For example, before the change, plan sponsors could "smooth" interest rates over four and five years (lessening the impact of bad returns in one

198. *See* Alan L. Gustman, Olivia S. Mitchell & Thomas L. Steinmeier, *The Role of Pensions in the Labor Market: A Survey of the Literature*, 47 INDUS. & LAB. REL. REV. 417, 434-35 (1994) (describing pre-Act movement away from defined benefit plans).

199. Pension Protection Act of 2006, Pub. L. No. 109-280, §§ 102, 111, 120 Stat. 780, 789-809, 820-26 (to be codified at IRC § 412 and 29 U.S.C. § 1083).

200. *See* CCH Pension and Benefits, Overview of Major Provisions of Pension Protection Act of 2006 (Aug. 14, 2006), http://hr.cch.com/news/pension/081406a.asp ("The Act radically changes the actuarial assumptions and methods used to determine present value, authorizing a new interest rate and a new mortality table. Specifically, the Act, while retaining the blended rate of corporate bonds, introduces a segmented 'yield curve' that would consist of three different interest rates (based on the unweighted average of interest rates on investment grade corporate bonds) applicable to benefits payable in different time periods.").

201. *Id.*

202. Pension Protection Act § 102. See *id.* § 402 for an explanation of how the Act provides an exception to the seven-year amortization requirement for the airline industry. The sponsor of a defined benefit plan that is either a commercial passenger airline or an entity that provides catering services to a commercial passenger airline as its principal business may elect (1) to fund the plan using the regular funding rules with a ten-year rather than a seven-year amortization schedule; or (2) generally, to freeze the plan benefits and to fund the plan using a seventeen-year amortization schedule. *Id.*

203. TOWERS PERRIN, HR SERVS., WHITE PAPER, THE PENSION PROTECTION ACT OF 2006: EXPECTED IMPACT ON RETIREMENT PLAN FINANCING — AND HOW EMPLOYERS ARE LIKELY TO RESPOND 1, 3 (2006), http://www.towersperrin.com/tp/getwebcachedoc?webc=HRS/USA/2006/200609/Pension_Pulse_whitepaper_final.pdf ("In addition, an updated mortality table will be mandated for valuing liabilities. For a typical plan sponsor, the mortality table change may result in a liability increase in the range of 5% to 10%.").

year).[204] Now, the Act requires interest rate smoothing over a two-year time period.[205] This one change alone will greatly increase employer contribution requirements.[206]

Fifth, the Act increases requirements for "at-risk" plans.[207] Employers that do not maintain a certain funding level will be subject to additional amortization amounts and PBGC premiums. Employers sponsoring plans with funding levels of eighty percent or below will be prohibited from applying past years' credit balances to offset a current year's required contributions. These same employers will be unable to provide benefit improvements or pay full, lump-sum amounts.[208]

Arguably, the Act's only significant contributions to encouraging defined benefit plan sponsorship are its prospective legalization of cash balance plans and its increased allowance for employer deductions. On the cash balance plan front, the Act provides prospective protection against age discrimination claims for cash balance and other hybrid plans.[209] For many years, the only major expansion in defined benefit plan coverage occurred in the area of cash balance conversions.[210] Nevertheless, recent legal challenges to cash balance plans' design threatened their existence. The cost savings components of these plans generated a great deal of controversy, particularly in the area of age discrimination claims based on the benefit formula's interest credit component. ERISA, the Age Discrimination in Employment Act ("ADEA"),[211] and the Code contain prohibitions against terminating accruals or reducing the rate of a participant's benefit accruals "because of the attainment of any age."[212]

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204. David M. Katz, *Pension Act Tilts to Cash Balance Plans*, CFO.COM, Aug. 23, 2006, http://www.cfo.com/printable/article.cfm/7830080?f=options.

205. Pension Protection Act secs. 102, 112, § 403(h)(1)(D)(ii).

206. Katz, *supra* note 204; *see also* TOWERS PERRIN, *supra* note 203, at 2-3 (discussing online survey of 126 major employers, which found change in Act "increases the pace for recognizing capital market changes, which presumably adds volatility").

