FITTING THE PENSION PROTECTION ACT OF 2006 INTO THE DEFINED CONTRIBUTION PARADIGM

Crystal L. Lyons, University of California, Los Angeles
Dear editors:

Enclosed please find a draft of my 20,000 word article, which I am submitting for consideration for publication in your journal. The article explores the broad ramifications of the Pension Protection Act of 2006, a revolutionary statute in a traditionally under-researched area of law. This new and unexplored statute dramatically affects U.S. retirement assets, valued at 14.5 trillion dollars in 2005, with a greater impact on retirement plans than any other law passed since the original ERISA in 1974. The Act was enacted against the controversial shift America has undertaken towards an ownership driven society. The article analyzes the statute in light of this shift, looking at the real effect of the Act rather than simply its stated, but largely unfulfilled, purpose of somehow rescuing the traditional pension system. It also suggests additional reforms, as the Act falls woefully short of protecting the needs of everyday Americans. The Act is an important but preliminary step toward shoring up our woefully inadequate retirement system. It is my hope that this article will increase awareness of the Act's effects and guide the next steps in our quest for greater retirement security.

Thank you for your time and consideration.

Sincerely,

Crystal Lyons
Student, UCLA School of Law
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Crystal L. Lyons

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Crystal L. Lyons*

INTRODUCTION

United Airlines filed bankruptcy in 2003,¹ not because of an inability to perform in the company’s core business as an airline, but because of the crushing weight of its pension plan obligations upon operations and future earnings. After three years of contributing nothing to the plan,² United successfully terminated its pension plan, transferring full responsibility of beneficiary payments totaling 7.1 billion dollars³ to the Pension Benefit Guaranty Corporation (PBGC).⁴ This sole plan termination represented 22.7% of the total claim amounts ever submitted to the PBGC.⁵ Unfortunately this is not an isolated incident. This is not even an isolated incident for the airline industry. United’s default was followed by announcements from Delta Airlines and Northwest Airlines that they too were filing bankruptcy.⁶ The steel and auto industries have been similarly afflicted, with key bankruptcies by Bethlehem Steel and LTV Steel garnering much media attention.⁷ The uniting theme of these bankruptcies is

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¹ See In re UAL Corp., 428 F.3d 677 (7th Cir. 2005) (upholding the legality of the agreement between the PBGC and United to terminate the pension plan without the consent from pension beneficiaries).
⁴ See 29 U.S.C. §1302; Pension Benefit Guar. Corp. v. LTV Corp., 496 U.S. 633, 636-637 (1990) (“PBGC is a wholly owned United States Government corporation... modeled after the Federal Deposit Insurance Corporation). The PBGC is an insurance program established for defined benefit plans and is entirely funded through premiums received from participating plans, at rates set by Congress. If a defined benefit plan is terminated by either the PBGC or the plan sponsors, the PBGC will guarantee retirement benefits to participants up to a maximum annual threshold amount, adjusted annually for inflation.
⁵ See CRS, supra note 3 (presenting data from the PBGC showing that nine of the ten largest plan terminations, representing 60.6% of all claims filed against PBGC since its formation in 1975, were filed in 2001 or later).
⁶ Lowenstein, supra note 2, at 56.
⁷ Id.; See discussion, supra note 5. The Bethlehem steel termination of $3.65B represented 11.5% of total claims against the PBGC and the LTV Steel termination of $1.96B represented 6.2% of all PBGC claims. See id.
the weight of corporate pensions, disabling the companies from competing in a more global, cost-conscious 21st century marketplace. The unifying effect of these bankruptcies has been debilitating to the PBGC, taking it from an operating surplus of $9.7 billion in 2001 to a $23 billion deficit in 2005. Indeed, nine of the ten largest pension plan claims against the PBGC have occurred since 2001.

Against this backdrop, Congress enacted the Pension Protection Act of 2006 (“PPA”) with the explicit purpose to “provide greater security for our Nation’s workers who have retirement benefit plans and greater stability for the Pension Benefit Guaranty Corporation.” With total U.S. retirement assets valued at $14.5 trillion at the end of 2005, security of retirement savings is necessary not only for the individuals holding pension accounts, but for the economy at-large. The Act meets these goals by changing provisions governing defined benefit plans, defined contribution plans, and individual savings account vehicles. Defined benefit plans offer participants a fixed periodic benefit amount in retirement, paid by their employers. Defined contribution plans, by comparison, offer participants a fixed periodic amount contributed to an individual account by the employer (or employer and employee) during the employment tenure, typically resulting in a lump-sum distribution at retirement or separation.

Although the PPA is criticized for “[accelerating] the demise of old-style [defined benefit] pensions” relied upon by middle class workers who value stability and a predictable income, the transition to a defined contribution paradigm is an inevitable and necessary step for today’s society. The PPA helps the economy transition from a traditional defined

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8 General Accounting Office, Walker Presents Report on Retirement Challenges, Tax Notes Today, September 26, 2006, LEXIS, 2006 TNT 186-25 (“Demographics, global competition (steel, auto), industry deregulation restructuring (airlines) have contributed to both plan and corporate weakness.”) (hereafter “GAO”).
10 CRS, supra note 3.
14 PPA also makes changes to improve medical benefits and long-term care insurance, and to revise charitable contributions law, both of which are outside the scope of this comment, as well as minor tariff provisions unrelated to the retirement system.
15 See Part I(A) for a more detailed description of defined benefit and defined contribution plans.
16 Jonathan Peterson, The Nation; Law May Hasten Decline of Pensions, Los Angeles Times, Sept. 04, 2006, at A1 (discussing the opinion of Lynn D. Dudley, vice president of retirement policy for the American Benefits Council, on the effect the PPA will have on tradition defined benefit pension plans).
17 Id.
18 See Edward A. Zelinsky, The Defined Contribution Paradigm, 114 YALE L.J. 451 (2004) (arguing that a fundamental shift has occurred in American thinking toward an individual savings account mentality for funding of retirement, education, and health through incremental changes in the tax code. These changes have eased the transition from a defined benefit to a defined contribution system of retirement savings and are transforming the tax code to a consumption-based model).
benefit pension system to a more realistic defined contribution system, while creating provisions to ensure that those defined benefit plans which are maintained are adequately funded to protect the workers that rely on them for retirement. 19 Under the PPA, defined benefit plans must fully funded using more accurate methods of computing liability amounts. The Act also adds stricter penalty provisions for plans that enter default or are determined to be “at-risk,” and increases tax deductions for annual contributions made to plans, helping companies bring plans closer to a fully-funded status. 20 The PPA updates defined contribution accounts to allow for automatic enrollment of plan participants, better returns on default investments, and more participant-favorable portability and vesting requirements.21 Individual savings accounts are strengthened by making permanent the provisions of the Economic Growth and Tax Relief Reconciliation Act of 2001 (“EGTRRA”))22 which had raised the annual tax-deductible contribution amount for these accounts.23

Though Congress focused public discourse primarily upon changes to shore up the current defined benefit scheme and protect those employees already covered by plans,24 the PPA does little to stem the tide toward a defined contribution paradigm. The PPA’s most lasting and most important impact will be the provisions that ease the transition from a defined benefit to a defined contribution world. The defined contribution system encouraged by the PPA correctly matches the obligations and risks incurred in providing retirement benefits to employees with the period in which the services are received.25 Defined contribution plans free the employer to concentrate on its core business, eliminating the moral hazard problem created by dividing management loyalties between the fiduciary duties owed to shareholders and ERISA-imposed duties to defined benefit participants.26 Conversely, a defined contribution system transfers retirement benefits to employees as they are earned, allowing participants earlier control over their savings and freeing them from concern about the continued solvency of their current (and former) employers.27

20 See Part II(A) and II(B) for detailed discussion of PPA provisions affecting defined benefit plans.
21 See Part II(E) for detailed discussion of PPA provisions affecting defined contribution plans.
23 Id.; See Part II(E) for detailed discussion of PPA provision extending the changes made by EGTRRA.
24 As indeed the name of the statute implies. See also Rep. William M. Thomas, Thomas Highlights Provisions in Pension Protection Act, Tax Notes Today, August 18, 2006, LEXIS, 2006 TNT 160-22 (reciting that the reform “first and foremost . . . protects workers by strengthening the pension rules to ensure pension plans are economically sound.”) (hereafter Thomas Highlights).
25 See Part IV(A) for a more detailed analysis.
26 See Part IV(A) for a more detailed analysis.
27 See Part IV(B) for a more detailed analysis.
This paper proceeds in five parts. Part I provides a background regarding the genesis of the defined benefit system and the circumstances that made reform necessary. Part II explores both the stated and the underlying implied purposes of the Act and interprets the prominent provisions supporting each purpose. Part III presents the criticisms of the PPA and the perceived shortcomings of the defined contribution paradigm. Part IV argues why today’s society should adopt a defined contribution model, and analyzes the ways that the PPA facilitates this transition. Part V suggests potential revisions that would further this transition while protecting the needs of individual employees. A brief conclusion follows.

PART I: HISTORY OF ERISA: WHY REFORM WAS NECESSARY

A. Introduction to the Defined Benefit and Defined Contribution Models

The traditional pension, or defined benefit plan, operates as an annuity providing an employee with a fixed payment, typically monthly, from retirement until the death of the employee.28 The payment amount is generally calculated based on the employee’s salary history and years of service with the employer, and is paid from a collective trust managed by the employer.29

Defined contribution plans offer an individual account structure in which the investment of both participant and employer contributions are directed by the participant.30 Employer contributions to defined contribution plans are generally based on a percentage of the employee salary, a matching percentage of employee contributions, a profit-sharing amount based on company results, or some combination of these three.31 Rather than receiving a fixed periodic payment, as in a defined benefit plan, the contribution to the plan is determinable and the participant usually receives a lump-sum distribution upon retirement or separation from the employer.32

An individual may possess insufficient retirement resources if one of three primary risks impact savings: investment risk, funding risk, and longevity risk.33 These risks are borne differently by defined benefit and

28 See Zelinsky, supra note 18, at 455-457 (introducing and comparing defined benefit and defined contribution plan qualities).
29 Id.
30 Id.
31 Id.
32 Id.
defined contribution plans. The primary distinction between a defined benefit and a defined contribution plan is the allocation of these three risks between employer and employee. Defined contribution plans generally place the burden on the employee to set aside sufficient funds for retirement. Defined benefit plans place the risk of sufficient funding on the employer, but in the process expose the employee to substantial risk of employer default or other failure, placing the employee in essentially the position of creditor-stakeholder.

Investment risk is the risk that the rate of return earned on retirement assets will not be adequate to support retirement needs. Investment risk is borne by employers in defined benefit plans, as the participant is guaranteed a fixed benefit amount regardless of the rate of return earned by the sponsor’s collective trust. In a defined contribution plan, the participant controls the investment of retirement contributions and any investment loss is borne by the participant alone. Conversely, any investment gains accrue solely to the benefit of the participant whereas in a defined benefit plan any gains above that projected would reduce future contributions required by the plan sponsor.

Funding risk is the risk that insufficient contributions will be made during the employee’s career to support retirement expenses. In a defined benefit plan, the employer is required to make annual contributions based on the net present value of expected benefits for all employees. Again, because the benefit amount received is fixed, the employer bears the responsibility of sufficient funding to meet the expected benefits. In a defined contribution plan, the participant bears the risk of ensuring aggregate contributions made to his plan are sufficient, including employer contributions.

Finally, longevity risk is the risk that the participant’s retirement assets will be exhausted too early. Defined benefit plans implement actuarial assumptions to determine the level of funding necessary to insure against this risk, but any shift in demographic trends toward longer lives,

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34 Id.
35 Id.
36 Indeed, some reform suggestions for defined benefit plans have concentrated on the importance of revising the bankruptcy code to provide plan participants a higher and more secure priority status in the event of an employer bankruptcy. See generally Justin R. Kaufman, Halting the Enron Train Wreck: Using the Bankruptcy Code to Rescue Retirement Plans, 76 TEMP. L. REV. 595 (2003).
37 See supra note 33.
38 Id.
39 Id.
40 Id.
41 Id.
42 Id.; See Part II(A) for a more detailed discussion of how defined benefit contributions are calculated.
43 Supra note 33. Arguably, however, the PBGC bears the ultimate risk of both investment and funding risk as the benefits are insured in the event of a plan termination. See Jefferson, supra note 33, at 643.
44 Id.
45 Id.
and hence a longer period of time to pay the fixed period benefit payment, is borne exclusively by the plan sponsor. Defined contribution plans rely on sufficient investment made by the participant to meet all retirement needs for their lifetime.

B. Historical Development of the Defined Benefit Paradigm

Traditional defined benefit pensions were first provided by the federal government as a form of social welfare for Civil War veterans and widows. By World War I public pensions had been extended to police officers, firefighters, and teachers, providing stability to critical government jobs as a trade-off to high wages. The first private pensions were offered at the same time, but employees only qualified for benefits after thirty years of service. It was not until World War II that defined benefit plans truly came in vogue. “Punitive tax rates made the pension shelter enormously attractive and a government freeze on wages meant that pensions were the only avenue for increasing compensation.” With management and labor incentives aligned, and as an extension of the collective responsibility sentiment that flourished during the New Deal, the number of private employees covered by pensions soared to 40% by 1960. By the early 1970’s, however, the model had broken due to “fiduciary abuses, funding failures, and vesting inequities common among defined benefit retirement plans in the 1950’s and 1960’s,” leading Congress to pass the Employee Retirement Security Act of 1974 (“ERISA”) to regulate and respond to these abuses and shore up the faltering defined benefit system.

