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Looking Backward, Looking Forward: Where is Pension Policy Headed?

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Abstract

Since the passage of the Employee Retirement Income Security Act of 1974, public policy has continuously shaped the trajectory of the US retirement system. It is clear that the policy process will continue to be key in the future reinvention of the retirement paradigm. Our study sets forth four perspectives on strengths and weaknesses of the current retirement system, with the goal of helping shape an environment more conducive to a vibrant, effective, and easily administered retirement system.

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Reinventing the Retirement Paradigm

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Chapter 2

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An inescapable element of the retirement paradigm is the public policy environment within which pension laws and regulations are developed. Issues of plan design, investment choices, and financing are matters that are principally determined by plan sponsors and participants with the help of service providers and other experts. Yet all of these decisions are made against the backdrop of a retirement system that is in large part structured according to rules that were either established or reaffirmed by the key pension law, the Employee Retirement Income Security Act (ERISA) of 1974, and by amendments to that law enacted over the past thirty years.

In the future, the retirement paradigm will be reinvented because people and entities directly engaged in designing and sponsoring plans, as well as those benefiting from plans, will make countless decisions about their immediate and long-term needs. They will adjust retirement plan programs, and retirement practices themselves, to accommodate those needs. Depending on how much thought is put into the development of the new paradigm, the pension institution may be refashioned in a logical and orderly way, or reinvented piece by piece. But, either way, to effectuate many of the changes that will lead to a new retirement paradigm will inevitably require public policy changes. In the best case scenario, the public policy arena will actually facilitate the development of the new paradigm. But if we are not so fortunate, the public policy arena will be the black hole into which thoughtful ideas plunge, never to emerge again. Because the public policy dimensions will be so crucial to the reinvention of a new retirement paradigm, this chapter identifies four elements that may help in the development of a paradigm suitable for the next thirty years. These are the key role of trust in a regulatory scheme; the importance of balancing objectives in pension policy; the key importance of recognizing expectations; and the need for retirement policy champions.

The Key Role of Trust

Government officials and private sector representatives from many countries have sought to learn about the US pension system as they wrestle with the development of private sector individual and employer-sponsored retirement systems in their own countries. It seems clear that, whatever else they might accept or reject from our system as they develop their own, they should give thoughtful consideration to the concepts enshrined in Title I of ERISA dealing with fiduciary responsibilities. This is because much of the success of the US retirement system relies on the fact that workers and employers are willing to turn over large sums of money to one or more third parties, believing that this money will be responsibly managed and prudently invested, and it will be used to pay retirees benefits many decades into the future.

Commensurate with this trust is the confidence that if, by chance, the people and entities to whom these funds are entrusted should act in a negligent or dishonest fashion, then an enforcement system will hold them to account. Such faith in the system is not based on a naïve confidence in the goodness of others; rather, it is based upon a belief in the essential soundness of the structure set forth in ERISA. That this system is largely self-policing is an even more remarkable tribute to how well it works most of the time. It is not merely a linguistic coincidence that the vehicle into which pension assets are placed is called a 'trust'.

The US pension system is, of course, far from perfect. But the unfortunate instances of neglect or abuse regarding private retirement plans that are identified (and punished) are attributable more to the misfeasance of a few, rather than due to fundamental shortcomings in the legal framework of the entire pension system. What is unclear, of course, is what percentage of those who act in a negligent or abusive manner are identified under the current regulatory and enforcement regime. Thus it is with some trepidation that I call for greater *trust* between the regulators and the regulated community when redesigning the pension regulatory structure.

Pension practitioners have long decried the growing complexity of pension law in the aftermath of ERISA. Perhaps those of us with little or no experience in other policy arenas (e.g. environmental and housing) may overstate the complexity of pension policy relative to other areas of the law. Even so, in a voluntary retirement system, the concerns of those who must be relied upon to establish and maintain plans cannot be lightly dismissed. Whatever the truth might be (and 'complexity' itself is a rather subjective condition), the fact that the rules governing the pension system are often difficult to understand and expensive to implement seems to be a point conceded even by those who believe that the rules are warranted.

In some respects, the complex regulatory scheme in place today is a byproduct of the breakdown in trust between the government and the plan sponsor community. This was perhaps most clearly evidenced in the reformulation of pension nondiscrimination rules in 1986, when a looser 'facts and circumstances' standard was changed to more precise mechanical rules. On one hand, the rejection of the 'facts and circumstances' approach was a response to complaints from plan sponsors themselves, who felt that the interpretation and enforcement of those standards were inconsistent and arbitrary (Gale et al. 1999). Plan sponsors had lost faith in the regulators. On the other hand, the movement toward a more rigid standard was also a manifestation of regulators unease as to whether plan sponsors were designing their plans in a way that was fair to participants at different income levels.

