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Private Pension Protections since ERISA: The Expanded Role of the Individual

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Designed to provide security and equity to defined benefit (DB) pension plans, the Employee Retirement Income Security Act (ERISA) became law in 1974. Since that time, the economy has shifted to a more globalized, non-unionized, service-based environment, where defined contribution (DC) plans replaced DB plans as the dominant type of private pension plan. Today workers and retirees bear the burden of managing their pension plans and the associated risks. To protect Americans against the financial risks they face in retirement and ensure greater economic security in old age, targeted financial education, research, and fundamental pension policy reform are required.

Key words: pensions, ERISA, retirement income, individual responsibility, financial education

Primary government programs, namely Social Security and Medicare, face significant shortfalls. Social Security, for example, faces a long-term financial imbalance (Munnell, 2011). Fewer workers will finance the retirement of the growing baby boom generation, yielding a system of benefits and current tax rates that are not sustainable in the future. Medicare, too, is at risk of not sustaining the current level of health insurance it provides adults. Between 1996 and 2005 out-of-pocket medical expenses increased by 39.4 percent (Paez, Zhao, & Hwang, 2009), a trend that is likely to continue. As a result, the role of private pensions is heightened, requiring private pensions to contribute larger amounts to retirement income. Nevertheless, the private pension landscape has shifted in ways that may

result in lower private pension wealth for retirees (Kapinos, 2009).

Private pensions have experienced profound change over the past forty years. Firms have shifted from the provision of defined benefit (DB) plans, where the employer bore the economic and demographic risk (Scahill, 1999), to defined contribution (DC) plans. Although the American welfare state is premised on a mix of private, tax-subsidized benefits, that pattern is being undermined as firms shift to providing 401(k) plans and reduce the benefits they provide employees (Peters, 2005). The transition from DB to DC plans has placed a premium on participants' decision-making competencies (Clark & Strauss, 2008). Today individuals must take more fiscal responsibility for their pension plans and retirement income, yet many are not equipped with the knowledge to manage this responsibility. This lack of knowledge can have a profound effect on retirement income and public and private policies, as they relate to administering private pension income to America's older adults. The erosion of employee pension benefits will have far-reaching effects, potentially decreasing retirement income and increasing poverty levels in old age.

Historical Development of Private Pensions

The Social Security Act and its Amendments were precursors to the large-scale development of private pension plans and prompted the growth of private pensions in the United States. Between 1940 and 1945 the number of pension plans grew dramatically. In 1940, 1,530 private pensions existed; this grew to a total of 6,700 in 1945, covering 6.5 million employees (Ippolito, 1997). This positive growth was due to changes in tax policy, the stabilization of wages during World War II and the Korean War, and actions of the War Labor Board (WLB) (Ippolito, 1997).

To finance World War II, Congress increased the top corporate and individual tax rates; six percent of the nation paid tax in 1939, which increased to nearly seventy-five percent by 1945 (Sass, 1997). As a result, tax sheltering became an important concern to the more highly compensated employees (Koff & Park, 1999). Additionally, the Revenue Act of 1942 regulated

tax incentives by tightening requirements for the qualification of pension plans and improving the tax advantage for qualified plans, which included no capitations on pensions paid by tax-exempt trusts, no vesting requirements, and the regulation of pension costing and funding (Sass, 1997).

The war experience demonstrated the usefulness of the pension as a compensatory instrument (Sass, 1997), where the deferred nature of the compensation would enhance employee loyalty to the company. As tax rates decreased and wage flexibility returned after 1945, the private pension emerged in the post-war era as a widely recognized management tool (Sass, 1997).

Labor, too, played a significant role in the development of pensions. Although organized labor's main interest in private pensions did not begin until after World War II, two main forces were instrumental in its development (Hacker, 2002). Unions, namely The United Auto Workers (UAW), put private pensions and welfare benefits at the center of their bargaining drives. These organizations embraced fringe benefits, specifically private pensions, in their negotiations with employers because they saw them as effective tools in their battle for benefits (Hacker, 2002). Second, the Federal government pushed pensions onto the bargaining table as a means to resist demands to increase public social insurance (Ippolito, 1997). In support of labor's efforts, in 1949 the Supreme Court approved a National Labor Relations Board ruling that pensions were a legitimate issue to use in collective bargaining (Hudson, 2005).

From 1950 to 1960 the largest employers, namely manufacturers, dominated the pension plan expansion. Over this same period the number of plans increased dramatically, as did the proportion of workers covered, which grew from 12 percent to 33 percent between 1940 and 1960 (Sass, 1997). Yet, during the 1950s, complaints surfaced about losses of employee pension benefits. For those who retired early, the requirements of age and service were barriers to their receipt of pension benefits (Hudson, 2005).