C. The Shortcomings of ERISA

46 Id.
47 Id.
48 See Lowenstein, supra note 2.
49 Id.
50 Id.
51 Id.
53 Colleen E. Medill, The Individual Responsibility Model of Retirement Plans Today: Conforming ERISA Policy to Reality, 49 EMORY L.J. 1, 5 (2000). The Studebaker auto manufacturer is an interesting case study of the problems faced by early pensions. To increase benefits and preserve union wages during an unprofitable period for the company, the UAW and Studebaker agreed to extend its pension funding schedule. The result was disastrous for thousands of employees who lost most of their pensions when Studebaker was bankrupt four years later. See Lowenstein, supra note 2.
54 Employee Retirement Security Act of 1974, Pub. L. No. 93-406, 88 Stat. 829 (1974) (hereafter ERISA). ERISA’s original stated goal was “to ensure retirement income security for millions of Americans”- the same goal touted as the impetus behind the PPA.
While it temporarily relieved some of the abuses of defined benefit plans, ERISA did not regulate the most common form of defined contribution plan, the 401(k), which would not be created for another four years. The funding requirements imposed upon defined benefit plans helped to regulate contributions and mitigate the investment and funding risks. Critiques of ERISA point out that the Act imposes no similar regulations upon defined contribution plans, as no fixed benefit amount is guaranteed. Therefore, plan sponsors can eliminate most of their fiduciary responsibility over investment risk simply by allowing participants to self-direct investments. Furthermore, no PBGC insurance protection extends to defined contribution plans, creating what many scholars see as an inequitable distinction between participants of different plans.

Defined contribution plans also suffer from an investment advice/investment education dichotomy. Briefly described, plan sponsors are reluctant to provide investment education to participants because it can easily be mistaken for investment advice, which triggers ERISA fiduciary responsibility of the plan sponsor over investment decisions, thus eliminating the advantage of self-directed plans. For the same reason, plan sponsors typically place default investments (those investments that the participant has failed to self-direct) in very safe securities which yield low returns but do not endanger the principle. Unlike defined benefit plans which must apply to all employees if a plan is offered, defined contribution plans often allow participants to contribute to the plan, creating a system in which the employee must elect to participate. This “opt-in” system suffers from low participation rates, leading to fewer participants covered by defined contributions plans than similarly situated employees in defined benefit systems.

55 Revenue Act of 1978, Pub. L. No. 95-600, 135, 92 Stat. 2763 (codified as amended at I.R.C. 401(k)). The new plan was not effective until 1980 and did not become widely implemented until after Treasury regulations were issued guiding 401(k) implementation. See Zelinsky, supra note 18, at 483-484.
56 See Jefferson, supra note 33 at 612-613; Zelinsky, supra note 18 at 476-477.
57 I.R.C. §404 (c), infra note 244.
59 See Czarney, supra note 58 at 172-174; Dana M. Muir, The Dichotomy Between Investment Advice and Investment Education: Is No Advice Really the Best Advice?, 23 BERKELEY J. EMP. & LAB. L. 1, 18-20 (2002); Jefferson, supra note 33 at 627-636.
60 Susan Serota et al, United States: Proposed DOL Regulation Will Provide Relief From Fiduciary Liability for Investments in “Qualified Default Investment Alternatives,” Mondaq Business Briefing, October 10, 2006; see Proposed Rule, infra note 181, at 56807.
61 Chris Silva, Working with Inertia: The Recent Pension Bill Gives a Big Boost to Automatic Enrollment, SMB Finance Vol.1 No.4, 8, October 2006 (describing the situation of the “reluctant investor” who fails to opt-in to the system); U.S. Newswire, U.S. Secretary of Labor Elaine L. Chao Announces Proposed Rue on Default Investment Alternatives for Participant-Directed Plans, Sept. 26, 2006 (“Too many workers, some overwhelmed by investment choices or paperwork, are leaving retirement money on the table by not signing up for their employer’s defined contribution plan.”).
ERISA’s defined benefit provisions are also subject to criticism. Plans were required to be funded at only 90% of the present value of expected benefits. Scholars questioned the wisdom of allowing managers to choose interest rate assumptions in measuring plan assets and liabilities, the accuracy of actuarial assumptions used for plan demographics, and the propriety of smoothing the value of plan assets over five years to minimize market fluctuations (and hence manipulating annual contribution requirements). Plan sponsors also took significant advantage of credit balances, which effectively allowed excess contributions from previous years to offset future contributions owed, regardless of the overall level of plan funding.

These provisions, combined with the PBGC insurance coverage of plan assets, create an obvious moral hazard problem for management. PBGC insurance frees management from some of the inherent investment risk of plan sponsorship, allowing riskier investment decisions whose downside is predominantly insured by the government. Management can negotiate unaffordable benefit concessions in labor negotiations, leaving future managers (or the PBGC) to pay for these promises. Moreover, the moral hazard created could be hidden from participants, the beneficiaries of the plan, by inadequate transparency and reporting requirements.

Most importantly, ERISA did nothing to stop the decline in popularity of defined benefit plans, which suffered from a general disenchantedment with social collectivism schemes generally and the demise of which was exacerbated by the advent of defined contribution plans and individual accounts. Defined contribution plans have grown in popularity since ERISA’s passage, fueled by lower regulatory and administrative costs and greater flexibility, especially among small employers who are particularly sensitive to the costs of defined benefit plans.

D. Modern Impetus for Reform

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62 See ERISA, supra note 54.
63 See Cummins, supra note 52 at 583-585. See generally sources cited infra note 91.
64 Id.
65 See Lowenstein, supra note 2 (discussing the moral hazard created by PBGC insurance its impact on the incentives of management and unions in negotiating, establishing benefit amounts, and making investment decisions. “A union pension expert tellingly explained to... the U.A.W. chief, that insurance [PBGC created through ERISA] would reconfigure the “incentives” of both labor and management”).
66 See Czarney, supra note 58 at 174; Jefferson, supra note 33 at 642-644.
67 See Lowenstein, supra note 2.
68 See generally Cummins, supra note 52 (comparing the lack of transparency and accountability in pension plans to the S&L and corporate governance scandals).
69 See generally Zelinsky, supra note 18; Medill, supra note 53.
70 See generally Zelinsky, supra note 18; Muir, supra note 59 (noting that defined benefit plans are 210% more costly to adminster than defined contribution plans).
The beginning of the 21st century once more shone the national spotlight on the shortcomings of the established defined benefit system and the need to look more closely at defined contribution plans as an alternative. The economic downturn caused by the burst of the technology bubble and September 11th resulted in a decline of stock prices and interest rates which adversely affected returns on investment earned by defined benefit plan sponsors. Plan assets were significantly diminished, leaving plan sponsors with daunting funding requirements that often went unmet. Many businesses failed, declaring bankruptcy and shifting the responsibility of their pension obligations to the PBGC. Under ever-mounting costs, many more defined benefit plans were frozen or eliminated in favor of either a hybrid plan or a pure defined contribution plan. Private pensions are now $450 billion underfunded and public pension obligations may be underfunded by as much as $700 billion, while the Congressional Budget Office forecasts that the PBGC is on a trajectory to operate at a deficit of $100 billion by 2025.

The corporate governance scandals of Enron and WorldCom affected defined benefit plan holdings of many public and private plans that invested in the stock of the companies, and personally left thousands of employees with no jobs and no retirement savings. The loss of the 401(k) savings of the Enron and WorldCom employees drew attention to the dangers of not diversifying retirement investments out of employer stock. Behavioral economists noted the reluctance of employees to diversify out of employer stock, a phenomenon that is only heightened if employer matching contributions are also invested in company stock. As a consequence, behavioral economists further examined participants’

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72 Id. As contributions requirements are based on the difference in the net present value of expected benefits and the plan assets, a decrease in the market will reduce the value of assets. This widens the gap between plan assets and liabilities and leads to larger required contribution amounts.
74 See Part II(C) for a description of hybrid plans. Cash balance plans are the most popular form of hybrid plan. While still technically a defined benefit plan with pooled assets and employer-borne investment and funding risk, cash balance plans create a hypothetical account emulating a 401(k) account that can be distributed in a lump-sum upon employee severance from the plan. See Zelinsky, supra note 18 at 499-500. Hybrid plans were created as a market response to employee demands for a more portable retirement plan.
75 See Zelinsky, supra note 18.
76 See Cummins, supra note 52, at 568-571.
77 Czarney, supra note 73, at 155.
78 Susan J. Stabile, Enron, Global Crossing and Beyond: Implications for Workers, 76 St. John’s L. Rev. 815, 820-824 (2005). (Highlighting the significant percentage of 401(k) assets held in employer stocks and that “as a result, many [Enron] participants lost between seventy and ninety percent of their retirement funds.”)
79 See Zelinsky, supra note 18, at 459; Muir, supra note 59 at 14; Medill, supra note 53, at 15-16.
investment decision-making and questioned the ability of individuals to make proper investment decisions at all.\textsuperscript{80}

Industry and demographic trends have reinforced the decline in popularity of defined benefit plans. Defined benefit plans are most common in heavily unionized industries and manufacturing, sectors which have been largely replaced by the expansion of the technology and service industries.\textsuperscript{81} Newer, post-New Deal industries tend to select defined contribution plans for their employees, seeing such plans as more responsive to their employees’ needs and more economically feasible.\textsuperscript{82} Increased employee mobility has only exacerbated the trend as employers respond to the demand of greater retirement asset portability by their workforce.\textsuperscript{83} The same demographic trends causing Congress to begin re-evaluating Social Security also impact the defined benefit analysis: the beginnings of Baby Boomer retirement coupled with the better availability of healthcare dramatically change the cost-benefit calculation of maintaining the defined benefit plans of the Social Security Administration, public pensions, and private pensions alike due to the increased longevity risk.\textsuperscript{84} While the President’s push to create private accounts in the Social Security was not successful, it did place the question of the agency’s ongoing viability at the forefront of national concern.\textsuperscript{85}

Finally, pension reform was timely as changes made in PPA will largely coincide with broader accounting reforms first effective in 2007, creating a net effect that will be difficult to isolate. The Financial Accounting Standards Board has issued new guidance which will require

\textsuperscript{80} See Part III(B) for a more detailed discussion of behavioral economics.

\textsuperscript{81} See Zelinsky, supra note 18, at 480-481.

\textsuperscript{82} Id.

\textsuperscript{83} Id. (Discussing how defined benefit plans are generally “back-loaded” so that an employee earns the most valuable benefits at the end of their career- when higher salaries are received- in the computation of their earnings based on salary and years of service. Employees that change employees frequently or lose employment before accruing those valuable years of salary are disadvantaged in the defined benefit system); See Muir, supra note 59, at 20 (“First, and most importantly, employers configure benefit plans to respond to the desires and needs of their workforces.”). \textit{But see} Zelinsky, supra note 18 (noting that employees may be only \textit{perceived} as being more mobile today than in previous generations). This distinction is artificial, however, as the end result is the same in that those persons who change jobs frequently will not qualify for the best defined benefit plan coverage.

\textsuperscript{84} Id. at 462 (discussion of allocation of longevity risk, or risk that the retiree will live beyond expending all retirement resources); Report of the President’s Commission, \textit{Strengthening Social Security and Creating Personal Wealth for all Americans}, December 2001; GAO, supra note 8.

\textsuperscript{85} See Presidential Signing Statement, supra note 19 (“To ensure more secure retirement for all Americans we’ve got more work to do. We must also prepare for the impact of the baby boomer generation’s retirement, and what that impact will have on federal entitlement programs like Social Security and Medicare... I’m going to continue to work with the Congress and call on the Congress to work with the administration to reform these programs so we can ensure a secure retirement for all Americans.”); \textit{Pension Protection Act of 2006}, 152 Cong. Rec. H 6040, H6160 (2006) (hereafter “House Record”), (Congressman Miller: “And as people started to look at that attack [on Social Security], and they saw the Federal privatization of Social Security, the started to look at their own pension plans, and they realized, as what we are doing with here today, that their own pension plans are very insecure.”).
companies to incorporate outstanding pension obligations onto their balance sheets, potentially and dramatically reducing the net worth of some corporations by billions of dollars. The changes, which highlight to all shareholders the actual cost of sponsoring a defined benefit plan, will likely cause a further reduction in the number of plans offered and will certainly lessen the attractiveness of a defined benefit plan when companies are considering retirement plan options. Any changes made by the PPA that may increase the attractiveness of defined contribution plans are only cumulative with the effect of the accounting changes.