207. The Pension Protection Act provides for at-risk liability calculations. It provides that, effective for plan years beginning after December 31, 2007, defined benefit plans that are not adequately funded will be considered "at-risk." Pension Protection Act sec. 102, § 303(i). Plans with a funding target attainment percentage for the preceding year of less than eighty percent (using regular valuation assumptions) and less than seventy percent (using at-risk assumptions) must use at-risk liability assumptions. *Id.* At-risk liability valuations assume that all participants take the most valuable available plan benefit (e.g., a lump sum) and that participants eligible to retire in the current or succeeding ten years retire at the earliest possible date. *Id.* In addition, plans that have been in at-risk status in two of the four preceding years must add a "loading factor" equal to $700 per participant plus four percent of total liabilities; the normal cost of these plans is also increased by four percent. *Id.* Under a special "transition rule," the "80-percent" test is sixty-five percent in 2008, seventy percent in 2009, and seventy-five percent in 2010. *Id.* Plans in at-risk status for less than five years (not taking into account pre-2008 years) have their at-risk liability valuation phased in. *Id.* sec. 102, § 303(i). This requirement does not apply to plans with fewer than 501 participants. *Id.*

208. TOWERS PERRIN, *supra* note 203, at 3.

209. Pension Protection Act § 701.

210. PURCELL, *supra* note 48, at 6; Weinberg, *supra* note 45.

211. 29 U.S.C.A. §§ 621-634 (West 1999 & Supp. 2007).

212. I.R.C. § 411(b)(1)(H) (2000); 29 U.S.C. § 623(i)(1)(A) (2000); *see also* 29 U.S.C. §

According to the age discrimination argument, older workers are discriminated against in two ways by cash balance plan conversions. First, their accrued benefit under the old traditional defined benefit plan formula is smaller because their final average pay is locked-in at the time of conversion.[213] Second, their accrued benefit under the cash balance plan will be smaller than the benefit accrued by younger workers because older workers have fewer years to reap the benefits from compounded yearly interest credits. [214]

Opponents of cash balance plans have enjoyed limited success,[215] but they have succeeded in making cash balance plan sponsorship more risky. Legal challenges slowed down the rate of conversions and led some employers to either freeze or terminate their cash balance plans.[216] According to a Watson Wyatt 2005 survey of the largest U.S. companies, only twenty-seven percent of responding employers sponsored a hybrid plan in 2005, compared to thirty-three percent in 2004.[217] Other employers were at least temporarily converting their cash balance plans back to traditional defined benefit plans. For example, under the guise of rewarding employee loyalty and long-term productivity, in 2005, SBC Communications, now AT&T, announced that it would move 55,000 managers out of its cash balance plan and back into a traditional defined benefit plan (an interim step to a defined benefit plan freeze?).[218]

The Act provides prospective protection against age discrimination claims for cash balance and other hybrid plans.[219] That protection has brought only a

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1054(b)(1)(H)(i) (making it unlawful for employer to terminate or reduce benefits "because of age").

213. *See* Befort, *supra* note 33, at 973 (discussing impact of cash balance conversion on age discrimination).

214. *Id.*; *see also* Cooper v. IBM Pers. Pension Plan, 274 F. Supp. 2d 1010, 1021 (S.D. Ill. 2003) (critiquing cash balance plans in light of age discrimination law (citing Edward A. Zelinsky, *The Cash Balance Controversy*, 19 VA. TAX REV. 683, 733-36 (2000)).

215. *See* Berger v. Xerox Corp. Ret. Income Guarantee Plan, 338 F.3d 755, 762-63 (7th Cir. 2003) (concluding that Xerox cash balance plan administrators violated ERISA's benefit accrual requirements by miscalculating lump-sum distributions to terminated participants); *Cooper*, 274 F. Supp. 2d at 1021 (finding that IBM's cash balance plan benefit formula violated ERISA's age discrimination prohibitions).