Growing evidence of fraud, embezzlement, and the mismanagement of investment pension funds exacerbated these problems, and Congress responded by enacting the Federal Welfare and Pension Plans Disclosure Act of 1958 (PL 85-836),

which was significantly amended in 1962 (McGill, Brown, Haley, Schieber, & Warshawsky, 2010). A weak component of the legislation was that plan participants had prime responsibility for monitoring pension plan activity. The individual plan participants were expected to spot fraud and criminal activity and the legislation provided them with a way to seek relief from the wrongdoing (McGill et al., 2010). This was a risk for participants because few were knowledgeable of pension plan activity and, for the most part, they had neither the time nor interest in this responsibility. Additionally, there were a number of gaps in corporate pension plans, such as the ability of a corporation to default on its obligations (Sass, 1997). These gaps alerted policymakers to the need for a new approach to retirement security. Although there were several attempts to regulate and oversee aspects of the private pension system prior to 1974, none were as comprehensive as ERISA.

ERISA

While the number of workers covered by private pensions increased through the 1960s and the burden of detecting fraud and criminal activity shifted from the plan participant to the Departments of Labor and Justice, individual participants had inadequate protections (Hacker, 2002). The most prominent issues that fostered the design of ERISA were defaults, namely that of the Studebaker Company, and abuses that became public as a result of the Studebaker collapse (Wooten, 2001, 2004).

The Studebaker-Packard Corporation (Studebaker) collapse, a prime focusing event (Wooten, 2001), created the impetus for moving private pension legislation forward. At the time, Studebaker was a large automotive manufacturing company in Indiana. Known as a model welfare capitalist firm, it had a negotiated contract signed by the UAW Union (Klein, 2003). Although the UAW union was a champion of conservative funding and investing, the Studebaker pension plan did not have the assets required to redeem all the benefits that were promised (Sass, 1997). The pension plan was millions of dollars short and 7,000 workers received little or nothing from the company (Klein, 2003). Moreover, there was rigorous

competition from Ford, General Motors, and Chrysler Corporation, the Big Three automakers, at the time. As a result, Studebaker closed its South Bend, Indiana plant on November 1, 1964 and terminated its labor contract one month later (Sass, 1997).

Based on the fall of Studebaker in 1964, a number of abuses in pension plan structure became public and prompted future legislation. Unreasonably high vesting thresholds prevented long-time workers from qualifying for benefits (Wooten, 2004). Also, pension rules defined "unbroken" service in narrow terms. For example, if a worker was re-assigned to a job with a different classification, this was considered a break in service and adversely affected the worker's pension benefit. Additionally, courts upheld practices of employers by reserving their rights to modify, decrease, or deny benefits or eliminate pensions at will (Sass, 1997). Employers avoided a number of liabilities by asserting in plan documents that workers were claiming benefits against the plan, and not against the assets of the corporation (Klein, 2003). Due to these abuses, the Studebaker shutdown became a catalyst for reform and prompted future legislation (Wooten, 2001).

Congress passed the Employee Retirement Income Security Act (ERISA) to eliminate abuses through greater federal regulation and guarantees (Klein, 2003). Additionally, the UAW pension specialists devised a remedy that became a precursor to Title IV of ERISA, the termination insurance program (Wooten, 2001). The remedy moved default risk (risk that a pension plan will terminate without enough funds to meet its obligations) (Wooten, 2001) and termination insurance onto the legislative agenda and stimulated the enactment of private pension legislation, ERISA. This effort took ten years to come to fruition.

The ERISA legislation originated as a Presidential initiative under Kennedy in 1963. Although Johnson pursued the drafting of the ERISA legislation, the labor movement and leading business groups were hostile to it, so the process came to an abrupt halt (Hacker, 2002). Nixon's administration countered the reform agenda, but with his resignation legislators were eager to prove to the American people that the political process was not broken. As a result, ERISA legislation was processed

expeditiously. It passed in the House on August 20, 1974, in the Senate on August 22, 1974 and was signed by the newly installed president, Gerald R. Ford, on Labor Day, September 2, 1974 (Sass, 1997).