II. EXPLORING AND INTERPRETING THE PROVISIONS OF THE PENSION PROTECTION ACT OF 2006

Under the intense pressure of this impending crisis, Congress enacted the Pension Protection Act of 2006. The PPA’s sponsors state two dominant goals of the Act: to provide greater security for the nation’s work force and to stabilize the increasingly volatile Pension Benefit Guaranty Corporation. Through a number of interrelated provisions, the Act incentivizes companies with underfunded defined benefit programs to honor their current plan obligations, but also contains several provisions aimed at facilitating the transition from a defined benefit to a defined contribution paradigm. This section will explore each of the stated or implied purposes of the Act, followed by interpretations of relevant provisions which will give effect to the underlying purpose.

A. Increase Accountability and Stability of Defined Benefit Plans

See 158, available at http://www.fasb.org/st/#fas158 (offering specific guidance on changes), see also FASB 87, 88, 109, 132 (R), and 106; Peterson, supra note 16 (discussing negative impact of financial accounting changes on the attractiveness of defined benefit plans).


88 See PPA, supra note 11.

89 See Presidential Signing Statement, supra note 19; Senate Record, supra note 12, at S8747 (Senator Enzi); House Record, supra note 85, at H6160 (Congressman Boehner); House of Representatives Ways and Means Committee, W&M Announces Passage of Pension Protection Act, Tax Notes Today, August 1, 2006, LEXIS, 2006 TNT 147-29; Thomas Highlights, supra note 24.

90 Note: Multiple provisions of the PPA provide for regulation of multiemployer plans. These provisions are treated as outside the scope of the comment as most of the analysis involved in examining the provisions would duplicate that performed for single employer plans. As a point of interest, however, the multiemployer provisions follow the trend after Sarbanes-Oxley of requiring more accountability and transparency, applying the principles to the largely union-sponsored plans and creating a number of new funding, benefit limitations, development of rehabilitation plans, and disclosure requirements. For a discussion of the increased disclosure requirements foisted upon labor unions in the wake of Sarbanes-Oxley, see Recent Regulation, Department of Labor Increases Union Reporting Requirements, 117 HARV. L. REV. 1734 (2004).

91 See Presidential Signing Statement, supra note 19 ("Americans who spend a lifetime working hard should be confident that their pensions will be there when they retire. . . The message from this administration . . . is this: You should keep the promises you make to your workers. If you offer a private pension plan to your employees, you have a duty to set aside enough money now so your
I. Full Funding Requirement. 92 -- Under the PPA, plans must be 100% funded according to the plan’s “funding target,” which is defined as the present value of all benefits (including early retirement) that plan participants have earned as of the beginning of the plan year. 93 To reach this goal, the plan must make a minimum required annual contribution of the plan’s normal cost (liability for benefit accruals in the current year), an amortization of any funding shortfall (calculated as plan assets less the funding target), and any funding waiver amortization amount. 94 Funding waivers are subject to IRS approval upon showing of financial hardship. 95 The amortization period is shortened to seven years for funding shortfalls and five years for any funding waiver amounts. 96 The 100% funding target will be phased-in incrementally from the previous funding requirement of 90%, but plans deemed to be “at-risk” 97 will be required to meet the 100% target in 2008. 98

In calculating the value of plan assets, the plan may use actuarial assumptions to determine the value fair market value of plan assets. 99 The use of smoothing in valuing plan assets (used in valuing plan assets to offset the effect of market volatility in calculating the funding target, and hence “smoothing” the minimum required contribution) is reduced from five years to two years. 100 In valuing plan liabilities, a corporate bond yield curve is

92 PPA §§ 101-116.
PwC, supra note 71; PPA, supra note 11 (collectively hereafter “Interpretive Sources”) 94 See Interpretive Sources, supra note 93.
95 Id. The requirements to qualify for financial hardship are unchanged from former law and will be based upon similar factors.
96 Id. The previous law allowed an amortization funding shortfalls of up to 30 years.
97 See Part II(A)(2) for a description of “at-risk” plans.
98 Id.
99 Id.
100 Id.
used, based upon when the plan benefits are projected to be paid, as provided by the Secretary of the Treasury.\(^\text{101}\) This change limits the ability of management to manipulate the interest rate assumptions to minimize contribution amounts.\(^\text{102}\) The use of credit balances (excess contributions over the minimum amount required in previous years used to reduce future contributions) is restricted and can only be used to offset the normal cost if the plan is at least 80% funded (and therefore not “at-risk”).\(^\text{103}\) The changes will close loopholes that had allowed significant delays in the time it took prolonged market downturns to impact contributions amounts owed and also allowed plans to use credit balances to skip contributions for several years even though the overall plan assets were significantly lower than plan liabilities. Collectively, these provisions will increase total contributions made to defined benefit plans, and make the determination of those amounts more accurate and reflective of changing market conditions.\(^\text{104}\)

2. Determination if a Plan is “At-Risk.”\(^\text{105}\) -- Two tests apply to determine if a plan is at-risk.\(^\text{106}\) The first test applies a “worst-case scenario” and assumes that all employees will retire at the earliest possible date, electing the most costly benefits, to determine if the funding target attainment percentage (assets less any credit balances divided by target liability) of the prior year is at least 70%.\(^\text{107}\) If the plan does not meet this first threshold, the plan is at-risk unless under the second test it is at least 80% funded using standard actuarial assumptions.\(^\text{108}\) Once a plan is determined to be at-risk, the full funding rules are no longer phased-in for that plan, but instead the 100% funding requirement will immediately apply.\(^\text{109}\) Additionally, if an at-risk plan was also at-risk for two of the previous four years, it is subject to a loading factor additional charge equal to 4% of the funding target plus $700 per participant.\(^\text{110}\) Any plans that are underfunded in the previous year will be required to make quarterly payment installments of their contribution requirement in the following year in a manner similar to those applied to individuals with income tax

\(^{101}\) Id.

\(^{102}\) See Part I(C) for discussion of moral hazard created by allowing management to chose interest rate assumptions. The change also reduces the effect of PBGC insuring the investment performance of a plan, as dictated by management through unrealistic interest rate assumptions. See Jefferson, supra note 33 at 643-644.

\(^{103}\) Id.

\(^{104}\) See Presidential Signing Statement, supra note 19 (“This legislation insists that companies measure their obligations of their pension plans more accurately.”); Senate Record, supra note 12 (comments of Senator Enzi).

\(^{105}\) PPA §§101, 102, 111, 112. Note that there are also limitations on benefits increases allowed by the plan based on its funding status which will be discussed in Part II(A)(3).

\(^{106}\) See Interpretive Sources, supra note 93.

\(^{107}\) Id.

\(^{108}\) Id. The 80% funding level will be phased-in over the next five years.

\(^{109}\) Id.

\(^{110}\) Id. Plans with 500 or fewer participants are not subject to the additional at-risk liability.
withholding shortfalls.\textsuperscript{111} The at-risk determination will ensure that underfunded plans will be brought current as quickly as possible and that plan administrators cannot continue to ignore their obligations by using previously accrued credit balances.\textsuperscript{112}

3. Benefit Limitations of Underfunded Plans.\textsuperscript{113} -- Underfunded plans are subject to benefit limitations.\textsuperscript{114} If a plan is funded at less than 60% of its target funding (disallowing the inclusion of any credit balances in the funding determination), it may not provide shutdown benefits or lump sum distributions and must freeze benefit accruals.\textsuperscript{115} If a plan is funded between 60% and 80%, lump sum distributions are limited to 50% of the accrued benefit.\textsuperscript{116} Additionally, any plan under 80% funded may not adopt benefit increases, unless the benefits are funded by the employer immediately.\textsuperscript{117} The benefit limitations will prevent employers from promising increased benefits they cannot afford when they are negotiating with their employees and reduces the likelihood that the PBGC would have to insure those benefits.\textsuperscript{118}

4. Increased Funding Deduction Amount.\textsuperscript{119} -- A plan sponsor may for tax purposes deduct 100% of the plan’s normal cost for the year, plus the full amount necessary to meet the plan’s overall funding target.\textsuperscript{120} Additionally, the plan can deduct a full 50% cushion of the funding target amount as well as any projected compensation and benefit increases.\textsuperscript{121} For

\begin{footnotes}
\item[111] Id.
\item[112] See Presidential Signing Statement, supra note 19 ("[PPA] closes loopholes that allow underfunded plans to skip pension payments."); Senate Record, supra note 12, comments of Senator Enzi.
\item[113] PPA §§103, 113.
\item[114] See Interpretive Sources, supra note 93.
\item[115] Id. A shutdown benefit is typically paid when a plant is closed temporarily, or permanently, as part of a restructure plan. Lump-sum distributions of defined benefit plans are sometimes offered to employees laid-off or taking early retirement as an alternative to the typical monthly pay-off scheme effective only upon the normal retirement date of the employee.
\item[116] Id. (the lump-sum distribution may also be limited to the present value of the PBGC guaranteed benefit if the amount is less than 50% of the accrued benefit).
\item[117] Id.
\item[118] See Presidential Signing Statement, supra note 19 ("Finally, this legislation prevents companies with underfunded pension plans from digging the hole deeper by promising extra benefits to their workers without paying for those promises up front."); House Record, supra note 85, H6157 (Congressman McKeon: “We pledged to craft a bill that values honesty by ending the practice of allowing employers and union leaders, when faced with a severely underfunded pension plan, to dig their hole even deeper by promising extra benefits to employees and retirees. And we have done just that.”); Senate Record, supra note 12, S8762 (Senator Baucus: “Employers and unions will not be able to negotiate for benefit increases without paying for them. Workers will have to push for better funding if they want to continue to earn benefits. The medicine may not taste very good. But it is necessary to keep the patient alive."). (Note that the PBGC is not required to insure all benefits immediately, so any increases may be subject to a lag time before full PBGC coverage. See Part II(B)(2) for discussion of change to PBGC benefits to further curtail the abusive practice of employers increasing benefits prior to a plan termination.)
\item[119] PPA §§ 801, 803.
\item[120] See Interpretive Sources, supra note 93. This amount includes the full amount of any amortized previous shortfalls or funding waivers that are due.
\item[121] See Interpretive Sources, supra note 93.
\end{footnotes}
employers that offer both defined benefit and defined contribution plans, the maximum allowable deduction for the combined plans is limited to 25% of the compensation paid or accrued to plan participants during the year, or the minimum required contribution to the defined benefit plan, whichever is greater.\textsuperscript{122} This limitation on combined plan deductions, however, does not apply if the defined benefit plan is PBGC insured. The limitation only applies to contributions in excess of 6% of compensation for those plans that are not insured.\textsuperscript{123} The increased tax deduction creates an incentive for employers to contribute excess cash to the plan and fund any benefit augmentations in full, thereby relieving tax liability for the year and offsetting future contribution burdens.\textsuperscript{124} Using the new deductible allowances, a plan can actually achieve funding of over 100% of the funding target and continue to deduct the normal cost annually, which operate to build up plan reserves on a tax-favored basis.

**B. Increase Stability of the PBGC to Prevent a Taxpayer Bailout**\textsuperscript{125}

I. **Determination of PBGC Premium Amounts.**\textsuperscript{126} -- Plans are subject to two premium calculations.\textsuperscript{127} All plans must pay a per capita premium of $30 year.\textsuperscript{128} A second variable-rate premium (VRP) is charged to any underfunded plan at the rate of $9 per $1,000 of funding shortage.\textsuperscript{129} The VRP calculation is based shortfall of the fair value of plan assets from the funding target, using a corporate rate segment yield curve to value

\textsuperscript{122} Id.
\textsuperscript{123} Id.
\textsuperscript{124} See Presidential Signing Statement, supra note 19 (“[PPA] raises caps on the amount that employers can put into their pension plans so they can add more money during good times and build up a cushion that can keep pensions solvent in leaner times.”); House Record, supra note 85, H6157 (Congressman McKeon: “We pledged to craft a bill that relies on common sense by enabling employers to build a cushion in their pension plans during good economic times. We have done just that.”). This approach directly creates a counter-incentive to fully fund benefit increases in the period they are agreed upon in contrast to the moral hazard incentives created to push funding requirements on to future periods.
\textsuperscript{125} See Presidential Signing Statement, supra note 19 (When some businesses fail to fund their pension plans and are unable to meet their obligations to their employees, it puts a strain on the entire system. And if there’s not enough money in the system to cover all the extra costs, American taxpayers could be called on to make up the shortfall.”); House Record, supra note 85, H6161 (Congressman Boehner: “[our goal is to] try to prevent a taxpayer bailout of the Pension Benefit Guaranty Corporation.”); Senate Record, supra note 12, S8747 (Senator Enzi: “The final guiding principle is: A taxpayer bailout of the PBGC is not an option. The full faith and credit of the United States does not stand behind the private pension insurance systems, and I am committed to keeping it that way by shoring up the finances of the agency without a taxpayer bailout.”)
\textsuperscript{126} PPA §§ 401-412.
\textsuperscript{127} See Interpretive Sources, supra note 93.
\textsuperscript{128} Id.; See Deficit Reduction Act of 2005, Pub. L. No. 109-171 (raising per capita premium from $19 to $30, effective 2007).
\textsuperscript{129} See Interpretive Sources, supra note 93. The previous law exempted plans from the VRP unless they were underfunded in two consecutive years out of the previous three years, this exemption has been eliminated in the PPA.
liabilities. These provisions aim to reduce the PBGC deficit and prevent a taxpayer bailout that would rival the Savings & Loan collapse.