216. Munnell & Perun, *supra* note 42, at 6.

217. Press Release, Watson Wyatt Worldwide, Watson Wyatt Urges Congressional Action, Deliberate Employer Response to Petition Trends (May 5, 2004), *available at* http://www.watsonwyatt.com/news/press.asp?ID=15991.

218. Stephen Taub, *SBC Shifts to Old-Style Defined Benefits*, CFO.COM, Jan. 27, 2005, http://www.cfo.com/article.cfm/3598850/c_3599065?f=TodayInFinance_Inside.

219. Pension Protection Act of 2006, Pub. L. No. 109-280, § 701(c), 120 Stat. 780, 998-91 (to be codified at 29 U.S.C. § 623(i)). Section 701(c) effectively amends the ADEA by inserting a new paragraph at the end of 29 U.S.C. § 623(i). The amendment provides that a plan does not violate age discrimination rules if a participant's accrued benefit would be equal to or greater than that of any similarly situated, younger individual. *Id.* sec. 701(c), § 623(i)(10)(A)(i). Further, "the accrued benefit may . . . be expressed as . . . the balance of a hypothetical account." *Id.* sec. 701(c), § 623(i)(10)(A)(iv). The amendment permits variable rates of return, and special interest crediting rules prohibit rates in excess of a market rate of return and a reduction of the account (generally applicable where a variable rate of return is used) below the value of its contributions. *Id.* sec. 701(c), § 623(i)(10)(B)(i)(II)-(III). In conversion, the plan must generally provide an A+B benefit (with "A" securing the full benefit accrued under the preconversion plan, and "B" representing the benefits accruing under the

few employers back into the fold. For example, in February 2007, FedEx announced its plans to freeze one of its traditional defined benefit plans and transfer employees into a cash balance plan as of June 1, 2008.[220] The less-than-enthusiastic response, however, may be attributable to the Act's requirements that, for cash balance plan protection, sponsors must adopt a three-year vesting schedule, limit the interest crediting rate,[221] ensure that participants' accrued postconversion benefit must equal the sum of the preconversion benefit under the prior plan formula and the postconversion benefit under the hybrid formula,[222] and preserve the value of early retirement subsidies associated with benefits accrued under the prior formula.[223]

The Act's only other provision that encourages defined benefit plan sponsorship increases employer contribution deduction limits. The Act increases the deduction limit to 150% of current liability for 2006 and 2007.[224] Thereafter, plans will be able to deduct an additional fifty percent of their funding target.[225] The increased deduction limits soften the blow of additional funding requirements but mean little to struggling employers that cannot meet the additional funding requirements.

The Act's strengthening and encouraging of the defined contribution plan system will also lead to fewer employers sponsoring traditional defined benefit plans. Historically, legislative and regulatory incentives for defined contribution plans have produced increases in these types of plan sponsorship.[226] Dating back to 1978, Congress set the stage for burgeoning defined contribution plan sponsorship when it enacted legislation creating a 401(k) feature for certain defined contribution plans.[227] The creation of 401(k) plans transformed defined contribution plans from their historical role as supplemental plans receiving

postconversion plan); if the participant qualifies for subsidized early retirement benefits, he must be added to the plan benefit. *Id.* sec. 701(c), § 623(i)(10)(B)(iv). Plans must provide for a three-year cliff vesting. Requirements are generally effective for periods beginning after June 29, 2005; for plans in existence on June 29, 2005, the interest crediting rules and three-year cliff vesting are effective in 2008. *Id.* § 904.

220. *See Plan Administration*, *supra* note 62 ("FedEx announced in February 2007 it will cap its traditional pension plan and transfer to a cash balance plan. Most employees who participate in a pension plan will accrue benefits under the Portable Pension Account (introduced in 2003), which begins June 1, 2008. Benefits already accrued will be capped May 31, 2008 and be payable monthly at retirement.").