Yet it would be an oversimplification to attribute much of the highly regulated nature of the pension system to a breakdown in trust between the 'regulators' and the 'regulated'. The late Michael Gordon (1999), one of the fathers of ERISA, summed up the essential paradox of ERISA when he wrote about the law's 'mandatory imposition of substantial regulatory standards on a totally voluntary system'. The fact that many employers who are not required to sponsor a plan continue to do so, despite costly and complex regulatory requirements, is a testament to the underlying strength of the system and the belief of plan sponsors that retirement plans are important, despite the difficulty of maintaining them. Yet, to the extent that the regulatory burden is cited by employers as a reason not to sponsor a plan, the challenge for the future is to forge a system in which the regulatory requirements do not undermine the willingness of plan sponsors to initiate or continue a plan.

Another dimension of the regulatory scheme that governs the pension system involves the substantial notice and reporting requirements that accompany the sponsorship of a private sector retirement plan. To the extent that these responsibilities require plan sponsors to report information to participants, the enduring challenge is to make sure that the information conveyed is relevant and understandable. When reporting requirements are based on the government's need to receive information in order to ensure compliance with the law, the regulated community should accept some burden as the application of the Reagan Doctrine of nuclear disarmament ('trust but verify') to the pension system. The problem is that if the new retirement paradigm is still to be based on the premise of a *voluntary* system, Congress and government agencies responsible for developing complex rules and for requiring the reporting of voluminous information must ensure that the regulatory burden satisfies a cost-benefit analysis at least in some rough sense. Future regulators must demonstrate more clearly than in the past that the information required, and the complex testing to which plans must be subjected is, in fact, necessary to achieve some greater objective.

How might this be accomplished? At the margin, legislative and regulatory relief could be enacted to strip away some of the more obvious forms of regulatory overkill that have developed as successive Congresses and agencies have developed new rules. Indeed in the last few years, Congressional action has simplified the operations of the pension system. But meaningful progress toward a new regulatory framework based on concepts of fairness and equity will require a different mindset between the regulated community and the regulators, one where the essential ingredient is the restoration of trust between plan sponsors and regulators.

From the regulators' perspective, this greater trust may need to take the form of looser rules that afford plan sponsors more flexibility in the operation of plans, with fewer precise hurdles that must be cleared. From the plan sponsors' perspective, this trust might be manifested in a willingness to accept even harsher penalties for failure to meet more flexible standards that would be established. In other words, the regulated community could be accorded more trust that they are designing and operating plans for the benefit of participants and beneficiaries within a broader framework of the enunciated public policy. In return, regulators would be accorded more trust that they will enforce the law consistently and fairly within that more flexible framework; and they would also be empowered to impose even greater sanctions, in instances when the actions taken are clearly inconsistent with the retirement security objectives of the underlying rule (e.g. abuse cases).

This trade-off would represent a fairly substantial gamble on the part of both the regulated community and the regulators, yet there is reason for optimism. In recent years, both the Internal Revenue Service (IRS) and the US Department of Labor have initiated programs in which pension plan sponsors are accorded more protections from sanctions for various violations if they come forward voluntarily to disclose the violation.[1]

One confidence-building measure to spur a more desirable regulatory structure would be to engage parties with a legitimate stake in the outcome of regulations more fully *with one another* during the development of regulations. Since ERISA's enactment, most retirement policy rulemaking has involved the agencies' inviting the input of parties with an interest in the rules to provide written comments, to testify at public hearings and to meet directly with regulators to discuss concerns. The level of communication between the regulators and interested parties is excellent, yet the many segments of the retirement system with disparate interests rarely engage in simultaneous discussions with one another and the regulators.[2]

The Importance of Balancing Objectives

The tax and labor aspects of pension policy have not always been in balance over the past three decades. As a result, there is currently no consistent legislative and regulatory regime, nor is there a coherent retirement income policy. On the one hand, regulatory agencies with enforcement responsibilities over the pension system have well-defined roles and have avoided directly conflicting activities since the adoption of Reorganization Plan No. 4 in 1978 [543 *Fed. Reg.* 47713, Oct. 17, 1978]. On the other hand, it is probably fair to say that the Congressional committees with oversight of pension law have been less consistent than the regulatory agencies about staying within the purview of their own jurisdiction.