2. PBGC Disclosure and Bankruptcy Provisions. -- A temporary special assessment premium of $1,250 per participant for companies emerging from bankruptcy is made permanent. If an employer enters bankruptcy, the bankruptcy date is treated as the termination date of the plan for purposes of determining benefits guaranteed by the PBGC. An employer shutdown or other contingent event is treated as a plan amendment, triggering the five-year phase-in period applicable to new benefits before they are fully guaranteed by the PBGC. Any employer that has a funding target attainment percentage of less than 80% is required to file plan and actuarial and employer financial information, including termination liabilities, with the PBGC annually. The PBGC must then provide a summary report of all such underfunded plans to the House and Senate. These provisions will limit the ultimate liability of the PBGC when plans are terminated by limiting the amount of guaranteed benefits, in particular by preventing the employer from increasing plan benefits after filing bankruptcy. The PBGC can recover more from employers who successfully emerge from bankruptcy after divesting their plan, which limits an employer’s attempts to gain an unfair tactical advantage by terminating its retirement plan. The provisions also facilitate greater Congressional oversight of the PBGC and closer monitoring of its potential liabilities.

C. Facilitate Transition from Defined Benefit to Hybrid Plans

130 See Part II(A)(1)(discussing use of yield curve in valuating benefits for determining plan funding target).
131 See Senate Record, supra note 12, S8747-48 (Senator Enzi: “The legislation repeals the full funding exemption on the variable rate premium which reduces the deficit at the PBGC by billions over the next 10 years...Congress’ adverse experience with the savings and loan problems of the past have taught us a lesson: A taxpayer bailout of the PBGC is not an option.”); House Record, supra note 85, H6156 (Congressman Owens: “It is going to be huge, like an economic asteroid collapsing on the economy when the pension benefit guaranty fund collapses as the savings and loan did.”).
132 PPA §401-412, 505.
133 Id.
134 See Interpretive Sources, supra note 93.
135 Id.
136 Id.
137 Id.
138 See Senate Record, supra note 12, S8758 (Senator Hatch: “Too many companies had severely underfunded pension plans. Companies had made promises to their employees, promises that those employees were depending on for their retirement. But the companies were falling short on those promises. This was not good for the bottom-line of the...PBGC, which is now, as the result of several high-profile bankruptcies, running at a considerable deficit. This was not good for employees, who in the event of plan termination would receive dimes on the dollar for their pension plans.”)
139 PPA §§701-702. See Senate Record, supra note 12, S8747, S8751-52 (Senator Enzi: “The legality of cash balance plans and other hybrid plans designs is clarified on a prospective basis under ERISA, the Internal Revenue Code, and the Age Discrimination in Employment Act, thus ending legal challenges that have driven hundreds of quality employers out of the defined benefit system. We have always felt that these plans are valid under the Code, ERISA, and ADEA.” “As we developed these new rules for
Hybrid plans are defined benefit pension plans that have characteristics of both defined benefit and defined contribution plans. The most popular hybrid is the cash balance plan that creates a “hypothetical” individual account for each participant while still collectively pooling assets in one trust. The PPA establishes testing principles for age discrimination: a plan does not discriminate if a participant’s accrued benefit as of any date is equal to or greater than the benefit of any similarly situated, younger individual. The “wear-away” of benefits occurs if at conversion, the account balance of the participant is less than the present value of their accrued retirement benefits, including early retirement benefits, under the previous plan; such wear-away is prohibited by the PPA. Lump-sum distributions of the hypothetical account balance are approved so as to eliminate any “whipsaw” effect. Participants in hybrid plans must be 100% vested after three years.

The PPA also creates a new hybrid plan for plan years effective after December 31, 2009, the DB/k, which combines a defined benefit and 401(k) plan for small employers. The DB/k allows assets to be held in one collective trust, but allocated to separate employee accounts. Like cash balance plans, DB/k plans provide a portable benefit distribution to participants upon separation. Employers are required to use a final average pay formula to determine defined benefit payments. The 401(k) portion is required to implement automatic enrollment and matching contributions. These changes encourage employers to convert traditional defined benefit plans to hybrid plans without fearing discrimination lawsuits, that the IRS will continue to abstain from issuing determination...
letter approvals for plans, or the threat of early distributions to a plan’s financial stability, while still protecting the reliance interests of the employees involved in plan conversions.148

D. Increase Transparency of both Defined Benefit and Defined Contribution Plans149

Defined benefit plans must provide all interested parties (PBGC, participants, beneficiaries, unions, and in the case of multiemployer plans, individual employers) a summary annual report (SAR) within 60 days of filing their annual report.150 Annual reports for the plans must be posted online by both the Secretary of Labor and the employer.151 Underfunded plans must file a report with the PBGC if the funding target attainment percentage is less than 80%.152 Any plan (1) in a distress termination initiated by the plan sponsor or; (2) in an involuntary termination initiated by the PBGC must also provide termination financial information to participants and other affected parties.153 Defined contribution plans must continue to provide benefit statements to participants on an annual basis (quarterly basis if investments are self-directed), whereas defined benefit plans are now required for the first time to provide individual benefit statements at least every three years, or more frequently upon a participant’s request.154 Participants also must receive notice of their right to divest of employer securities 30 days before they are eligible to do so.155 These provisions work increase the information available to plan participants, enabling participants to hold their employers accountable for any deficiencies, informing them of their rights as plan beneficiaries, and

148 See Senate Record, supra note 12, S8751-S8752 (Discussion by Senator Enzi of the various concerns facing hybrid plans, including ongoing lawsuits and the IRS moratorium on determination letters for the plans.). Note that the changes in maximum deductible contributions for combination of plans also facilitates employers offering multiple plan options or maintaining a frozen defined benefit plan while offering a defined contribution plan to employees. See Part IV(C) for further analysis of hybrid PPA provisions on corporate behavior.
149 PPA §§ 501-509. See House Record, supra note 85, H6157 (Congressman McKeon: “We pledged to craft a bill that promises greater transparency by giving employees timely and straightforward information about the health of their plans. And we have done just that.”); Senate Record, supra note 12, S8748 (Letter to Congress from Congressman Boehner: “Under this compromise, workers and employers can be assured of predictability and transparency in their pension plans.”). See also comments, supra note 90, discussing multiemployer requirements.
150 See Interpretive Sources, supra note 93. (Additional annual reporting requirements have been imposed, with most of the substantial additional requirements directed toward multiemployer plans.)
151 Id.
152 See Interpretive Sources, supra note 93.
153 Id.
154 Id.
155 Id. See discussion of diversification provisions Part II(E)(2).
keeping them appraised of the true value of their retirement assets to plan, and save, accordingly.\footnote{See Senate Report, \textit{supra} note 12, S8754 (Senator Kennedy: “We owe it to our workers to give them the best information so they can make the best choice for themselves and this bill makes that possible.”)}

\textit{E. Expand Opportunities for Individuals to Save for Retirement and Invest Wisely}\footnote{See Presidential Signing Statement, \textit{supra} note 19 (“expanding opportunities for Americans to build their own nest-eggs for retirement” “the bill I signed today also contains provisions to help workers who save for retirement through defined contribution plans like IRAs and 401(k)s. These savings plans are helping Americans build a society of ownership and financial independence.”); House of Representatives Ways and Means Committee, \textit{W&\textgreater M Announces Passage of Pension Protection Act}, Tax Notes Today, August 1, 2006, LEXIS, 2006 TNT 147-29 (The Pension Protection Act also incorporates tax provisions that will enhance retirement security for millions of Americans.); Senate Report, \textit{supra} note 12, S8760 (Senator Kohl: “Aside from reforming traditional pensions, the bill also includes important provisions to boost retirement savings. Most importantly, it improves and makes permanent the saver’s credit, which helps low- and moderate-income workers save. It encourages companies to automatically enroll workers in 401(k) plans and makes pensions more portable. And it provides protections to workers in the wake of the Enron accounting scandal.”).}

\textbf{I. EGTRRA Provisions Made Permanent and Expanded}\footnote{PPA §§ 811, 812, 824, 830, 833.} -- The PPA makes permanent Economic Growth and Tax Relief Reconciliation Act of 2001 (EGTRRA)\footnote{Economic Growth and Tax Relief Reconciliation Act of 2001, Pub. L. No. 107-16.} provisions increasing annual tax deductible contribution amounts to elective IRAs and qualified retirement plans.\footnote{See Interpretive Sources, \textit{supra} note 93.} These changes include increasing 401(k) elective deferrals to $15,000 and 401(k) catch-up contributions (for individuals age 50 or older) to $5,000 for 2006, with cost of living adjustments thereafter, as well as increasing the tax deductible contribution and catch-up contribution amounts for IRAs.\footnote{\textit{Id.}} Also made permanent is the Saver’s Credit, a nonrefundable tax credit for low and middle-income families for up to 50\% of a retirement savings contribution of up to $2,000, indexed to inflation.\footnote{\textit{Id.}} Beginning in 2006, taxpayers may direct the Internal Revenue Service to direct deposit their income tax refunds to a designated IRA account.\footnote{\textit{Id.}}

Retirement savings are made more portable by allowing direct rollovers from retirement plans to Roth IRAs and rollovers of after-tax contributions from one qualified plan to another, in either defined benefit or defined contribution form.\footnote{\textit{Id.}} EGTRRA also imposed shortened vesting requirements for all employer contributions to defined contribution plans. Contributions must vest either 100\% after three years of service (cliff-vesting), or may gradually vest at 20\% per year beginning with the second
year of service and ending with full vesting after six years of service. These provisions encourage retirement savings and allow those savings to be retained by the employee in protected accounts where they can appreciate into a substantial retirement amount.

2. Diversification of Defined Contribution Investments. Defined contribution plans must provide a minimum of three investment options for participants to self-direct their investments, other than in employer publicly traded securities, to achieve a diversified portfolio. The employer may not require the participant to invest any portion of the employee contributions in employer stock. Any employee contributions directed to employer stock may be diversified at any time upon the participant’s direction. Employer contributions to the account may be diversified after three years of service. Employer securities held in a free-standing Employee Stock Option Program (ESOP) are excepted from this requirement. This provision incorporates traditional investment advice regarding diversifying one’s portfolio to spread risk among complementary investment categories to approximate an average rate of return. Permitting participants to minimize investment in employer stock protects employees from future corporate governance scandals and the potential loss of their entire retirement savings.

3. Investment Advice Provided to Participants. Fiduciary responsibilities imposed under ERISA prohibited parties in interest, typically those parties providing investment services to the plan, from offering investment advice to participants without accepting fiduciary

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165 See Interpretive Sources, supra note 93.
166 See Senate Report, supra note 12, S8752 (Senator Enzi: “[EGTRRA provisions] help Americans save for retirement, increase portability, protect plan integrity, increase the limits on defined benefit, defined contribution plans and IRAs. EGTRRA allows catch-up provisions for individuals who are age 50 and older and they make permanent many other beneficial tax and ERISA provisions.”); See also supra note 157.
167 PPA §901.
168 See Interpretive Sources, supra note 93.
169 Id.
170 This exception does not apply to the increasing number of K-SOP plans offered as a hybrid between a 401(k) and ESOP program with the benefit of dividend deductions for the employer. See Dana M. Muir & Cindy Schipani, The Challenge of Company Stock Options for Director’s Duties of Loyalty, 43 HARV. J. ON LEGIS. 437, n.177 (2006) (citing sources).
171 See Jefferson, supra note 33 at 653.
172 See Jane Bryant Quinn, When Your Paycheck Stops, Newsweek, April 17, 2006 (“Diversify into mutual funds no matter how good you think your company is.”); Senate Record, supra note 12, S8760 (Senator Kennedy: “In addition, [PPA] includes clear protections to prevent employees from being stranded by future Enron-type crises because firms force them to invest their retirement savings in company stock.”); Senator Grassley (S8763): “This bill will protect workers from the next Enron by prohibiting employers from stuffing company stock in their 401(k) plans.”).
173 PPA §601.
responsibility for the investments made. Fiduciaries must act in accordance with the exclusive benefit rule and only undertake those actions which inure solely to the benefit of the participants and beneficiaries, and not for any profit motive of the party providing the advice or sponsoring the plan. The PPA adds an exemption from fiduciary responsibility for investment advice provided to participants who direct the investment of their accounts. The exemption is predicated upon the use of an independently certified objective computer model, or alternatively that the fees received by the advisor do not vary depending on the investment advice provided. The exemption is subject to further requirements, including disclosures to participants of the advisor’s material affiliations and an annual audit of a computer program used. Access to personalized investment advice works in tandem with the diversification provision to maximize the opportunity of a participant to invest wisely and earn a sufficient rate of return on defined contribution investments to meet his retirement needs.