221. Pension Protection Act §§ 102, 111. The Act essentially codifies the result reached by the Seventh Circuit in a recent opinion holding that IBM's cash balance plan did not violate ERISA provisions prohibiting age discrimination. *See* Cooper v. IBM Pers. Pension Plan, 457 F.3d 636, (7th Cir. 2006).

222. Pension Protection Act sec. 701(a), § 1054(b)(5)(B)(iii).

223. *Id.* sec. 701(a), § 1054(b)(5)(B)(iv).

224. *Id.* § 801(d).

225. *Id.* § 801(a).

226. *See* Karen C. Burke & Grayson M.P. McCouch, *Social Security Reform: Lessons from Private Pensions*, 92 CORNELL L. REV. 297, 302-03 (2007) (discussing how ERISA's regulatory scheme favors defined contribution plans).

227. Revenue Act of 1978, Pub. L. No. 95-600, § 135, 92 Stat. 2763, 2785-87 (codified as amended at I.R.C. § 401(k) (West 2002 & Supp. 2008)).

employer contributions to plans primarily funded through employee salary deferral contributions.[228] Subsequent legislation dealing almost exclusively with increasing savings incentives under 401(k) plans and individual retirement account arrangements also added to defined contribution plan sponsorship.[229] In response to past legislative changes that promoted defined contribution plan sponsorship, Verizon and other large, publicly traded companies abandoned their defined benefit plan sponsorship in favor of defined contribution plan sponsorship, particularly 401(k) plan sponsorship.[230]

Some of the Act's defined contribution plan provisions will encourage further exodus from defined benefit plans. For example, the Act provides for automatic enrollment and automatic increases in 401(k) plan salary deferral contributions.[231] Employers can now design or amend their 401(k) plans to enroll eligible employees automatically in the salary deferral contribution feature of the plan.[232] Unless participants opt out within a ninety-day period, a percentage of their compensation will be deferred automatically to a default investment selected by plan sponsors.[233] Further, the Act permits plan sponsors to design or amend their plans to increase salary deferral contribution percentages automatically from three to six percent over a four-year period. Automatic enrollment and increases in deferral percentages will have a positive effect on the twenty percent of the workforce that is eligible to participate in an employer-sponsored 401(k) plan but does not make an affirmative election to make plan contributions.[234] There are, however, drawbacks to this approach. As more plan participants contribute through these automatic features, employers will have less incentive to provide benefits under traditional defined benefit plans (e.g., nondiscrimination testing for 401(k) plans is more easily satisfied). Further, default contribution rates and investments do not produce gains similar to those gains achieved by other 401(k) plan participants. And, as previously noted, all defined contribution plan gains are meager compared to gains achieved by defined benefit plans.[235]

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228. *See* EMPLOYEE BENEFIT RESEARCH INSTITUTE, FACTS FROM EBRI, HISTORY OF PENSION PLANS (1998), http://www.ebri.org/publications/facts/index.cfm?fa=0398afact (explaining qualified deferred compensation plans established under Revenue Act of 1978).

229. *Id.*

230. Bob Rayner, *More Firms Freezing Pensions*, RICHMOND TIMES-DISPATCH, Dec. 10, 2005, at C1.

231. Pension Protection Act of 2006, Pub. L. No. 109-280, § 902, 120 Stat. 780, 1033-39 (to be codified in scattered sections of 26 U.S.C.).

232. *Id.*

233. *Id.*; *see also id.* § 624 (requiring Department of Labor to provide regulations "on the appropriateness of designating default investments that include a mix of asset classes consistent with capital preservation or long-term capital appreciation, or a blend of both").

234. Eileen Alt Powell, *401(k)s: The Pension Effect Pension Reform Bill Brings Big Changes to 401(k) Retirement Savings Accounts*, ASSOCIATED PRESS, Aug. 13, 2006 (citing Employee Benefit Research Institute's findings that approximately twenty percent of workers do not make affirmative election under 401(k) plans).