For instance, the numerous parallel provisions of pension law enshrined in ERISA and in the Internal Revenue Code (IRC), resulted, in part, from the lack of trust between Congressional tax and labor committee members when the pension law was crafted in 1974. Each committee wanted to protect its turf and ensure ongoing oversight authority. This dual regulatory structure may be a necessary outgrowth of the fact that pension policy is and must be an amalgam of labor and tax policy. That said, were there more collaboration between and among the Congressional committees of jurisdiction and—to a lesser extent—the executive branch agencies with jurisdiction over the nation's retirement system, the oversight of the pension system today would be a great deal simpler and more consistent.

Some observers have suggested that the dual jurisdiction of the US Department of Labor and the US Department of Treasury/Internal Revenue Service could be merged into a single federal department with retirement system oversight. In support of this idea, critics emphasize conflict between the US Treasury Department's mission of raising tax revenue, and the retirement system's goal of promoting saving (Siciliano 2004). The idea of a unified federal agency certainly bears thoughtful consideration, but it is possible to achieve greater retirement system cohesion without going that far.

The principal impetus for ERISA was the need to protect pension rights, so fiduciary concerns were a strong motivating force for its enactment. Despite its origins, however, in the intervening years, tax policy has driven the principal changes in the pension system, resulting in increasing conflict between tax and labor aspects of pension policy. From the Revenue Act of 1978 through the Economic Growth and Tax Reform and Relief Act of 2001, there were more than twenty pieces of major legislation that changed pension law, typically through changes in the tax code (even where parallel ERISA provisions were also adopted). This dominance of tax over labor aspects in pension policy is not absolute, of course. For example, attention has been devoted to participants' diversification rights and fiduciary responsibilities in the aftermath of the Enron and WorldCom problems. On the other hand, the larger conflict in pension policy over much of the past thirty years has not been the schism between 'tax' and 'labor' policy but, rather, has been the tension between tax legislation enacted primarily for revenue raising purposes, and tax legislation enacted for retirement income security purposes.

This point was made clearly during the 1980s and early 1990s, when much pension law was enacted in an effort to address substantial federal budget deficits rather than driven by the need to boost saving. Moreover, much of the legislation designed to curtail the federal tax revenue loss attributable to tax-qualified pension contributions[3] was enacted intermittently between *other* bills designed to shore up the funded status of pension plans.[4] This somewhat schizophrenic pattern exposed the absence of any coherent retirement income policy, and it also made evident the conflict between tax policy limiting lost tax revenue and tax policy protecting pension benefits. These problems were mitigated somewhat in the mid to late 1990s as the transformation of budget deficits into surpluses eased efforts to enact nearly annual tax measures curtailing tax expenditures accorded to pensions. In addition, the stronger economy until 1999 produced better funded plans and less need to legislate improvements in funding standards.

It would be unfair to attribute the revenue loss versus retirement security conflict in the pension system entirely to the regulatory environment. Some have observed that, among plan sponsors themselves, the various corporate functions which direct pension policy have not always worked in harmony. The corporate model has been compared to that of a car in which (*a*) the head of human resources is the driver, with a foot pressing the accelerator in the hope of providing progressive and generous benefits to workers and retirees; (*b*) the chief financial officer is a concerned passenger in the front seat leaning over and trying to apply the brakes and control costs; and (*c*) the company actuary is sitting in the back seat, looking out the rear window giving the other two directions. In recent years, the finance concerns of plan sponsors have often taken a 'front seat' role in the determination of companies' pension decisions, as witness some firms freezing pension accruals in light of the long-term uncertainty about the interest rate that will be required for calculating defined benefit (DB) plan liabilities.

While it would be imprudent of Congress and policymakers to dismiss the cost implications of the pension system and proposed retirement policy, many run the risk of understanding the *cost* of pensions much better than they understand their *value*. This is in part the result of extensive government focus on the tax revenue loss implications of pensions, with the annual publication of pension tax expenditure and calculations of federal revenue estimates by the Congressional Joint Committee on Taxation. Any serious effort to reinvent the pension paradigm will require much more concerted attention to questions that have been all but ignored to date. These are issues such as proper balancing of interests between the major stakeholders in the retirement system—individuals, employers, and the government; better definition of the adequacy of retirement; and benefits and drawbacks of different types of retirement vehicles.