4. Automatic Enrollment of Participants in Defined Contribution Plans. -- To encourage voluntary automatic enrollment in defined contribution plans, the PPA preempts any conflicting state wage withholding laws preventing the practice. The provision extends fiduciary relief to plans investing participant contributions in “qualified default investment alternatives” (QDIA), thereby encouraging employers to adopt the program for their employees. Employers must provide annual notice to participants, written in plain English, indicating the participant’s default enrollment in the plan, describing the default investment selection,

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174 See Muir, supra note 59 at 9-10.
175 Id.; See Interpretive Sources, supra note 93.
176 See Interpretive Sources, supra note 93. The provision is subject to a DOL determination by the end of 2007 if an objective computer model is available that is appropriate for a broader range of investment options. See Sen. Chuck Grassley, Grassley provides Summary of Pension Protection Act, Tax Notes Today, August 7, 2006, LEXIS, 2006 TNT 151-52.
177 Id.
178 See House Record, supra note 85, H6161 (Congressman Boehner: “There is not enough diversification in their portfolios, and if we don’t get real investment advice and personalized investment advice into their hands, we know that they are not going to have the type of retirement that they are expecting. Thankfully, those provisions are included in this bill to help make sure that investment advice gets there.”); Presidential Signing Statement, supra note 19 (And this legislation will… ensure that workers have more information about the performance of their accounts, provide greater access to professional advice about investing safely for retirement, and give workers greater control over how their accounts are invested.”); Senate Record, supra note 12, S8751 (Senator Enzi: “One provision concerns the expansion of investment advice to workers while other provisions are designed to allow ERISA plans to achieve similar benefits and efficiency of our modernized financial markets that is currently available to retail and other institutional investors.”).
179 PPA § 902.
180 See Interpretive Sources, supra note 93.
informing the participant of his right to elect to self-direct the investment, and directing the participant to sources of further information about the plan and investment options offered.\textsuperscript{182} Employees are allowed to withdraw any automatic contributions within the first 90 days of plan enrollment, penalty free.\textsuperscript{183} The “qualified automatic enrollment feature” and compliance with the proposed QDIA regulations creates a safe harbor from annual nondiscrimination testing and from top-heavy rules.\textsuperscript{184} The provision sets a floor for a minimum employee deferral percentage of 3\%, increasing by 1\% each year to a minimum contribution of 6\% after four years of participation in the plan.\textsuperscript{185} The ceiling, or maximum automatic deferral percentage, is set at 10\%.\textsuperscript{186} Employers are compelled to make a minimum nonelective contribution of 3\%, or a matching contribution of up to 3.5 \%.\textsuperscript{187} All employer contributions are subject to a two-year cliff vesting.\textsuperscript{188}

The employer must comply with DOL regulations (Proposed Rule)\textsuperscript{189} and exercise adequate fiduciary responsibility in selecting and monitoring the chosen QDIAs for participant investment. If an appropriate QDIA option is implemented, the participant is treated as having self-directed the investment, and the employer is relieved of any fiduciary responsibility over the performance and selection of the investment.\textsuperscript{190} The Proposed Rule imposes six conditions for fiduciary relief: (1) participant assets must be invested in a QDIA; (2) participant must have had the opportunity to self-direct and failed to do so; (3) participant must be provided notice at least 30 days before enrollment the first year, and each subsequent year thereafter (as described in above paragraph); (4) any material provided to the plan regarding the investment (e.g. proxy statements or voting materials) must be forwarded to the participant; (5) the participant must be provided the opportunity to change his investment selection as frequently as participants who self-direct, and at least every three months, and; (6) the plan must offer a “board range of investment alternatives” to achieve a diversified portfolio.\textsuperscript{191} The Proposed Rule imposes five requirements for a QDIA: (1) the QDIA shall not hold or acquire employer securities (except for (a) those securities held by a Registered Investment Company (RIC) invested in by the plan and acquired under independent investment objectives; or (b) those employer stocks held as matching contributions or acquired by the participant through self-

\textsuperscript{182} Id.
\textsuperscript{183} Id.
\textsuperscript{184} Id.
\textsuperscript{185} Id.
\textsuperscript{186} Id.
\textsuperscript{187} Id.
\textsuperscript{188} Id.
\textsuperscript{189} See Proposed Rule, supra note 181.
\textsuperscript{190} See Proposed Rule, supra note 181; Interpretive Sources, supra note 93.
\textsuperscript{191} See Proposed Rule, supra note 181.
direction, subject to allowance of the investment manager to divest of the securities as soon as is allowable; (2) no restrictions or penalties may be imposed on a participant who chooses to self-direct funds out of the default investment; (3) the QDIA must be managed by either an investment manager or RIC who acknowledges their fiduciary responsibilities and liability under ERISA; (4) the investment must be diversified so as to minimize the risk of large losses, and; (5) the QDIA must use one of three types of investment products, portfolios, or services (presuming the advisor to know only the participant’s age and no other personal information or investment/risk preferences), (i) a life style or target-retirement date fund, diversified and chosen based on participant’s age, expected retirement, or life expectancy, (ii) a balanced fund, diversified based on demographics of the plan as a whole, or (iii) an individually professionally managed account diversified based on the age, expected retirement, or life expectancy of the individual participant.192 The Proposed Rules are required to be finalized, per the PPA, by February 17, 2007.193 The automatic enrollment feature of defined contribution plans is expected to foster a higher rate of participation in retirement savings plans with a higher rate of return earned on default investments, both increasing the aggregate retirement savings available.194

PART III: PRIMARY OPPOSITION: THE ARGUMENT TO PRESERVE THE DEFINED BENEFIT PARADIGM

A. Critiques of the Pension Protection Act

193 PPA; Proposed Rules, supra note 181. (as of March 20, 2007 the Final Rule had not been released)
194 See Proposed Rules, supra note 181; U.S. Newswire, U.S. Secretary of Labor Elaine L. Chao Announces Proposed Rue on Default Investment Alternatives for Participant-Directed Plans, Sept. 26, 2006 (“Too many workers, some overwhelmed by investment choices or paperwork, are leaving retirement money on the table by not signing up for their employer’s defined contribution plan. This regulation would boost retirement savings by establishing default investments for these workers that are appropriate for long-term savings.”); Presidential Signing Statement, supra note 19 (“And this legislation will make it easier for workers to participate in these plans. It will remove barriers that prevent companies from automatically enrolling their employees in these savings plans...”); Senate Record, supra note 12, S8762 (Senator Baucus: “Fourth, automatic enrollment: I am proud that this bill included a provision that I have been pushing for some time to allow 401(k) plans and 403(b) arrangement to automatically enroll workers unless they opt out. This means that the workers’ salaries will be reduced to put savings into the retirement plan unless the worker instructs the employer not to do this withholding. And we let employers automatically increase the amount saved each year unless the worker says no. Many studies have found that this “opt-out” approach significantly increases workers’ retirement savings.”); House Record, supra note 85, H6154 (Congressman Johnson: “This bill makes a simple change that will result in 85 to 90 percent of working Americans who work for companies with pension plans participating in those plans, as opposed to 50 percent. That is big. That is important. It is a simple mechanism, but it will help many, many more young people to get into those pension plans, take advantage of employer contributions, and prepare for their retirement.”).
The PPA received broad bipartisan support\(^{195}\) in both the House and Senate, passing by a wide margin of 279-131 in the House\(^ {196}\) and 93-5 in the Senate.\(^ {197}\) While the bill was not without critics, debate surrounding the PPA passage focused largely on the risk the PPA would “accelerat[e] the demise of old-style pensions,”\(^ {198}\) rather than strengthening them. Of primary concern was the provision limiting the period allowed for smoothing plan assets, which subjects contributions to greater volatility to fluctuating market conditions.\(^ {199}\) Congressman Pomeroy stated in his debate, “when you make funding too onerous or too unpredictable, you force the executives to cancel or terminate or freeze the plan.”\(^ {200}\) His sentiments were echoed by the American Benefits Council which, while praising many provisions of the plan, was concerned that the new provisions “will inject more unpredictability into [corporate defined benefit] pension financial obligations.”\(^ {201}\)

Concern about this erosion of defined benefit plans has centered on its effect on older workers nearing retirement. Many fear that the impact of plans freezing or converting to hybrid plans will be the loss of much of the baby boomers’ anticipated retirement savings.\(^ {202}\) These same concerns fueled many of the PPA provisions designed to prevent such a loss, but critics believe the Act did not go far enough to shield older workers.

**B. Defined Benefit Supporters Cling to Social Collectivist Ideals**

Those critics who would preserve the defined benefit system cite two primary advantages over the defined contribution model: risk allocation and behavioral economics.

When allocating the investment, funding, and longevity risks of attaining sufficient retirement savings, supporters of defined benefit plans believe that corporations are in a much better position than individuals to bear those risks. Defined benefit supporters believe a corporation is in a “better position to retain financial experts”\(^ {203}\) helping the corporation garner economies of scale and efficiency gains when investing a common pool of assets, leading to lower administrative costs and higher returns on investments.\(^ {204}\)

\(^{195}\) See House Record, *supra* note 85 at H6153 and H6156 (indicating broad support for the PPA from Democrats and Republicans, corporations and unions).

\(^{196}\) Id. at H6169.

\(^{197}\) See Senate Record, *supra* note 12 at S8763.

\(^{198}\) See Peterson, *supra* note 16.

\(^{199}\) See Part II(A)(1).

\(^{200}\) See House Record, *supra* note 85 at H6157.


\(^{202}\) See House Record, *supra* note 85 at H6157, H6160.

\(^{203}\) See Jefferson, *supra* note 33 at 636-638.

\(^{204}\) See Zelinsky, *supra* note 18 at 468.
Behavioral economics refers to the manner in which the investing decisions of individuals are influence by a number of improper factors, leading them ultimately to act in a manner divergent from the course a rational self-maximizer would pursue.205 Behavioral economics causes participants to engage in a host of investment faux pas, including insufficiently diversifying one’s portfolio, investing too conservatively to meet long-term return needs, making decisions solely based on the physical presentation of information, and over-reliance upon uninformed or biased investment advice (or perceived advice) provided by employers, family, and friends.206 There is a “substantial consensus” that most employees are poor investors regardless of the amount spent to educate and advise them, and would therefore be better off in a defined benefit plan with the sponsor bearing all investment risk.

PART IV: THE DEFINED CONTRIBUTION SOCIETY: A MORE NATURAL FIT

A. Should Employers be Responsible for the Retirement Security of Employees?

In passing the PPA, Congress recognized that the pension system is in dire straits. The number of defined benefit plans has dramatically declined since the 1980’s,207 while those pensions that should be the strongest (Social Security,208 public pensions,209 and large union pensions)210 are running at disastrous deficits or simply declaring bankruptcy.211 But rather than looking at whether defined benefit plans are economically feasible at all,212 especially in light of recent key demographic

205 See Muir comments, infra note 272 at 11-18.
206 See Sources cited, infra, note 280.
207 See supra note 69; Employment Benefits Research Institute, EBRI Databook on Employee Benefits Chapter 10: Aggregate Trends in Defined Benefit and Defined Contribution Retirement Plan Sponsorship, Participation, and Vesting, Table 10.1a Retirement Plan Participation (Updated December 2005) Available at www.ebri.org. (Showing that while 84% of employees at medium and large firms participated in a defined benefit plan in 1980, that number dropped to 33% by 2003.)
209 See Generally Janice Revell, The $366 Billion Outrage: All Across Americ, state and city workers are retiring early with unthinkably rich pay packages. Guess who’s paying for them? You are., Fortune, May 31, 2004. (Discussing the massive underfunding of government pension plans that provide benefits well in excess of financial sound decision-making and can only be paid for by massive government service cuts or tax increases.).
210 See Lowenstein, supra note 2.
211 See Cummins, supra note 52.
212 It can be argued that Congress did do just that, however, through the increased funding requirements of defined benefit plans and increased premiums to the PBGC passed by the PPA. If the provisions are taken in aggregate, along with accompanying debate comparing the PBGC crisis to the Savings and Loan crisis, it appears that Congress is attempting to shore up plan reserves and PBGC reserves for the inevitable continuing trend of plan bankruptcies. See Part II(A) and Part II(B).
shifts, pension reform debate has instead centered on the allocation of risks involved in saving sufficient resources for retirement. With responsibility divided amongst individuals, corporate employers, and tax-funded government programs, it is not surprising that corporations have not garnered a whole lot of pity. Any real debate has centered on the allocation of risk between corporations and the government. With the present shift towards a defined contribution paradigm combined with a broader emphasis on creating an ownership society (inapposite to the social collectivism sentiment that spawned defined benefit plans), perhaps the time has come to evaluate the question anew.