235. The impact of default contribution rates on employees' participation levels was explored in Jodi DiCenzo, *Behavioral Finance and Retirement Plan Contributions: How Participants Behave, and*

While increasing the likelihood of employer abandonment of defined benefit plan sponsorship, the Act does little to increase retirement security under defined contribution plans. Purportedly, the Act increases retirement security by mandating faster vesting schedules for employer contributions,[236] "allowing" plan participants the option of diversifying employer contributions made in the form of employer securities after completing three years of service,[237] and providing a prohibited transaction exemption that partially insulates plan sponsors from liability for investment advice rendered by qualified financial advisers.[238]

In reality, the changes do little to promote retirement security. Faster vesting for employer contributions will ensure that plan participants do not forfeit benefits by terminating their employment prior to the shorter period of time. Nevertheless, the vesting requirement does nothing to increase plan benefit accruals, which, as noted in Part IV, *supra*, are often deficient.[239] Further, allowing plan participants to diversify employer contributions made in the form of employer securities will not result in significant plan asset diversification.

Prescriptive Solutions, ISSUE BRIEF (Emp. Benefit Research Inst., Washington, D.C.), Jan. 2007, *available at* http://www.ebri.org/pdf/briefspdf/EBRI_IB_01-20071.pdf, which explained:

> While automatically enrolling [defined contribution plan] participants increases plan participation (particularly in certain demographic segments), enrollees exhibit what is called *default behavior*, specifically the tendency to retain the plan's default contribution rate and investment. In the plan studied, automatic enrollment increased participation among new enrollees from 37 percent to nearly 86 percent, but more than 70 percent of automatically enrolled participants retained the automatic 3 percent contribution rate invested in a money market fund (the investment default). Even after one year, more than half the participants remained at the default contribution rate, and after two years, 40 percent still continued to save 3 percent, despite a 50 percent employer match on contributions up to 6 percent of salary after one year of employment.
>
> . . . [In another study] participation rates dramatically improved when plans added an automatic enrollment feature, with increases between 20 and 34 percentage points after three years of employment.
>
> At the same time, automatically enrolled workers again appeared to anchor to the default contribution rates and default investments . . . . [D]efault behavior does appear to decline over time. After six months, between 48 percent and 73 percent of participants are wholly investing in default investments at the default rate. After two years, the rate of default behavior falls to between 37 percent and 50 percent. And after three years, between 29 percent and 48 percent of automatically enrolled participants continue to exhibit default behavior.

Id. at 3-4 (footnotes and citations omitted).

236. Pension Protection Act § 904 (requiring that effective for plan years beginning after December 31, 2006, vesting of employer contributions must occur no slower than on three-year cliff vesting schedule or six-year graded vesting schedule, increasing nonforfeitable percentage by twenty percent per year starting after second year).

237. *Id.* § 401 (effective for plan years beginning after December 31, 2006 but phased in over three years).

238. *Id.* § 601 (explaining that prohibited transaction exemption, effective for plan years beginning after December 31, 2006, permits plan fiduciaries to be paid to provide investment advice to plan participants).

239. See *supra* notes 147-65 and accompanying text for a discussion of how plan benefit accruals are deficient.

Under the Enron 401(k) plan, only eleven percent of the company stock concentration was attributable to employer matching contributions, with the remaining concentration attributable to participants' own investment decisions.[240] Yet, despite the Enron debacle, plan participants continue to invest a significant percentage of their own employee contributions in employer securities, with recent estimates placing the company stock concentration in 401(k) plans as high as thirty percent of account balances.[241] Further, there is often inertia to change for previously selected plan investments.[242] Plan participants may fail to direct employer contributions made in the form of employer securities to other plan investment alternatives. The Act's prohibited transaction exemption for qualified investment advisers does not ensure that all plan participants will receive investment advice. The exemption does provide some encouragement by insulating plan sponsors from fiduciary liability for monitoring the specific advice given to plan participants and beneficiaries. But it does not insulate sponsors from liability for imprudently selecting and monitoring advisers.[243] The change also falls well short of requiring investment advice as a cost of ERISA Section 404(c) fiduciary liability relief.[244]