The current economic environment and the resurgence of federal budget deficits may once again threaten the tax-favored treatment of employer-sponsored retirement plans. But if the tax expenditure accorded to pensions—the second biggest expenditure in the federal budget[5]—has been responsible for frequent Congressional efforts to reduce revenue loss through changes in retirement plans over the past thirty years, that dynamic is very likely to change over the next thirty years. For the entire period of time since ERISA's passage, the baby boomer generation has been in the workforce; the tax qualified contributions made to the retirement plans of this sizable segment of the population have dwarfed the taxable retirement benefits paid out to the smaller generation that preceded the boomers. Thus, the tax exclusion for contributions to retirement plans has exceeded the taxes collected on retirement benefits, resulting in the large expenditures. But as the boomers now begin to receive retirement benefits and pay taxes on them, these trends might reverse, and the tax structure accorded to the private retirement system may become a revenue raiser. Regardless of whether that occurs, the challenge for retirement policy in the next several years—in periods of surplus or deficit—will be largely the same: to resist formulating policy based on the revenue implications alone, but rather on the basis of what will be required to ensure retirement income security for an aging population. Clearly, the task will be made much more difficult if large deficits persist, but greater difficulty should not be permitted to interfere with the fundamental necessity of the task.

This effort will require that Congressional tax-writing committees will work in concert with the labor committees, with whom they share an interest in retirement income security. This will not be easy, as it will require collaboration over corresponding changes in both ERISA and IRC provisions. This represents a golden opportunity that public policy makers will have to address the really important questions about the future of the retirement system and retirement security.

The Relevance of Expectations

The pension system has not lacked for controversy over the course of the past several years, so it would be unrealistic to think that the future will be free of controversy or debate over the nature of the pension promise. But a new better-functioning retirement paradigm can be one in which constituencies with different perspectives and agendas make a more concerted effort to appreciate each other's expectations.

The current debate over hybrid pension plans represents a good example of where the retirement policy environment would benefit from more recognition of others' expectations. In large measure, the controversy over transitions from traditional DB to hybrid plans erupted over the issue of whether future benefit accruals could change: that is, whether the employer could modify the benefit that workers expected that they would receive if they continued to work and the plan remained unchanged. For critics of hybrid plans, the answer was an emphatic 'no', while hybrid plan advocates maintained that the law protects pension rights earned up until a certain point, but it provides no guarantee of future benefit accrual. Without delving into the details, it is plain to see that on one level, at least, the dispute is one of 'expectations'. Workers have expectations that certain conditions and events will transpire (e.g. their continued employment and the continuation of their company's pension plan). Correspondingly, plan sponsors have an expectation that they will continue to have the flexibility to change the design of their plan without being legally bound to pay benefits beyond those accrued.

It may be that these two competing expectations cannot be reconciled and will, instead, have to be resolved in the courts or in the public policy arena. Indisputably, however, the public discourse over such fundamental questions would be far more civil and productive if each side of the debate began by recognizing the other side's legitimate and competing expectations. It is possible, for example, that a hybrid plan advocate would insist that in a vibrant voluntary pension system, plan sponsors must have absolute flexibility to change their plans prospectively; while at the same time they may still acknowledge that such flexibility could be contrary to plan participants' expectations. Similarly, a hybrid plan critic would advocate that continuing certain pension plan features is more important than plan sponsor flexibility; while at the same time, they might acknowledge the harm that will be done to plan sponsors, or other participants, if employers are denied that flexibility. In practice, however, debates over the key pension questions are rarely posited to acknowledge the legitimacy of the other side's view. It is never done in a litigation context, and it seldom occurs during the course of legislative or regulatory debate.

This hybrid plan example is merely illustrative of the broader problem that plagues the retirement system debate. Of even greater concern than the resolution of any single individual policy issue is the need to make meaningful progress toward the reinvented retirement paradigm. Without a more honest recognition of others' reasonable perspectives, the nation is unlikely to make much progress on difficult retirement policy questions nor achieve the appropriate balancing of interests among participants, plan sponsors, the government, and other pension stakeholders.

To successfully implement this proposal, each of the competing interests in the retirement system debate will need to develop confidence that they can publicly acknowledge the legitimate views of others without concern that that recognition will be portrayed as a lessening in the advocacy of their position. What can be done to overcome the mistrust that often interferes with the willingness of competing interests in the retirement system to acknowledge the viewpoints and expectations of others? Initial confidence-building measures might include efforts by the media to portray in a balanced fashion competing interests involved in a variety of pension decisions. In addition, perhaps all advocacy groups could be asked, when making the case for their own agenda, to acknowledge where their own positions may be perceived as contrary to the interests of others. For example, all negotiating sessions could begin not only with a list of demands from each side, but also a rendition of each side's understanding of the other side's concerns and objectives. These measures are worth trying as a means of breaking long-standing logjams and thinking creatively about a new retirement policy paradigm.