Although its creation was a lengthy process, ERISA was designed to redress regulatory shortcomings that deprived employees of old-age retirement income security (Ledolter & Power, 1984). Among its many provisions and amendments, ERISA's over-riding purpose remains the provision of security and equity to the retirement income of private-sector employees (Altman & Marmor, 1988). As the first comprehensive legislation regulating many aspects of private pensions and savings plans, ERISA was the product of four congressional committees: the House Ways and Means Committee, the House Labor Committee, the Senate Labor Committee, and the Senate Finance Committee, which are members of the Departments of Labor and the Treasury (Scahill, 1999). ERISA's objectives were:

- to ensure that workers and beneficiaries receive adequate information about their employee benefit plans;
- to set standards of conduct for those managing employee benefit plans and plan funds;
- to determine that adequate funds are set aside to pay promised pension benefits;
- to ensure that workers receive pension benefits after they have satisfied certain minimum requirements; and
- to safeguard pension benefits for workers whose pension plans are terminated. (Coleman, 1989, p. 3)

The successes of ERISA are noteworthy; benefit security and fiduciary responsibility have improved, as has funding for poorly managed funds (Scahill, 1999). As a result, between 1975 and 2005 there was a significant increase in total number of pension plans, number of participants, as well as in the financial assets of private pension funds. More retirees and employees are participating in pension plans than ever before. Through the ERISA legislation, employers are required to adhere to guidelines that did not exist prior to 1974.

Pension Eligibility, Participation, and the Termination of Plans

For pension plans to operate fairly and effectively, ERISA requires certain criteria to be met. For example, to participate in a private pension plan, an employee must be eligible. The term 'eligibility' refers to the conditions an employee must meet before being covered by a pension plan; these conditions generally involve attaining a minimum age and completing a minimum period of service with an employer (Coleman, 1989). ERISA does not set these minimums; it only requires that these criteria are set in advance, are clearly communicated to participants, and are not arbitrarily changed by the employer (Sass, 1997).

Pension contributions begin to accrue as soon as an employee satisfies eligibility requirements and becomes a participant in a pension plan. Yet, no legal right to receive any benefits from those contributions exists until an employee becomes vested (Coleman, 1989). Vesting periods are waiting periods before rights to benefits can be exercised (Crystal & Shea, 2003). These periods are established by employers and can range from five to fifteen years. Once vested, an employee "owns" the right to receive a retirement benefit from that plan when retired; in most cases, this right is maintained even if they leave that employer (Coleman, 1989). If an employee leaves a company before vesting, they forfeit any right to a benefit upon retirement.

Benefits accrue differently in defined benefit (DB) and defined contribution (DC) plans. In DB plans, once an employee is a participant, the employee begins to accrue a specific amount of money each year toward a monthly retirement benefit (Coleman, 1989), which is invested by the employer. The amount accrued each year is based on a formula applied to salary and years of service. The employee gains a legal right to the accruals, when vested, but does not actually receive the benefit until the agreed-upon retirement period time is reached. In a DC plan, the participant's accrued benefit is the balance in an individual's account and is invested and managed by the participant.

In 1974, at the time of the implementation of ERISA, three Federal agencies were made responsible for its

administration: the Pension Benefit Guaranty Corporation (PBGC), the Department of the Treasury, including the Internal Revenue Service (IRS), and the Department of Labor's Employee Benefits Security Administration (EBSA). While the latter two are responsible for DB and DC benefit plans, including 401(k) plans, the PBGC guarantees benefits of DB plans only. The PBGC was designed to reduce the risk of pension forfeiture by mandating that all firms participate in a common insurance pool (Hacker, 2002). This governmental underwriting of private pension risk marked a novel departure for the federal government in the pension field (Hacker, 2002).

The PBGC is a tax-exempt, self-financed, independent corporation, whose income comes from premiums paid by private pension plans that are subject to termination insurance (Coleman, 1989). It provides plan termination insurance ensuring employees are paid at least part of their benefits upon termination of a plan. Additionally, it is liable for the payment of all guaranteed or insured benefits in single-employer benefit plans. The PBGC also provides loans to financially troubled multi-employer pension plans (Coleman, 1989). The PBGC receives no funds from general tax revenue, and its obligations are not backed by the credit of the U.S. government (Sass, 1997). Its operations are funded by the insurance premiums, assets from pension plans trusteeed to PBGC, investment income, and recoveries from companies responsible for trusteeed plans (Sass, 1997).