VI. CONCLUSION AND RECOMMENDATIONS

Although designed to shore up failing defined benefit plans and generally to encourage private employer retirement plan sponsorship, the effect of the Act is to accelerate employers' tendency to shy away from traditional defined benefit plans.[245] Since its enactment in August of 2006, dozens of companies, including Whirlpool Corp., Citigroup, and the Hershey Company, have announced significant changes to their defined benefit plans, including plan terminations, freezes, and benefit cutbacks.[246]

240. PURCELL, *supra* note 177, at 3.

241. Richard L. Kaplan, *Enron, Pension Policy, and Social Security Privatization*, 46 ARIZ. L. REV. 53, 75 & n.139 (2004).

242. Letter from Mary S. Podesta, Senior Counsel, Inv. Co. Inst., to Robert Doyle, Dir., Office of Regulations and Interpretations, Employee Benefits Sec. Admin. (Sept. 7, 2005), *available at* http://www.ici.org/statements/cmltr/05_dol_auto_enroll_com.html.

243. *See* J. COMM. ON TAXATION, TECHNICAL EXPLANATION OF H.R. 4, THE "PENSION PROTECTION ACT OF 2006," AS PASSED BY THE HOUSE ON JULY 28, 2006, AND AS CONSIDERED BY THE SENATE ON AUGUST 3, 2006, at 131 (2006), *available at* http://www.house.gov/jct/x-38-06.pdf ("The provision does not exempt the employer or a plan fiduciary from fiduciary responsibility under ERISA for the prudent selection and periodic review of a fiduciary adviser with whom the employer of plan fiduciary has arranged for the provision of investment advice.").

244. 29 C.F.R. § 2550.404c-1(c)(4) (2006) (providing that fiduciary has no obligation to provide investment advice to participant or beneficiary under ERISA Section 404(c) plan).

245. Pamela Yip, *Change to Boost 401(k)s, Put Brakes on Pensions, Bush Likely to Sign Bill That Experts Say Will Doom Defined-Benefit Plans*, DALLAS MORNING NEWS, Aug. 7, 2006, at 1A (quoting James Klein, president of American Benefits Council as saying, "I believe we will witness an unprecedented number of companies closing their well-funded defined-benefit pension plans to new employees").

246. Pension Rights Center, *supra* note 71 (providing listing of company press releases, SEC filings, news stories, and other sources).

Further, while the Act fuels the shift away from defined benefit plans and toward defined contribution plan sponsorship,[247] it does nothing to provide sufficient protection for defined contribution plan participants. With every passing year, more of America's workforce will be covered under 401(k) plans, with no fixed benefit offered for retirement years and account assets easily dissipated through unwise investment selection and easy access to distributions in preretirement years.[248]

Considering that any retirement plan sponsorship is a voluntary endeavor, Congress needs to enact laws that meaningfully increase retirement plan security without unduly burdening plan sponsorship. While defined benefit plans may be going the way of the dinosaur, Congress must provide some economic incentive for employers sponsoring healthy, fully funded plans. The PBGC premium increases and the Act's increased funding requirements disproportionately affect healthy plans. The vast majority of defined benefit plan participants are covered by well-funded plans, offering little potential for future PBGC liability.[249] Further, the vast majority of defined benefit plan terminations do not result in PBGC liability. In the last twenty years, ninety-eight percent of all terminated plans were fully funded and satisfied all liabilities to participants and beneficiaries by either purchasing annuities or making lump sum distributions.[250] In the last five years, approximately seventy-five percent of all PGBC liability has come from companies in the airline and steel industries.[251] The increased insurance and funding requirements penalize the vast majority of healthy companies (ninety-eight percent of plan sponsors) by placing the economic burden on them to keep struggling industries afloat (the other two percent). At the very least, Congress must relax PBGC premium increases and funding requirements for healthy plans.