The corporate tax system (and indeed corporate law generally) is premised upon the separate entity principle, a legal fiction permitting a corporation to enter into contracts, sue and be sued, have taxes levied upon its profits, and pursue its goal of maximizing shareholder profit. To accomplish this goal, management pursues the core business objective of the corporation, whether it is manufacturing, transportation, retail, or services. While concededly the corporation also owes some duty of social responsibility, it plays a very different role in society than the government. The role of government, by contrast, is to meet the needs of its citizens through a social contract, raising capital to do so through the tax system rather than engaging in profitable enterprise. Even when viewing

213 See supra note 208; Senate Record, supra note 12, S8754 (Senator Isakson: “Pensions have come into jeopardy over time because of changes in the workforce, changes in longevity, and the pressures that have been put on the pension system.”).
214 See Zelinsky, supra note 18 at 458-465 (Discussion of the three major types of risk allocated in any retirement plan; investment risk- risk that the assets will earn an inadequate rate of return, funding risk- risk that sufficient funds will not be contributed to the plan, and longevity risk- risk that the retiree’s life expectancy will exceed retirement resources.)
215 See GAO, supra note 8 (“Appropriate balance of responsibility for retirement among employers, government and workers remains unclear.”).
216 See Czarney, supra note 73 (Offering as a potential solution to the mounting PBGC deficit that a mandatory portion of defined benefit plan assets be invested in FDIC insured IRA accounts- thus allocating the investment risk between two government agencies rather than one).
217 See generally Zelinsky, supra note 18.
218 Id.; See Presidential Signing Statement, supra note 19 (“Helping Americans build a society of ownership and financial independence.”). The current philosophy of America is in stark contrast to the New Deal social collectivism popular when defined benefit plans became entrenched in retirement planning. See supra note 52.
219 See Binda Sahni, The Interpretation of the Corporate Personality of Transnational Corporations, 15 WID. L.J. 1, 4 (2005) (citing Salomon v. Salomon & Co., A.C. 22 (H.L.) (Eng.) (1897); See also Dodge v. Ford Motor Co., 204 Mich. 459, 170 N.W. 668 (1919) (Case holding that “a business corporation is organized and carried on primarily for the profit of the stockholders” and that “the powers of the directors are to be employed to that end” “the discretion of directors... does not extend to a change in the end itself, to the reduction of profits, or to the nondistribution of profits among stockholders in order to devote them to other purposes.”)
221 See Jefferson, supra note 33 at 649, 662 (Discussing the possibility of the government creating an insurance program for defined contribution plans to meet the need of individuals to invest retirement
the government as an employer, the widespread acceptance of the
government’s role in serving the needs of its citizens is implicit and
pervasive such that employees, policymakers, and voting taxpayers alike
expect the government to provide more generous retirement benefits than a
private employer.222 Indeed, a typical public employee receives an average
retirement benefit equal to 60% of their salary (or 75% for those without
Social Security coverage) after 30 years of service, compared to an average
benefit of 45% of salary for a similarly situated private pension
beneficiary.223 Furthermore, 80% of public defined benefit plans include
cost-of-living adjustments, a feature unheard of in the private sector.224
Unfortunately, public pensions are also floundering.225 Public pensions are
constitutionally or statutorily protected from any reduction in benefits in 41
states, forcing many localities to either cut services or raise taxes to pay
their pension obligations. 226 Even these measures are not always sufficient,
and municipalities such as San Diego have been faced with bankruptcy due
to stifling pension plans.227 Far from serving their original goals of
offsetting lower wages and rewarding long and loyal service,228 today’s
defined benefit plans are most often provided for higher-wage, stable union
and government jobs. 229 The plans are offered with shorter vesting
requirements and at a substantially higher cost to plan sponsors, who are
also required to internalize the increased longevity risk.

Requiring a corporation to sponsor a defined benefit plan,
especially as regulated by ERISA and amended by the PPA, creates an
inherent tension with the separate entity principle and the corporation’s goal
of profit maximization.230 The obligations imposed by ERISA require

savings more aggressively, and noting that a private plan with an independent profit motive would have
a difficult time competing with a revenue neutral federal program).
222 See Revell, supra note 209. (Discussing how even when faced with a decline in the economy,
policymakers will still vote to increase retirement benefits of government employees and pointing out
that public pensions are constitutionally or legally protected in 41 states). The same argument can
logically be extended to explain why heavily unionized industries also are expected to provide more
generously for their employees as unions were formed explicitly to meet the needs of the employees.
223 Id.
224 Id.
225 See Cummins, supra note 52 at 568-571. (Noting that public pensions may be as much as $700 billion
underfunded.)
226 See Revell, supra note 209.
227 Id. The PPA also contains a provision in § 611 facilitating public pension investments in hedge funds
investment vehicles that typically earn an above average rate of return- to support public pension effort
to maintain financial stability.
228 See Part I(B) discussing the historical development of pensions.
229 See Revell, supra note 209 (noting that public employees frequently make more than their private
counterparts).
230 Note that the tension discussed in this section applies primarily to defined benefit plans that
management feels coerced to provide, or are otherwise unsupportive of the plan. The argument is not be
propounded that no defined benefit plan can work; a defined benefit plan can be well funded and the
employer can voluntarily undertake the risks involved successfully, particularly (and perhaps limited to)
if the company’s mission or corporate structure is one that supports employee needs over profitability.
fiduciary adherence to the exclusive benefit rule,\textsuperscript{231} and the mandatory funding requirements\textsuperscript{232} force the employer to fully absorb and insure participants against all demographic and market risks. Thus management is responsible to successfully fund, invest, and take actions only in the best interests of a pension fund which may be wholly unrelated to its core business. These conflicting duties drive the moral hazard problem that leads to plan underfunding, overextension, and insolvency.\textsuperscript{233} The problem is only exacerbated in times of economic downturn when minimum funding contributions increase to offset any fair market value decline in plan assets (and therefore the gap between the fair value and the funding target of the plan) at the same time that the business is typically struggling with reduced profits and is less capable of meeting its contribution requirements. The rational manager, owing a duty of profit to shareholders, has a choice to reduce benefits or dividends,\textsuperscript{234} and “when [management has] a hard choice between starving the capital base to feed the pension plan, or making capital investments to become more productive, to the extent there is permission that’s what you do.”\textsuperscript{235}

Ironically, the PPA correctly reflects this moral hazard by allowing divestiture of any and all employer stock from defined contribution plan assets,\textsuperscript{236} reflecting a distrust of management’s decisions that directly impact the security of only a fraction of the employee’s retirement assets. At the same time, supporters of defined benefit plans ardently advocate preventing their demise, seeking to entrust the very same management with an employee’s entire retirement security. This classic game of good corp/bad corp cannot reflect consistently reasoned principles. Right or wrong, the market is aware that the burden of retirement security is misplaced when borne by corporations. Corporations that divest of their defined benefit plan are rewarded with a corresponding influx of capital by rising stock prices.\textsuperscript{237}

\textsuperscript{231} See Muir, supra note 80 at 9-10.
\textsuperscript{232} See discussion of funding requirements in Part II(A)(1).
\textsuperscript{233} See Cummins, supra note 52 (drawing a parallel between the potential moral hazard inherent in pensions to the recent corporate governance and accounting scandals); Peterson, supra note 86 (discussion of three major defined benefit plan freezes since the passage of the PPA, all agreeing that the traditional pension is “viewed as costly weights on a company’s competitiveness,” but that increased employer contributions would be made to the defined contribution plans).
\textsuperscript{234} See Part I(C) elaborating on the moral hazard problem created by PBGC insurance and managerial control over interest rate assumptions.
\textsuperscript{235} Interestingly, a similar agency problem may also be created by unions dividing the loyalty of the employees between pursuit of the best interest of the corporation and the best personal interests of the employee, which may actually be detrimental to the overall health of the corporation. For example, the compromise reached between the UAW and Studebaker contributed to the bankruptcy of the company. See discussion in supra note 53.
\textsuperscript{236} Lowenstein, supra note 2 (quoting Delphi CEO Robert S. Miller).
\textsuperscript{237} See Revell, supra note 209.
Most importantly, by placing upon employer’s the longevity and market risks, defined benefit plans violate the matching principle of accrual based accounting. The matching principle requires that expenses be recognized in the same period as the revenues they help to generate. Pure application of the matching principle requires that the entire liability generated for retirement benefits of an employee be spread over the time the employee is working, on a pro rata basis, and be fully accounted for before the retirement date of the employee. Theoretically, if a defined benefit plan functions appropriately the matching principle will not be violated, as contribution amounts are based on the present value of expected retirement benefits. The impact of the market risk or longevity risk spoils this theoretical match. If either the market declines such that the rate of return on investment is lower than the rate used in calculating the present value of liabilities; or the retiree lives beyond his actuarial assumptions, the company incurs an additional expense for retirement benefits of that employee in periods when they are not receiving any benefit from his services. The economic downturn of the recent past coupled with greater longevity among retirees has created this situation for many companies, helping to drive recent bankruptcies and plan terminations.

In contrast, defined contribution plans always conform to the matching principle. Employer contributions to defined contribution plans are fixed as a percentage of either participant salary or matching contributions, or are based on profit-sharing. Contribution amounts are only required of the employer during periods when the participant is an employee of the company (and thus providing a benefit to it). The market and longevity risks do not impact the analysis because the corporation has fulfilled its obligations to fund the plan based on the fixed contribution calculation. Furthermore, if defined contribution investments are self-directed by participant or are placed in a QDIA, the employer is alleviated of any fiduciary responsibility for investment risk. The individual account structure of defined contribution plans allows the corporation to focus on its core business and fiduciary duties owed to shareholders, thus avoiding the problem of dueling loyalties. Finally, a defined contribution plan eliminates any moral hazard problems created by

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239 Id.
240 Tax accounting, however, requires that the employer deduct the expense in the same period as the payment is received by the employee, as deferred compensation. The tax code specifically exempts qualified retirement plans from this requirement. I.R.C. §219(a), codified at 26 U.S.C. §219(a).
241 This discussion assumes funding risk neutrality; that the plan made sufficient contributions in all periods based on the net present value of expected benefits.
242 See Introduction and Part I for further background regarding recent plan terminations.
243 See Part II[E](4) for a definition of QDIA investments.
244 I.R.C. §404(c) (exempting the sponsor from fiduciary responsibility when the plan investments are self-directed and other requirements are met).
PBGC insurance and in negotiations with employees.\textsuperscript{245} When contributions are fixed they are treated as normal wage and salary expenses and must be funded in the current period. Thus there is no temptation to push obligations onto future periods or manipulate assumptions to create lower contribution requirements. When contributions are based on profit-sharing, the employer is only responsible for contributions when they are successful in their core objectives, thus aligning the goals of management and plan participants to increase company profits.\textsuperscript{246}

\textbf{B. Will Employees be Adequately Protected by a Defined Contribution Paradigm?}

The most difficult issue to address in arguing for a shift to a defined contribution paradigm is the reliance interests of older workers. These workers depend on stability of the defined benefit plans in place to provide for their retirement, and they may not have sufficient private savings to offset any expectations shortfall created by a conversion to a defined contribution plan. The PPA contains numerous provisions to ease the transition for this group of workers. The full funding requirements, limitations on benefit increases, and higher PBGC premiums will help shore up existing defined benefit plans, ensuring that substantially all benefits accrued to date will be received. This is achieved through either adequate funding of the plan to meet pension obligations, or by building sufficient PBGC resources to support claims of failed plans.\textsuperscript{247} Most of the provisions, especially those concerning hybrid plans, are designed to allow changes in benefits to occur on a prospective basis only.\textsuperscript{248} The increased transparency provisions will help all workers keep apprised of their retirement benefits earned as well as the stability of their employer’s plan.\textsuperscript{249} More information will facilitate participants’ ability to hold plan sponsors accountable for full funding and to make adjustments to their own personal savings levels if it appears those benefits earned or funded are insufficient to meet their retirement needs. Hybrid plan provisions eliminated the

\textsuperscript{245} See Part I(C) for discussion of moral hazard created by PBGC insurance. Interestingly, the full funding requirements of defined benefit plans will also reduce this risk. The power of the PBGC to involuntarily terminate a plan notwithstanding any collective bargaining agreement (CBA) in place, is very limited if the plan is fully funded. Similarly the sponsor would not be able to use the bankruptcy code to cancel the CBA and voluntarily terminate the plan if it was in good funding standing. See In re UAL Corp, supra note 1 (holding that the PBGC had the authority to involuntarily terminate a plan irrespective of any CBA and can enter into settlement agreements with a corporation without including the union as a party to the transaction).

\textsuperscript{246} Profit-sharing plans are subject to minimum funding requirements to maintain standing as qualified plan. See generally 26 U.S.C. §401.

\textsuperscript{247} See Part II(A) and Part II(B). Subject to PBGC annual benefit limitations for individual participants.

\textsuperscript{248} See sources cited, supra note 139. (Discussing the desire of Congress to give sponsors the freedom to change plans on a prospective basis).