Today the PBGC insures the pensions of 44 million workers in more than 27,000 private sector DB pension plans (U. S. Government Accountability Office, 2011a). Yet, during the past decade, the PBGC has come under pressure. There has been an unprecedented number of pension plan terminations with substantial levels of underfunding. A number of insolvent pensions, predominantly in the airline industry, were turned over to the PBGC in the early 2000s, which assumed the pensions' liabilities. In 2004 the PBGC posted its largest shortfall in the agency's 30-year history. Losses from completed and probable pension plan terminations totaled \$14.7 billion for the year (U. S. Government Accountability Office, 2011a). At the end of fiscal year 2010, the PBGC's net accumulated financial deficit was \$23 billion (U. S. Government Accountability Office,

2011a). As a result, the Government Accountability Office (GAO) placed the PBGC's single-employer program on its list of 'high risk' government programs in need of immediate attention in July, 2003 and added the multiemployer program to the list in January, 2009 (U. S. Government Accountability Office, 2011a). Today each program faces increased risk due to the steep downturn in the financial markets (U. S. Government Accountability Office, 2011a).

Operation of Private Pension Plans

In 2004, 51 percent of all workers in the United States between the ages of 21 and 64 participated in an employer-sponsored private pension plan (Munnell & Perun, 2006). In addition to an employee's level of income, participation in employer-sponsored plans depends on the size of the employer, employment status (e.g., full-time or part-time), age, union status, tenure, and industry. Until recently, employers offered retirement benefits because of Federal income tax advantages, the anticipated reduction in employee turnover, and as a retirement incentive for older employees (Ippolito, 1997), creating powerful financial incentives that influence individual work and retirement decisions of employees and employers.

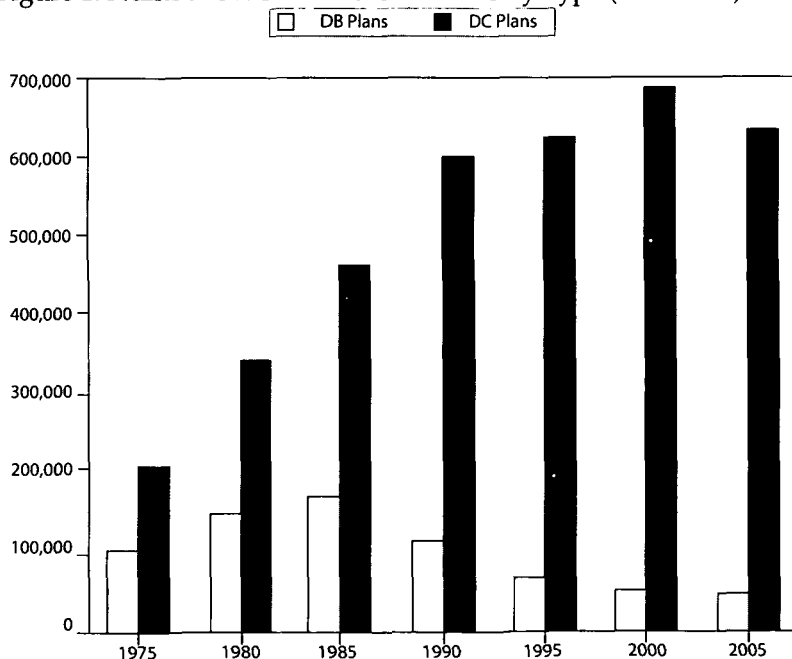
As a form of deferred income, private pensions are administered as DB and DC plans. The employer, who makes pre-tax contributions into a pension fund for all participants, funds the DB plan. Participants typically do not make contributions. Plan contributions are held in a trust on behalf of all participants, where contributions are subject to federal funding rules and regulations. In this type of pension plan, the employer owns the assets in the fund, directs the investments, and bears the risk (Gale, Papke, & VanDerhei, 2005). A DB plan provides income that commences after an employee retires; this is considered a guaranteed annuity.

As long as the employer's financial health is strong, the fulfillment of retirement income is probable through a DB plan. However, when businesses encounter financial difficulty, the promise is at-risk. Since this risk jeopardizes retiree's incomes, employers are required to pre-fund DB pension plans. Through the ERISA legislation, the PBGC guarantees the benefits within

limits and charges insurance premiums to the plans, which are intended to cover the agency's expected costs (Gale et al., 2005).

In contrast to a DB plan, a DC plan provides an employee with an individual account in which the benefit provided consists of contributions made by the employee and the employer, and includes any investment earnings gained. The employer's contributions are based on a pre-determined formula; most often the employee and the employer contributions are placed in an individual account on behalf of the participant. It is then the responsibility of the participant to manage the investment, and as a result, the employee bears the risk of the fluctuating asset values (Gale et al., 2005). A DC plan is not subject to the termination insurance program (PBGC), hence the individual bears the risk of the plan.