Congress must also provide further incentives for cash balance plan sponsorship. While cash balance plans do not provide the retirement security of traditional defined benefit plans, they provide a particularly attractive alternative to defined contribution plan sponsorship. Cash balance plans are defined benefit plans and, as such, offer major advantages in the areas of

247. Wyand, *supra* note 31 (quoting James A. Klein, president of American Benefits Council as stating that, "[i]n general, [the Act] is going to accelerate movement to defined contribution plans from defined benefit plans . . . . because of unpredictable funding requirements for defined benefit plans and because [the Act] makes defined contribution plans more attractive").

248. See *supra* Part IV for a discussion of the erosion of retirement benefits through defined contribution plan sponsorship.

249. OPTIMAL BENEFITS STRATEGIES, LLC, *supra* note 10, at 6.

250. PENSION BENEFIT GUAR. CORP., *supra* note 72, at 8 ("The other two percent were distress or involuntary terminations of underfunded plans. Upon termination, these latter plans are trusteed and administered by the PBGC.").

251. PURCELL, *supra* note 19, at 2 ("Nine of the ten largest pension plan claims for PBGC insurance occurred between 2001 and 2005. These nine claims accounted for 63% of the total dollar value of claims made on the PBGC since the agency began operating in 1975." (citation omitted) (citing the following ten largest claims, nine of which came from the airlines and steel industries: United Airlines, Bethlehem Steel, U.S. Airways, LTV Steel, National Steel, Pan American Air, Weirton Steel, Trans World Airlines, Kemper Insurance, and Kaiser Aluminum)).

participation rates, investment risk, annuity requirements, and federal PBGC guarantees. Participation in a cash balance plan does not depend on an employee's decision to participate in and make annual contributions to the plan. Investment decisions remain with the employer or with an investment manager appointed by the employer or other plan fiduciary. If plan fiduciaries responsible for investment matters mismanage or poorly invest plan assets, the plan sponsor is responsible for any shortfall and plan participants still receive the benefit promised under the terms of the plan.[252] Cash balance plans are required to offer benefit payments in the form of life annuities or joint life annuities.[253] This benefit form promotes securing an income stream throughout retirement years, compared to 401(k) lump sum distributions that encourage immediate consumption in preretirement years. Cash balance plans also offer portability similar to defined contribution plans and can provide a comparably larger benefit to employees who change employers numerous times throughout their careers.[254]

On the defined contribution plan front, Congress must enact legislation that meaningfully increases retirement security. There are numerous ways to shore up account balances for postretirement years. First, Congress can apply the stricter defined benefit plan diversification requirements to all defined contribution plans that serve as an employer's primary retirement plan. Under these requirements, employers and plan participants would be prohibited from investing more than a specified percentage in employer securities or any other nondiversified investment alternative.[255] Originally, defined contribution plans were exempt from most of the diversification requirements under ERISA.[256] The rationale for the exemption was that defined contribution plans were primarily supplemental plans funded by employer contributions made in the form of company stock.[257] Today, with more defined contribution plans serving as participants' primary retirement security vehicle, that exemption has become a relic of its time. These plans bear no resemblance to the supplemental defined contribution plans that originally warranted special treatment, and there are important public policy and tax policy reasons for ensuring 401(k) plan participants' retirement security.[258] The time has come to apply ERISA

252. U.S. Department of Labor, *supra* note 48, at 2.

253. *Id.*

254. WATSON WYATT WORLDWIDE, HYBRID PENSION CONVERSIONS POST-1999: MEETING THE NEEDS OF A MOBILE WORKFORCE 7 (2004) (noting that employees who change jobs three times during their careers receive nearly eighteen percent more in retirement benefits under cash balance plan than received under traditional defined benefit plan); Zelinsky, *supra* note 214, at 731-33.

255. 29 U.S.C. § 1104(a)(1)(C) (2000) (requiring diversification); *id.* § 1107(a)(1) (providing ERISA prohibition on defined benefit plans investing more than ten percent of plan assets in employer securities and real property).

256. *Id.* §§ 1104(a)(2), 1107(b).