The Need for Retirement Policy Champions

Virtually every history of ERISA portrays in glowing terms the statesmanship of a cadre of strong legislative leaders from both political parties.[6] These lawmakers possessed the vision about the need for a comprehensive law to regulate the pension system, and they also diligently immersed themselves in the minutiae of the statutory provisions needed to bring to fruition what ultimately became ERISA.

It is unfortunate that the last thirty years have produced only a handful of members of Congress who could genuinely be called legislative champions of the pension system. This is despite the prominent role that pensions play in our economy, and despite the fact that retirement security is frequently a rallying cry in congressional and presidential campaigns. Only very recently have a few members of Congress moved to lay claims to this moniker. Perhaps this change is a reflection of the aging of the workforce and the growing awareness of the need to address the demographic realities that will make retirement policy an even more prominent issue on the domestic policy agenda.

Nonetheless, the paucity of pension champions may be due to the extraordinary complexity of pension law and the difficulty of mastering what has obviously become very detailed subject matter. It may also be due to the fact that for about half of the past thirty years, Congress has struggled with substantial budget deficits. Consequently, most pension legislative activity emerged from efforts to curtail the pension tax expenditure in order to either reduce federal budget deficits or help pay for cuts in other more visible types of taxes, or both.

Whatever the reasons for the past dearth of pension legislative champions, it is difficult to imagine how positive pension policy in the future will emerge unless more members of Congress make pension issues a personal priority. There are simply too many natural obstacles to thwart forward motion on retirement policy development—tax revenue implications, jurisdictional battles between and among committees with authority over pension policy, the difficulty of mastering intricate details of pension law, and the political reality that the benefit of some pension changes are not felt, and therefore cannot be confirmed, until many years into the future. The success of prudent pension policy is often measured not in the positive conditions that it creates but, rather, in negative conditions that it prevents from occurring.

A shortage of pension legislative champions has resulted in at least two significant casualties. At the micro level, there is a lack of consistency among many of the statutes approved by Congress. At a macro level, it has resulted in the absence of a coherent national retirement income policy. The value of having retirement laws that are consistent with one another is self-evident. The arguments in favor and opposed to developing a national retirement income policy are much more complex and nuanced—and developing such a policy would be much more difficult to achieve even if there were widespread agreement that it should be done.

The challenge, therefore, is for those interested in a robust retirement system to engage in a dialogue with thoughtful members of Congress, of both parties and in both houses. Convincing lawmakers to do so should be a somewhat easier task in the years ahead than it has been in the past, because the demographic realities of an aging population and the growing emphasis on retirement policy issues in the media means that pension policy issues are much more important to the public discourse and, therefore, to elected officials.

To cultivate a larger group of retirement policy champions who will be effective, regardless of the particular agenda that they may wish to advocate, it also will be necessary to persuade more future political leaders that it is worth their while. They will have to learn the intricacies of pension policy sufficiently well that they can earn the respect of their colleagues who will *not* be retirement policy leaders, but who will rely upon the leaders' judgment in making some extraordinarily difficult decisions. It is a tall order, but it is necessary to reinvent the retirement paradigm.

Endnotes

1. Employee Plans Compliance Resolution System, Revenue Procedure 2003–44; Voluntary Fiduciary Correction Program, RIN 1210-AA76, March 28, 2002.
2. USC Sections 561–570. The Negotiated Rulemaking Act authorizes and encourages a process wherein, in real time, the disparate views of multiple interested parties and the regulators can be discussed. Apart from some Pension Benefit Guaranty Corporation rulemaking, however, the negotiated rulemaking process has been rarely employed in the development of pension regulations. It might be tried more frequently by the US Department of Labor and the Internal Revenue Service to see whether it leads to an improved pension regulatory framework. At a minimum, it might lead to a regulatory system in which interested parties more fully understand and accept the outcome of the rulemaking process. This

approach, by itself, would not represent the reinvention of a retirement regulatory paradigm. But it could offer one possible tool for building it.

3. These include the Tax Equity and Fiscal Responsibility Act of 1982 (TEFRA), Deficit Reduction Act of 1984 (DEFRA), Tax Reform Act of 1986 (TRA '86), and the Omnibus Budget Reconciliation Act of 1993 (OBRA '93).
4. These include the Single Employer Pension Plan Amendments Act of 1986 (SEPPAA), Omnibus Budget Reconciliation Act of 1987 (OBRA '87), and the Revenue Reconciliation Act of 1990.
5. Estimates of Federal Tax Expenditures for Fiscal Years 2004–2008, Joint Committee on Taxation, December 22, 2003.
6. See for instance Sass (1997).

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