Figure 1. Number of Private Pension Plans by Type (1975-2005)

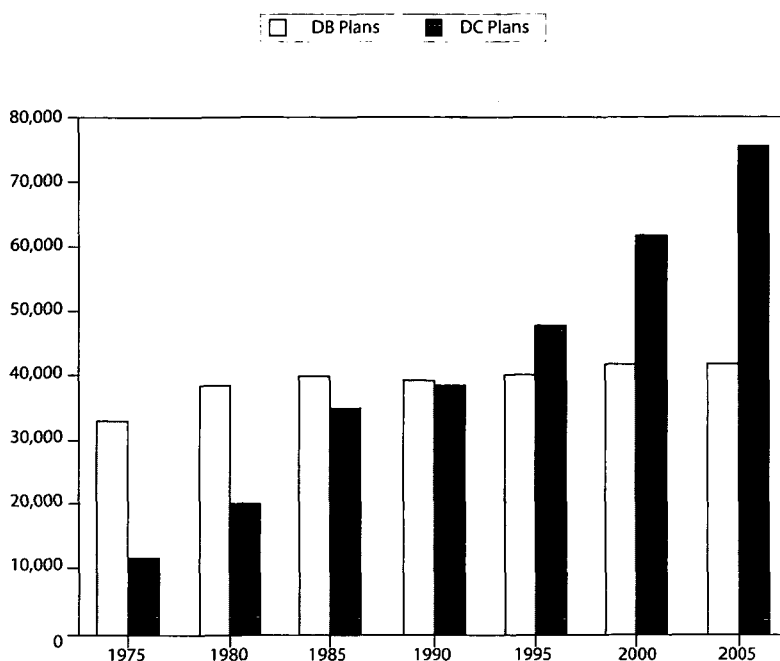


Source: U.S. Department of Labor (2011) (Table E1)

A hybrid of a DB and DC plan also exists and is known as a cash balance plan. Cash balance plans, introduced by Bank of America in the early 1980s, are DB plans that look and feel like

DC plans, where the basic benefit is provided as a lump-sum, and not as an annuity (McGill et al., 2010). An annual allocation is provided to the participant's account as a percentage of pay; these accounts grow through a rate established by a predetermined formula (McGill et al., 2010). Schieber (2005) reported that hybrid plans are preferable for younger and more mobile workers.

Figure 2. Number of Private Pension Plan Participants by Type, in thousands (1975-2005)



Source: U.S. Department of Labor (2011) (Table E5)

As Figures 1 and 2 indicate, since the enactment of ERISA in 1974, the number of pension plans and participants in pension plans grew dramatically. The total number of DB and DC plans grew from 311,100 in 1975 to 680,000 in 2005, where DC plans accounted for the majority of the growth. In 1975, 66.8 percent of all plans were DC plans, whereas in 2005, 93 percent of all plans were DC plans. New plan formations in recent years have been small, with the total of single-employer private plans increasing by about 1 percent, where new plan creations

were offset by terminations and mergers (U. S. Government Accountability Office, 2011b). These trends are noteworthy because of their implications for workers and retirees.

In addition, there has been a significant increase in the total number of plan participants. In 1975, approximately 44.5 million individuals participated in a private pension plan; this increased to 117 million in 2005 (U. S. Department of Labor, 2011), a 163 percent increase in the number of participants. Similar to the growth in the number of DC plans, the number of DC plan participants also grew more than DB plan participants. In 1975, 26 percent of the total participants were in DC plans; whereas in 2005, 64 percent were in DC plans (U. S. Department of Labor, 2011).

Corporations that replaced DB plans with DC plans predominantly responded to a dynamic economic and political environment. DB plans initially evolved with the growth of the manufacturing sector in the United States. Essentially, large firms and unionized work forces bargained for these plans. But as the economy shifted to a more non-unionized, service-based environment, DC plans proliferated. Moreover, government regulation is known to be more onerous on DB plans than on DC plans. The PBGC requires firms offering DB plans to pay premiums to maintain insurance; the regulations for DB plans impose a complicated set of funding rules, limitations, and regulations pertaining to pension investment (Clark, Craig, & Wilson, 2003). As a result, shifts in union status, firm size, and regulations explain much of the trend toward DC plans.

Employees gained control of their retirement benefits through the proliferation of DC plans. They then had the ability to manage their individual retirement accounts, contribute to them, and take the accounts with them when they left their employers. With the advent of 401(K) plans, the predominant type of DC plan, workers gained the ability to direct their own investments. Employees were offered the ability to make tax-deductible employee contributions, making this investment vehicle quite attractive (Brown, 2008).