257. *See* Mitchell & Utkus, *supra* note 36, at 3-4.

258. *See Enron and Beyond: Legislative Solutions: Hearing Before the Subcomm. on Employer-Employee Relations of H. Comm. on Education and the Workforce*, 107th Cong. 67 (2002) (written statement of Erik Olson, Board Member, AARP) ("There is a legitimate and substantial public policy interest in ensuring that the assets of ERISA-governed, trusteed, tax-qualified retirement plans are

diversification to all retirement plans that serve as an employer's primary retirement security vehicle.

Second, defined contribution plan sponsors must be required to provide universal, regulated investment advice as a cost of ERISA Section 404(c) fiduciary liability relief. More than half of 401(k) plan participants have only a beginner's level of investment knowledge.[259] Voluntary employer initiatives are inadequate and jeopardize participants' retirement security. Mandating investment advice helps to ensure that ERISA Section 404(c) plans achieve returns commensurate with defined benefit plan returns and that plan participants do not jeopardize their retirement security by making uninformed investment decisions.[260]

Third, Congress needs to enact legislation that applies stricter distribution access requirements to shore up account asset availability for postretirement years. These plans are afforded tax incentives (employer deductions, employee income exclusions, and tax-free buildup of retirement plan earnings) to promote retirement savings.[261] These tax incentives result in billions of dollars in federal tax revenue foregone due to preferential tax provisions.[262] This loss of revenue affects all taxpayers—including the almost fifty percent of the workforce that does not benefit under any employer-sponsored retirement plan.[263] ERISA and Code requirements need to ensure that America's sacrifice produces the desired result of retirement security. Acknowledging that access to plan asset investments does promote higher employee contribution levels, plan loans, hardship distributions, and other in-service distributions should be further limited but not prohibited.[264] Additionally, postemployment distributions prior to attainment of fifty-nine and one-half years should be limited by requiring direct rollovers to other tax-deferred arrangements.

In conclusion, the Pension Protection Act of 2006 was only a small step toward providing retirement security for American workers. Through increased defined benefit plan funding and PBGC insurance premium requirements, the Act ensured the PBGC's short-term viability. Through increased incentives and

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invested in a prudent, diversified manner, so as to minimize the risk that the tax advantages accorded to those assets will fail to achieve their intended purpose of providing additional economic security in retirement.").

259. Stefanie Kastrinsky, *ERISA Section 404(c) and Investment Advice: What Is an Employer or Plan Sponsor to Do?*, 80 CHI.-KENT L. REV. 903, 911 (2005) (citing recent study showing that almost fifty-six percent of 401(k) investors had only beginner's level investment knowledge).

260. See *supra* notes 166-75 and accompanying text for discussion of the lack of investment education or advice in 401(k) plans and the resulting effect on rates of return and account size.

261. *See* EMPLOYEE BENEFIT RESEARCH INST., TAX EXPENDITURES AND EMPLOYEE BENEFITS: AN UPDATE FROM THE FY 2005 BUDGET, FACTS FROM EBRI 1 (2004), *available at* http://www.ebri.org/pdf/publications/facts/0204fact.pdf (noting that tax-favored, employment-based retirement benefits account for largest tax expenditure—approximately $120 billion).

262. *Id.*

263. *See* Munnell & Perun, *supra* note 42, at 2 (noting that, in 2004, only approximately forty-six percent of all private workers aged twenty-five to sixty-four years participated in plans).

264. *See* Holden & VanDerhei, *supra* note 176, at 11 (citing research indicating that availability of plan loans increases 401(k) participation and employee contribution rates).

protections for defined contribution plan sponsorship, the Act attempted to strengthen retirement security in burgeoning 401(k) plans. The Act did not, however, do anything to retard employers' exodus from traditional retirement plan sponsorship. Further, it did nothing to ensure that defined contribution plan participants receive substantial account assets in postretirement years. As a further step forward, Congress must accept the changing retirement plan landscape and enact legislation consistent with the aforementioned recommendations.