\textsuperscript{249} See Part II(D)
problem of wear-away so that future conversions away from traditional benefit plans will not result in any loss of accrued benefits.\textsuperscript{250} Catch-up contributions to both 401(k) plans and IRA accounts allow workers age 50 or older to contribute substantially more on an annual basis to tax-free retirement savings than younger workers are able to do. These catch-up contribution years correspond to the same years when individuals are usually earning their highest salary amounts and will have greater ability to save additional amounts.\textsuperscript{251} Finally, it is worth noting that the costs of a collapse of either the Social Security system or the PBGC will fall disproportionately on younger workers.\textsuperscript{252} Both systems have enough resources to survive the retirement of today’s current older workers, but will be crippled if changes are not made in the way retirement is approached for the younger generations.\textsuperscript{253}

Defined contribution plans give an employee greater control over his retirement assets, and by extension, his retirement security. Defined contribution and hybrid plans tend to be portable, allowing the employee to retain account assets upon severance of employment as well as upon retirement.\textsuperscript{254} Shifting employment trends have created a highly mobile workforce; today’s typical 25 year-old will work for seven or more employers before reaching age 65.\textsuperscript{255} With this mobility, few members of the younger generation will be eligible to participate in the exemplary defined benefit model which provides a valuable pension after 30 years of service with one employer,\textsuperscript{256} preferring instead defined contribution plans with individual accounts that may be withdrawn and transported. Even those employees who choose not to change jobs frequently should not be required to risk their retirement savings on the probability of their employer remaining profitable throughout their entire career and their entire retirement. The preference for the flexibility of defined contribution plans is exemplified by the small business approach to retirement benefits. Small businesses tend to only offer defined contribution plans, responding to the valid concern of their employees of their long-term solvency and also

\textsuperscript{250} See Part II(C)
\textsuperscript{251} See Zelinsky, supra note 18 at 467 (noting that the most lucrative years of employment are generally at the end of an employee’s career).
\textsuperscript{252} See Report of the President’s Commission, Strengthening Social Security and Creating Personal Wealth for all Americans, December 2001; Zelinsky, supra note 18 at 466.
\textsuperscript{253} Id. Taking the steps to preserve Social Security will also have the added benefit of maintaining a defined benefit portion of retirement savings for all retirees. The balance of responsibility between individuals and the government for retirement security is well beyond the scope of this comment and will be happily kept there.
\textsuperscript{254} Many participants are able to and chose to leave their account balance in their established 401(k) account to benefit from lower costs and greater access to investment advice. See Quinn, supra note 172.
\textsuperscript{256} See Revell, supra note 209; but see Peterson, supra note 86 (Commenting that defined contribution plans are less appealing to “factory workers who expect to stay put and have planned on a predictable income in retirement.”). See also discussion cited, supra note 83.
freeing the company to build its core business during the crucial developmental years when substantially all earnings must be reinvested immediately into the company. The PPA responds to this demographic shift by increasing the portability of retirement assets, allowing more plans to be rolled over without triggering tax consequences, and by lending support to hybrid plans which allow for a lump-sum distribution of accrued benefits upon severance. Defined contribution plans also provide more flexibility and control to participants by allowing pre-separation withdrawals of plan assets in the case of a hardship or under other authorized conditions. Additionally, the lump-sum distributions of defined contribution plans allow participants the choice of investment decisions in retirement. Defined benefit plans only offer an “annuity” option that does not allow the individual access to earned retirement funds in the case of personal hardship or even simply large expenses early in retirement, and does not allow the participant to invest assets in retirement in a manner that best meets their needs, if an annuity option does not do so.

Greater control over retirement assets also insulates employees from any moral hazard problem created by management’s conflicting goals. Matching employer contributions to the period in which the employee’s services are provided benefits the employee by eliminating the coercive power of the employer to threaten bankruptcy in order to extract bargaining concessions from employees in defined benefit plans. Defined contribution plans afford a very valuable opportunity for labor to negotiate with employers for increased employer contributions to the plans. If properly wielded by labor, this bargaining power can equalize the perception, and reality, of the value of defined contribution relative to defined benefit plans. This negotiating ability is arguably more valuable than that offered by defined benefit plans because it eliminates the moral hazard problem in negotiating and funding plans. Any concessions granted by management will be recognized in the employee’s individual accounts

257 See Lowenstein, supra note 2 (Noting that during the 1990’s new companies only offered defined contribution plans as younger workers did not want “pension strings [tying] them to a single employer”). 258 See Part II(E)(1). 259 See Part II(C). 260 See generally I.R.C. §401. 261 See Quinn, supra note 172 (noting that most investment planners recommend against the purchase of an annuity with 401(k) distributions or personal retirement savings as other investments will provide more flexibility coupled with a higher rate of return). It seems that if general investment wisdom is to not pour an individual’s entire retirement savings into an annuity, a defined benefit plan which operates as an annuity might also not be the best investment mechanism for many individuals. 262 See Part III(A). 263 See Cummins, supra note 52 at 584 (Discussing how companies use the threat of bankruptcy to extort concessions from plan beneficiaries). 264 Allowing labor greater negotiating power over employer contribution percentages may warrant a closer look at applicable anti-discrimination and top-heavy funding rules to make sure the provisions do not become counter-productive in actually limiting the ability of workers to negotiate for better benefits.
the same period. This eliminates relying on the goodwill or good decision-making of future managers to meet contractual benefit obligations. The employee is also freed from reliance on the continued solvency of the company for any employer contributions owed in future periods, as all retirement benefits earned are already deposited into their individual account. As the economy continues to trend away from longer life-cycle heavily unionized manufacturing industries towards more technology and service-oriented companies, in an atmosphere of a highly competitive global economy, the odds that any employer will be in existence long enough to bear the investment and longevity risks of a defined benefit plan for today’s 25 year-old employee is very remote.

The PPA helps to insulate participants from moral hazard problems by allowing diversification of account assets out of employer stock, thus reducing the dependency upon the employer’s continued viability or profitability for retirement security. The PPA gives effect to the ability to diversify by requiring that employers notify all employees of their right to divest employer stocks, eliminating any potential advantage management would retain by not providing that advice to participants. Allowing diversification of assets out of employer stock is an implicit recognition that the matching principle is the correct method of determining when an employee should gain control of retirement benefits earned. The shortened vesting requirements of EGTRRA also recognize this truth.

Defined contribution plans give participants control over investing their account assets, allowing any gains to accrue solely to the individual’s benefit. While some participants are already sophisticated investors, most are influenced heavily by the manner in which investment and election information is presented to them, and may under-diversify or be overly conservative in their investments. The PPA cures ERISA’s shortcomings by allowing plan sponsors to provide investment advice to employees, based on objective models, to help maximize those returns earned on account

265 See Zelinsky, supra note 18; see also Peterson, supra note 16 (Noting the burden of defined benefit plans on the competitiveness of corporations, leading many employers to freeze the plans).
266 See House Record, supra note 85, H6160 (Congressman Miller: “There is probably no employer in this country that can tell you that that pension plan will be there for their employees 75 years from now, 65 years from now, and be paying out 80 percent of the benefits. So people have come to realize that they need retirement security.”); GAO, supra note 8; Lowenstein, supra note 2 (Delphi CEO Robert Miller: “A pension plan makes no sense in today’s world. It’s not wise for a company to make financial promises 40 or 50 years down the road.”).
267 See Part II(E)(2).
268 See Part II(D).
269 See Cummins, supra note 52 (arguing for ever increased transparency and accountability in pension plans to prevent managers from Enron-type abuses).
270 See Part II(E)(1).
271 See Zelinsky, supra note 18 at 458.
272 See Muit, supra note 80 at 11-18 (providing insight at how behavioral economics affects decision-making of plan investors, leading to investment decisions based on how information is presented to them creating a divergence from acting as rational self-maximizers); Medill, supra note 53.
assets without sponsors incurring fiduciary liability over investment decisions.  

The PPA’s strongest contribution to protect employees’ retirement security in the shift to a defined contribution paradigm is the now universal availability of automatic enrollment in defined contribution plans. The automatic enrollment feature will help to cure the “reluctant investor” problem of persons who “are simply not interested or willing to make choices on their own” by “[taking] advantage of investor inertia.”  The absolute number of defined contribution plans has risen substantially in the past twenty years, much more than the commensurate decline in defined benefit plans available. The limited percentage of employees covered by defined contribution plans can be largely attributed to a lack in participation in defined contribution plans rather than the unavailability of those plans to employees. Thus automatic enrollment works as a form of soft paternalism to guide individuals to make choices that will benefit them. The role is not unlike Social Security in automatically deducting amounts for retirement, but has the advantage that the employee may still choose to opt out of the plan and will personally benefit from any investment gains, thus maximizing individual autonomy. Automatically enrolled participants benefit from guaranteed matching employer contributions and a very short two-year cliff vesting period for those employer contributions. Also in line with the soft paternalism quality of the feature, and responding to the concerns raised by behavioral economists that even availability of investment advice will be insufficient to overcome the tendency of many

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273 See Part II(E)(3). This provision helps to solve the investment education/advice dichotomy described in Part II(C).
274 See Part II(E)(4).
275 Chris Silva, Working with Inertia: The Recent Pension Bill Gives a Big Boost to Automatic Enrollment, SMB Finance Vol.1 No.4, 8, October 2006 (Quotation attributed to Christopher Jones, Chief Investment Officer for Financial Engines).
276 See Silva, supra note 275 (quotation attributed to Charlie Vieth, President of T.Rowe Price Retirement Plan Services); James J. Choi et al., For Better or for Worse: Default Effects and 401(k) Savings Behavior (Nat’l Bureau of Econ. Research, Working Paper No. 8651, 2001) (“Under automatic enrollment, 65-87% of new plan participants save at the default contribution rate and invest exclusively in the default fund.”).
277 Employment Benefits Research Institute, EBRI Databook on Employee Benefits Chapter 10: Aggregate Trends in Defined Benefit and Defined Contribution Retirement Plan Sponsorship, Participation, and Vesting, Table 10.1a Retirement Plan Participation (Updated December 2005) Available at www.ebri.org. (showing that while defined benefit plan participation has declined from 80% in 1985 to only 33% in 2003, defined contribution participation has only risen from 41% to 51% participation during the corresponding period). This result can be largely attributed to a lack in participation in defined contribution plans rather than the unavailability of those plans to employees as the absolute number of defined contribution plans has risen substantially in that time and much more than the commensurate decline in defined benefit plans available. Id. at Chart 10.1 Comparison of the Net Change in the Number of Primary Defined Benefit and Defined Contribution Plans, 1985-1998.
278 Id.
279 See Part II(E)(4).
participants to make poor investment decisions, the automatic enrollment plan is reliant upon establishing default investments for employee and employer contributions. These default investments, or QDIA’s, must consider either the participant’s age or the demographics of the plan participants as a whole in choosing among investments to maximize long-term returns for participants.

C. How Will Corporate Behavior Change in Light of the PPA’s Endorsement of the Defined Contribution Paradigm?

The beneficial treatment of retirement plans by both the corporate and individual tax systems will ensure their continued viability as a tax-preferred method of delivering employee benefits. Employer contributions to qualified retirement plans, defined benefit and defined contribution alike, are deductible from corporate income taxes and exempt from payroll taxation. Because employees also do not pay tax on their contributions when they are made, receiving a deferral on taxation of employer and employee contributions until plan assets are withdrawn in retirement, employees are not only receptive to collecting a portion of their total salary through retirement plans but are desirous of doing so.

Americans are more concerned with retirement than any other form of savings. Employers respond to the concerns and needs of their workforce when configuring their benefit plans and accordingly employer outlays on retirement benefits have consistently remained approximately 50% of the total benefits package, a number that has remained constant.

280 See Zelinsky, supra note 18 at 459 (referring to “substantial consensus” that most employees are poor investors regardless of how much is spent to educate and advise them); Jonathan Clements, A Victory for the Economists Who Want Investors to Change Their Behavior, W.S.J., September 27, 2006, at D1 (“And those who do participate [in 401(k) plans] often end up with undiversified portfolios, stashing too much money in company stock or leaving everything in a money-market fund.”); Medill, supra note 22 at 15-21 (discussing the ways in which behavioral economics distorts investment decision-making and citing the Bernheim study findings that up to 75% of employees are generally confident in investment information provided by their employer and will rely on it, rarely seeking investment guidance and instead relying on their own judgment or the advice of friends and family); see also Olivia S. Mitchell & Stephen P. Utkus, Lessons from Behavioral Finance for Retirement Plan Design, in Pension Design and Structure 3, (Olivia S. Mitchell & Stephen P. Utkus eds., 2004). See Part III(B).

281 See Part II(E)(4); See Proposed Rules, supra note 181 (rules designed to relieve fiduciary liability to employers in creating default investments that meet the long-term retirement needs of the participant as opposed to the low-risk, typically money-market, investments that had been made with the goal of capital preservation rather than income growth so as to insulate the employer from fiduciary liability for investment performance).


283 See Zelinsky, supra note 18. (discussion of how the label “tax expenditure” is inappropriate for contributions to individual accounts as taxation is simply deferred and the proper timing for taxation of the amounts is subject to reasonable debate). Penalty provisions do apply, however, to early withdrawal from defined contribution plans except for in limited approved circumstances. See I.R.C. §401.

284 Id. at 25.

285 See Muir, supra note 80.
despite the dramatic rise in medical insurance rates. This commitment level demonstrates that corporations have determined retirement benefits are an essential component of their benefits package necessary to stay competitive in the labor market and retain the good will of their employees. A further decline in the popularity of defined benefits should not affect this equation, as indeed the marked decline in the number of defined benefit plans offered has been offset by a more than commensurate increase in the number of defined contribution plans offered. Employers and academics both observe that spending on defined contribution plans rise as defined benefit spending falls. The increase in the number of defined contribution plans offered and rising employer contributions to those plans confirm that retirement benefits are not in danger of elimination, and in fact may become more critical once employees focus negotiations on higher employer contributions.