Yet, the pension landscape was not secure for retirees during the 1980s, 1990s, and 2000s. Funding rules were weak and premiums for plans covered by the PBGC were not adequate. Additionally, some employers began manipulating DB

pension plan benefits to serve corporate profitability and did not adequately provide the retirement security that workers expected. This trend is documented by Schultz (2011), who claimed that in the 1990s corporations used a variety of accounting techniques, tax incentives, and other forms of manipulation to syphon money from pension plans and serve corporate purposes. She provides an example called the “accounting effect,” where a company could reduce benefits by hundreds of millions of dollars and record the change as a profit. This practice benefited corporate executives, who were compensated by reaching certain profit targets, and shareholders, but in many cases workers and retirees, subjected to this deception and fraud, were cheated out of retirement income. Many workers did not realize they were victimized until the DB plans went into default and were turned over to the PBGC.

The Pension Protection Act of 2006

The underfunding of pension plans continued to threaten firms’ abilities to pay retirees their pensions (Campbell, Dhaliwal, & Schwartz, 2010). Pension defaults threatened the fiscal viability of the PBGC. In 2005, when United Airlines became the largest pension default in U.S. history, pension legislation regained its prominence in Congress. In response to the pension crisis, Congress adopted the Pension Protection Act of 2006 (PPA), which is a comprehensive piece of legislation. Initiated as PL 109-280, the PPA passed the House by a vote of 279-131 on July 28, 2006. The Senate voted 93 to 5 to approve the bill on August 3 and the legislation was signed into law on August, 17, 2006 by President George W. Bush.

The PPA provided major revisions to the DB pension system, DC qualified plans, individual retirement accounts, and annuities (Landsberg, 2008). Silver-Malyska and Jenkins (2006) claimed that the focus of the law was to increase funding for DB plans through stricter fund requirements and limits on benefit increases and lump-sum distributions. The PPA made significant changes to the rules governing DC plans as well, specifically provisions that encourage automatic enrollment. The GAO (US Government Accountability Office, 2011b) reported:

In order to encourage greater participation by employees with access to an employer-sponsored pension plan, provisions of the Pension Protection Act of 2006 facilitated the adoption of automatic enrollment policies in DC plans by providing incentives for doing so and by protecting plans from fiduciary and legal liability if certain conditions are met. With such policies, new hires and existing employees who are not contributing to their 401(k) plan would be automatically enrolled and contributing unless they affirmatively take action to stop those contributions. (p. 9)

Data from the Current Population Survey (CPS) show that in 2008 about 53 percent of private-sector wage and salary workers, aged 25 - 64, worked for employers that sponsored a retirement plan, and about 44 percent participated in a plan (US Government Accountability Office, 2011b). Because the CPS does not ask respondents about the type of pension plan, the data reflect both DC and DB plans. Yet, in DB plans, coverage and participation are synonymous, whereas in DC plans participation is voluntary, resulting in varying rates of coverage and participation (Purcell, 2004). The automatic 401(k), which harnesses the power of inertia by setting the default option at each phase of the 401(k) saving cycle, is designed to improve retirement security for millions of workers without requiring them to become financial experts (Gale, Iwry, & Walters, 2009).

In sum, although the PPA made progress in improving the PBGC program and in providing automatic enrollment to employees, it did not fully correct the firms' failures to fund their pension obligations adequately. Since the U.S. Government Accountability Office (2011a) designated single-employer and multiemployer DB pension plans as high-risk in 2003 and 2009, respectively, the financial position of the PBGC remains poor. Additionally, today half of the workforce lacks access to any employer plan, requiring these individuals to rely on savings and Social Security in retirement. These issues remain a challenge. Between worries about insolvency of Social Security, the substantial underfunding of public, state, and local pension plans, high profile losses in 401(k) plans at firms like Enron, the impact of the recent economic recession, and the fact that the PBGC had an accumulated deficit of \$23 million in September,

2010, more than double the deficit of two years earlier (U.S. Government Accountability Office, 2011a), public confidence in the nation's retirement system is low (Brown, 2008).

Expanded Role of the Individual

The GAO reported that over the last three decades, DC plans have replaced DB plans as the dominant type of private-sector employer pension plan and, by almost any measure, have taken on a primary role in how workers save for retirement (U.S. Government Accountability Office, 2011b). By 2007 (the most recent year with available data), DC plans comprised 93.1% of all plans and active DC participants in the private sector outnumbered those in DB plans 66.9 million to 19.4 million (U.S. Government Accountability Office, 2011b).

Table 1: Life Expectancy at Birth, 1970 - 2007, and Projected Life Expectancy, 2010 - 2020

Year	Total	Male	Female
1970	70.8	67.1	74.7
1980	73.7	70.0	77.4
1990	75.4	71.8	78.8
2000	76.8	74.1	79.3
2007	77.9	75.4	80.4
2010 (Projected)	78.3	75.7	80.8
2015 (Projected)	78.9	76.4	81.4
2020 (Projected)	79.5	77.1	81.9

Source: Xu, Kochanek, Murphy, & Tejada-Vera, 2010

By participating in a DC plan, individuals enjoy the benefits and flexibility of saving for retirement. DC plans provide lump-sum payments; they offer workers more liquidity before and during retirement, and they are portable, which means that workers can take their individual funds with them when they leave their company (Hacker, 2002). This type of disbursement is appealing to many employees and employers, but may present a challenge to an employee or retiree who is unfamiliar with the concepts of amortization and life expectancy, and lacks knowledge about investment options and the

associated tax implications. Ideally, it is in the best interest of the employee and retiree to invest this lump-sum so it will last through the retirement years. If an individual does not have this knowledge or foresight, the DC participant essentially faces the risk of outliving his or her pension income. In light of existing and projected increasing life expectancies (Table 1), outliving one's income is possible for many older men and women. In addition to the benefits accrued by participating in a DC plan, there are risks.

The recent economic recession created significant financial losses for many Americans. Not only did the decline in equity values decrease 401(k) accounts by 30%, many Americans lost their jobs, corporations suspended their 401(k) matches, and hardship withdrawals from 401(k) accounts ticked upward (Munnell, Kopcke, Golub-Sass, & Muldoon, 2009). Based on these recent developments, income from a DC pension plan is likely to be less than anticipated. In addition, there has been an overall decline in plan coverage and participation between 2000 and 2008 (U.S. Government Accountability Office, 2011b). And among those who participate in a plan, mistakes are made in the management of their accounts (Munnell & Sunden, 2004). Over half fail to diversify their investments, many over-invest in company stock, and almost none re-balance their portfolios in response to their age or market returns (Munnell, 2006). Mitchell, Mottola, Utkus, and Yamaguchi (2006) found that most workers with DC plans are inattentive portfolio managers and are characterized by inertia. The declining prevalence of DB pensions that provided a guaranteed lifelong income have put much of the responsibility for preparing for retirement directly on workers (Purcell, 2009), yet there is little evidence that supports the notion that workers are equipped to handle this responsibility.

In order to make informed financial decisions about issues such as financial entitlements, pension plans, insurance matters, investment strategies, budgeting, and health care (Mackell, 2008; Skinner, 2007), Americans must be financially educated and learn to view themselves as individually responsible for their financial well-being. Those who lack financial literacy are less likely to plan for retirement, are more likely to be poor in retirement, are less likely to invest in stocks, and are

more likely to accumulate expensive debt (Lusardi & Mitchell, 2008). Lusardi and Mitchell (2007a, 2007b) also found that financial literacy is not widespread among older Americans. Only half of the respondents aged 50 and over could correctly answer questions about compound interest and inflation. Additionally, women displayed much lower levels of financial literacy, raising concerns about the ability of older women to make sound saving and investment decisions related to their retirement (Lusardi & Mitchell, 2008).

Discussion

As the first wave of baby boomers turns 65 years of age in 2011, governmental agencies, researchers and policy makers are at a pivotal crossroad. ERISA and the PPA promised greater economic security to employees and private pension retirees. Although these promises may have been met early in the ERISA and PPA life-cycles, pension policy of the past decades has reduced the retirement security of the baby boom generation and is not capable of delivering the necessary pension protections of today's economic environment. Economic uncertainty, increased globalization, an increased non-unionized workforce, and longer life expectancies for men and women necessitate further change in the pension system. Baby boomers will be the first generation to have spent their whole careers under the regulated retirement system that exists today (Schieber, 2005), where there has been a transfer of fiscal responsibility from employers to pension plan participants. As a result, we must work to minimize financial risks older Americans will face in retirement. Following are a few practice, policy, and research considerations.