The purchase of good will in a defined contribution system, however, is far less costly to the employer as it comes without the burdens of fiduciary responsibility over plan management, and without investment and longevity risks. The automatic enrollment provision of the PPA will likely result in the participation of many more individuals in defined contribution plans as fiduciary responsibility over the investment performance of default investments has been eliminated with QDIA compliance and should no longer be a concern to employers. Similarly, more investment advice should be provided to plan participants because the PPA enables interested parties, namely the investment companies servicing the plans, to provide objective investment advice without incurring fiduciary responsibility over investments chosen. Providing investment advice to participants responds to the needs of employees in a tax-preferred manner, making it a good benefit for employers to offer. Subcontracting all investment services, including investment advice and default investment management, to third party investment managers such as Fidelity or Vanguard preserves many of the efficiency and economies of scale gains the

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287 See EBRI data cited, supra note 277 at Chart 10.1 Comparison of the Net Change in the Number of Primary Defined Benefit and Defined Contribution Plans, 1985-1998.  
288 See Peterson, supra note 16 (Noting that companies that drop or freeze their defined benefit plans typically contribute more money to their defined contribution plans.). Employment Benefits Research Institute, *EBRI Databook on Employee Benefits Chapter 3: Employer Costs for Employee Compensation*, Table 3.2 Compensation Costs (Updated April 2005) Available at www.ebri.org.  
289 See Part II(E)(4).  
290 See Part II(E)(3).  
291 See Economic Growth and Tax Relief Reconciliation Act §665 (codified as I.R.C. §132(a)(7) and §132(m) (defining, in conjunction with §125(f), benefits that may be provided under a cafeteria plan); 26 C.F.R. §1.125-2T Q&A-1 (1986)(listing specifically benefits that may be provided under a cafeteria plan), both cited in Muir, supra note 59 at 24 & n.62.
corporation can receive in the form or lower transaction and servicing fees. These savings aid defined contributions participants in the same manner defined benefit advocates cite as supporting allocation of investment risk to employers. This allocation also increases the overall benefit to society by allowing the individual (the most vested participant in the total retirement assets acquired) to make retirement decisions in an efficient manner and allow the corporation to focus on their comparative advantage of creating profits and jobs to grow the economy.

The PPA increased the maximum allowable tax-deductible employer contributions to defined benefit plans by over 50%. Furthermore, funding of any expected benefit increases or projected salary hikes is also fully deductible. This distinction is critical for negotiations with employers for better benefits. The employer can, during profitable years, promise greater benefits and pay for the increases in full without losing any tax benefit from doing so. The impact of the provision is bolstered by the exemption of PBGC-insured defined benefit plan contribution amounts from the relevant deduction combination limitations that would otherwise apply if an employer operates both a defined benefit and defined contribution plan. The increased deduction creates a substantial incentive for corporations to contribute more to these plans as a great place to invest extraordinary gains, or even unexpected profit, on a tax-sheltered basis. The IRS has taken a hard-line approach to tax shelters in recent years, aggressively pursuing claims against all but purely legitimate tax shelters, established by code provisions. For a large defined benefit plan like GM’s, the allowable additional contribution amount would be around $3.5 billion, on an annual basis. Because this deduction applies only to defined benefit plans, this creates an incentive not only for those plans to be tremendously shored up, but also for sponsors to maintain these plans going forward to preserve the deduction.

The specific and explicit approval of hybrid plans by Congress should send a message to both the judicial system and the IRS that the plans are not only legal, but encouraged. The PPA provision authorizing

292 See Part III(B) for a more detailed discussion of economies of scale gained by corporations.
293 Id.; See Quinn discussion, supra note 254.
294 See Part II(A)(4).
295 See Part II(A)(4).
296 See Part II(A)(4).
297 Don Korb, Tax Shelters, lecture delivered at UCLA School of Law, October 23, 2006. (Chief Counsel of IRS discussing the IRS objective to severely curtail the use of corporate tax shelters).
298 General Motors Corporation and Subsidiaries Notes to Consolidated Financial Statements, General Motors Corp, 10-k, March 28, 2006, available at http://www.gm.com (U.S. Pension Plan benefits paid in 2005 were $6.7 billion. The allowable deduction would be considerably higher if the plan had a large funding shortfall as total plan obligations as of 12/31/05 were $89 billion).
299 See sources cited, supra note 139. The IRS for its part, has received the message and is now beginning to again issue determination letters for cash balance plans. See Linda S. Marshall, IRS
lump-sum distribution of the hypothetical account balance of a participant upon severance produces a substantially similar net effect by a cash balance plan as offered by defined contribution plans.\textsuperscript{300} This result is especially accurate as applied to the significant percentage of employees who will change jobs before retirement. But as cash balance plans are actually defined benefit plans, employers will be allowed the huge deduction preference. The combined effect of the provisions will probably be the conversion of a large number of traditional defined benefit plans to hybrid plans rather than simply freezing them, an analysis which will depend on the tax incentives of the company as well as the demographic make-up of its employees, but will benefit the vast majority of participants.\textsuperscript{301} DB/k plans\textsuperscript{302} have the potential to become popular for the same reason.

\section*{PART V: PRESCRIPTIONS FOR THE FUTURE}

The Pension Protection Act of 2006 takes many steps to ease the transition from a defined benefit to a defined contribution paradigm. While the shift represents a more efficient distribution of responsibility between corporation and employee, Congress must be mindful of protecting individuals and meeting the very diverse needs of retirees. The following suggestions would continue the trajectory facilitated by the passage of the automatic enrollment provision in creating a more protective system for employees.

The mandatory minimum employer contribution limits and two year cliff vesting of employer contributions required with participation in an automatic enrollment plan\textsuperscript{303} should be extended to cover all defined contribution plans. If retirement benefits are indeed part of a benefits package offered to employees, they are implicitly included in wage and salary calculations. As part of the total salary package offered, the employee should be fully entitled to the benefit of any employer contributions attributable to the period in which the employer benefited from the employee’s services. Employer contributions under this system


\textsuperscript{300} Cash balance distributions no longer are required to apply complicated calculations to project benefits forward to the projected retirement date of the employee, then discount the projection back to the present value. See CRS, supra note 140.

\textsuperscript{301} The conversion to a hybrid plans will also benefit participants in making plan termination by the PBGC under §1367 agreements with employers less likely. These agreements often include “no follow-on” provisions to prevent PBGC abuse by disallowing the company to establish a substantially similar retirement plan for a period of years after the plan termination. Conversion to a hybrid plan preserves the plan and allows participants to continue accruing benefits. See In re UAL Corp., \textit{supra} note 1.

\textsuperscript{302} See Part II(C) for description of DB/k plans.

\textsuperscript{303} See Part II(E)(4).
would fully comply with the matching principle. Any incentives the
employer wishes to create to either reduce turnover or motivate the
employee to work towards the success of the corporation can be created by
an additional profit-sharing contribution rather than through a threat to
earned benefits. Thus the employer contribution amount would be divided
between a mandatory contribution based on a percentage of salary or
matching contribution, and an additional, voluntary profit-sharing
contribution not subject to the heightened vesting requirements. This
change reflects a fair trade-off for the reduction in fiduciary responsibility
the corporation gains by adopting a self-directed defined contribution plan.
The automatic enrollment provision is a good test experiment to monitor the
impact of shorter vesting and minimum matching contributions. The
requirements should be evaluated against any negative impact they may
have on participation levels among plan sponsors before extending the
requirements to all plans.

The default investment funds (QDIAs) established for the automatic
enrollment feature should be extended and offered as an election option for
self-directing participants. The QDIAs are subject to multiple criteria which
protect employees and maximize long-term returns on investment.304 These
same rigorous criteria, tailored to the age of the participant, would benefit
all participants, not solely those automatically enrolled in the program. The
extension of the default investment option should not result in significant
costs to the employer, as the default investments will already have been
selected. Each defined contribution plan must contain a default investment
selection even if it does not participate in automatic enrollment, to cover
those situations in which election options are changed, as when an
investment option is eliminated, and participants have not yet directed
another option.305 Offering the default investment as an election would
benefit those employees who are already enrolled in the plan and would like
to retain control of their contribution percentage, but may be risk averse
toward investment decisions, may recognize their own investment
knowledge limitations, or may simply prefer to have a professional make
investment decisions for them.306 This change can be implemented by
simply changing the first condition for relief from fiduciary obligations, as
stated in the Proposed Rules, to apply if the participant “had the opportunity
to direct the investment of assets in his or her account but did not direct the
assets”307 to include “or elected the default investment.” The change

304 See Proposed Rules, supra note 181.
305 Id.
306 See Mary Rowland, Taking the Power of the 401(k), and Handing it to Someone Else, N.Y. Times,
June 18, 1995, at F5 (stating that many plan participants have turned over their retirement investing to
outside stockbrokers, recognizing their own investment inadequacies) cited in Jefferson, supra note 33 at
628 & n.86.
307 See Proposed Rules, supra note 181.
acknowledges the concerns of behavioral economists that even supporting additional investment advice may not necessarily lead to sufficient retirement savings.\textsuperscript{308}

Unrelated to the automatic enrollment provision, the PPA enacted a minor provision relating to annuity distributions. The provision exempts annuities from meeting the “safest annuity available” requirement normally imposed on plan fiduciaries when the annuities are offered as an alternative distribution option from a defined contribution plan, rather than the traditional lump-sum payment.\textsuperscript{309} This provision should be expanded to require all defined contribution plans to offer an annuity distribution. While annuities do not meet the retirement return and risk needs of every participant,\textsuperscript{310} they provides a steady stream of income that simulates the security of a defined benefit system for participants that want to insulate themselves from any further market or longevity risk.\textsuperscript{311} Offering an annuity distribution option would protect those employees that are not sophisticated investors and may not otherwise know that annuities are available or who would not know how to purchase one. Furthermore, monthly payout amounts average 4% higher for annuities purchased wholesale, through corporations,\textsuperscript{312} than those purchased by individual investors, effectively capturing the efficiency gains garnered by large corporate purchases and passing it to their employees.\textsuperscript{313}

Finally, measures should be taken to encourage individuals to maximize their annual contributions to a defined contribution plans. Two suggestions have been posited which, if allowed, could easily substantially impact total defined contribution savings. The first, suggested by economists Richard Thaler of the University of Chicago and Shlomo Benartzi of UCLA is premised upon the theory of investor inertia that drove the automatic enrollment feature. Under their Save More Tomorrow (SMarT) plan, employees can chose to fund increases in future contribution amounts through pay increases they receive, thus leaving their take-home pay unaffected while contributing more to their plan.\textsuperscript{314}

The second, suggested by the National Association of Government Defined Contribution Administrators (NAGDCA), allows a participant to rollover unused flexible account dollars (such as those allocated to

\textsuperscript{308} See Zelinsky, supra note 18 at 459.
\textsuperscript{309} PPA § 625; See Interpretive Sources, supra note 93.
\textsuperscript{310} See Quinn, supra note 172 (“Most of the planners NEWSWEEK spoke with say they avoid annuities—especially costly bonus annuities.”).
\textsuperscript{311} See Zelinsky, supra note 18 at 460, 462.
\textsuperscript{312} Jane Bryant Quinn, Retirement: Cracking Open the Nest Egg, Newsweek, September 11, 2006.
\textsuperscript{313} See Jefferson, supra note 33 at 636-638.
Dependent Care or Health Care Accounts) to their defined contribution plans.\textsuperscript{315} Although the suggestion was originally limited in application to government employees, and capped at a maximum rollover amount of $500,\textsuperscript{316} the proposal would be equally beneficial to private employees; even more so without the artificial limits on dollar amount. Allowing the rollover would not hinder the purposes of either the defined contribution or flexible accounts as the contribution limit of neither would be exceeded and both are endorsed as vehicles for pre-tax investments. Furthermore, the current “use it or lose it” model of flexible spending accounts discourages a habit of maximizing savings by individuals.

CONCLUSION

Defined benefit plans were a lynchpin development in stabilizing the workforce during the New Deal as a necessary response to economic securities and labor regulations of that time. Stability for the competitive environment and changing demographics of the 21st century workforce requires shifting to a defined contribution paradigm. The PPA has been wrongly characterized as the 21st Century savior to traditional pension plans; it fails to meet this responsibility. It should fail to do so. The projected deficits of the both Social Security and the PBGC, combined with a market demand for defined contribution plans as a prerequisite to competitiveness in a global economy,\textsuperscript{317} illustrate that defined benefit plans are not economically feasible. Stepping back to consider that defined benefit plans also violate the matching principle of accrual based accounting, and create a moral hazard for employers, leads one to question if defined benefit plans were ever a feasible allocation of risk.

The Pension Protection Act of 2006 takes crucial first steps designed to ease the necessary transition to a defined contribution paradigm. The PPA requires employers to honor the promises already made to employees, while allowing them to adapt to the new system on a prospective basis. Thus reliance interests of older workers dependent upon the established defined benefit system are protected, as the name of the Act suggests, without clinging to a system that will undermine the retirement security of younger generations. It is important to realize, however, that the PPA needs to be built upon. The transition to a defined contribution paradigm is by no means complete or without consequences, and additional protections must be implemented to create a defined contribution system that responds to the real needs of all employees.

\textsuperscript{316} Id.
\textsuperscript{317} See Peterson comments, supra note 265.