Because financial literacy is associated with retirement planning and planning has a positive relationship with retirement savings (Lusardi & Mitchell, 2007b), offering targeted financial education programs is critical, specifically among minorities and women, who face the greatest economic risk in retirement. It is unlikely that men and women will spend the time and money needed to develop the financial knowledge necessary to make informed investment decisions (Schulz, Rosenman, & Rix, 1999). Hence, workers should be trained

and educated about financial issues while in the workplace (Kim, 2008). In a study of benefit administrators at 212 corporations, Volpe, Chen, and Liu (2006) recommended that future educational programs focus on retirement planning and the basics of personal finance because employees have inadequate knowledge in these two areas. The positive impact of financial knowledge extends beyond retirement planning (Hira & Loibl, 2005), and is known to benefit the employer and employee through increased levels of productivity and decreased absenteeism (Kim & Garman, 2003). In addition to offering targeted financial education programs, comprehensive research that evaluates existing programs is needed, focusing on the long-term effects of participants' financial well-being among the diverse array of workforce populations (Kim, 2008).

Moreover, we face a major challenge understanding the relationship between behaviors and economic decision-making. The field of behavioral economics, combining research from psychology and economics, offers a unique area of developing knowledge that can help us better understand the motives, acts, thoughts, and feelings behind the behaviors related to participating in pension plans. Developing a common language and framework to promote interdisciplinary research and an exchange of knowledge (Heckman, 2011) in these two fields is recommended.

Additionally, there are a number of areas where pension policy reform is required. One area pertains to the retirement savings behaviors of individuals. For example, automatic enrollment plans and lifecycle balancing plans (Mitchell et al., 2006) anticipated increased levels of retirement savings, but they have not realized their intended impact. Tergesen (2011) reported that the total amount put into 401(k) plans increased by 13 percent since 2006, but the average savings rate has fallen in recent years. Additionally, some employers have not yet offered their employees the auto-enrollment feature because of the cost of the employer match to the organization. Life-cycle balancing plans, which balance risk and return for investors using a pre-determined time horizon, have not yet produced their intended results either. Many investors do not participate in these types of plans. Consequently, revised pension policy correcting these unintended consequences is needed.

Because the increased administration cost associated with government regulations exceeded the tax advantage of pension saving for workers at lower pay levels in small employers, many small employers terminated their DB plans over the past two decades (McGill et al., 2010). This has resulted in low participation rates for low-income workers. Congress should consider the implications of their past pension policies and promote pension policies with lower administration costs so smaller employers can offer attractive pension plans to all employees, specifically, low-income workers. Moreover, tighter federal regulations are needed to control the retirement system that has been abused by corporations, who siphoned money from pension plans to serve corporate purposes. These executives managed the system for their own benefit at the expense of the retirement security of employees and retirees.

An additional policy recommendation pertains to strengthening the PBGC. Similar to legislation introduced by Senator Kohl (D-WI) in 2009, entitled *The PBGC Governance Improvement Act of 2009* (S. 1544), future legislation is required to strengthen the limitations of the PBGC, specifically its structure and practices. The proposed legislation of 2009 amended ERISA by revising the composition and duties of the Board of Directors of the PBGC and requested that the Board form audit and investment committees to improve their effectiveness and establish a risk management position. If this type of legislation is enhanced, re-introduced, and ultimately becomes law, the improved functioning of the PBGC would be one positive step toward providing better protection to millions of workers participating in DB plans.

Policy initiatives that respond to the current economic environment, which is similar to the economic period when DB plans were first introduced, will be beneficial also. Federal policy that promotes the growth of pension plans with DB characteristics, including DB-DC hybrids, the DB(k) plan, and traditional multiemployer portable DB plans that are common among mobile workforces (Ghilarducci, 2006) may offer viable alternatives to employees and employers. For example, in DB-DC plans, employees and employers contribute to the plan, but the employee does not have the responsibility for managing it (Munnell & Quinby, 2009). In fact, in the Netherlands,

where collective risk-sharing is preferred to individual investor autonomy, hybrid pension plans (also known as “average-wage” schemes) have evolved, which effectively balance risk among employers, employees, and retirees and help maintain social solidarity among its citizens (Ponds & van Riel, 2007).

The economic environment has changed drastically over the past 40 years. The role of private pension plans is heightened because of the financial shortfalls facing Social Security and Medicare. Public policy has had a huge impact on pensions in the past and could provide greater security in the future. Legislation that protects the financial interests of workers and programs that increase financial knowledge among workers and retirees will provide a critical path toward ensuring financial well-being in late life. Additionally, pension policy should guard against financial risks and promote participation so workers of all income levels have an incentive to participate in a private pension plan. Pension reforms that improve retirement security are needed. By fixing the private pension system, confidence in the nation’s retirement system will be restored.

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