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Enron and the Pension System

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The collapse of Enron and the resulting consequences for participants in the Enron pension plan represent a watershed event for the future of the modern American pension system. In terms of national notoriety, this event is similar in magnitude to two prior public scandals in the history of the pension system. The first such scandal occurred during the decade of the 1960s: the closing of the Studebaker automobile plant and the termination of its underfunded pension plan. Shortly thereafter came the second scandal, heralded by Congressional hearings revealing the misuse of plan assets for personal gain by officials of the Teamsters union. These two landmark events raised public awareness of problems in the pension system and led to the enactment of the Employee Retirement Income Security Act of 1974 ("ERISA").[1] ERISA forms the underlying regulatory structure for the pension system today.

The Enron story challenges all of the stakeholders in the modern American pension system to reconsider ERISA's regulatory structure. This structure derives from a paradigm that no longer exists today—the workplace environment and the business market structure of the 1950s and 1960s. The fundamental public policy question raised by Enron is how to modernize ERISA so that the pension system remains viable for American businesses and their workers in the twenty-first century.

I. HISTORICAL PERSPECTIVE: ENRON AS A MODERN TWIST ON STUDEBAKER AND THE TEAMSTERS

Beginning in the late 1940s, pension plans first became widely available to unionized workers in the mining, steel, and automobile manufacturing industries through collective bargaining agreements. Although federal labor laws regulated the collective

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[1] Employee Retirement Income Security Act of 1974, Pub. L. No. 93-406, 88 Stat. 829 (1974) (codified as amended in scattered sections of 26 & 29 U.S.C.) ("ERISA").

bargaining agreement process that led to the establishment of pension plans, the key features of pension plans themselves, such as vesting and adequate employer funding, were left unregulated by federal law. In essence, a worker's pension benefits were only as financially secure as the employer itself.

The problems associated with this lack of federal oversight over the pension system became national news in the early 1960s, when the Studebaker Corporation ("Studebaker") closed its automobile manufacturing plant in Indiana due to financial difficulties.[2] Since 1950, the workers at Studebaker had been covered by a pension plan negotiated on their behalf by the United Automobile Workers Union ("UAW"). When the plant closed, Studebaker and the UAW negotiated an agreement to terminate the pension plan. Under this termination agreement, of the approximately 10,500 retirees and active workers covered by the plan, only 3,600 individuals received their full benefits promised under the terms of the plan. Due to grossly inadequate funding, the remaining plan participants received little or nothing from the terminated pension plan. The plight of these plan participants, many of whom had long years of service with Studebaker, was well-publicized by the media. Studebaker became a public symbol of the insecurity of pension plan benefits, one of the focal points of subsequent Congressional hearings on the need for pension system reform.

While Congress and a Presidential committee[3] were investigating the Studebaker incident and reporting on the need for pension system reform, another Congressional investigation uncovered serious financial abuse concerning the management of assets held in employee benefit plans sponsored by the International Brotherhood of Teamsters ("Teamsters") for union members. Union officials responsible for administering the plans and investing plan assets were being personally enriched, sometimes by millions of dollars, through dubious and self-dealing transactions. Members of Congress were shocked to learn that, under existing federal law, such misuse of plan assets was not prohibited. These revelations emphasized the need for federal law to impose more stringent standards of fiduciary conduct upon the persons who administer pension plans and manage plan assets. In the words of one first-hand observer and participant in the formation of ERISA, "Federal fiduciary standards leaped to the top of the emerging pension reform agenda."[4]

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[2] For a detailed, and fascinating, historical account of the Studebaker incident, see James A. Wooten, *"The Most Glorious Story of Failure in the Business": The Studebaker-Packard Corporation and the Origins of ERISA,* 49 BUFF. L. REV. 683–739 (2001).

[3] In 1962, President John F. Kennedy established the President's Committee on Corporate Pension Funds and Other Private Retirement and Welfare Programs to study the implications of the growing pension plan system for the national economy. The Committee's final report, issued in 1965, recommended that the system be reformed through mandatory minimum vesting and funding standards and a federal program of termination insurance that would guarantee pension benefits to plan participants. *See* PRESIDENT'S COMMITTEE ON CORPORATE PENSION FUNDS AND OTHER PRIVATE RETIREMENT AND WELFARE PROGRAMS, PUBLIC POLICY AND PRIVATE PENSION PROGRAMS: A REPORT TO THE PRESIDENT ON PRIVATE EMPLOYEE RETIREMENT PLANS (1965).

[4] S. PRT. 98-221, CHAP. 1, AT 10 (1984) (Michael Gordon's explanation of why ERISA was enacted).

The Studebaker incident and revelations of misuse of plan assets for personal gain by the Teamsters created the political atmosphere that, eventually, led to the enactment of ERISA and the creation of the modern American pension system. Viewed from this historical perspective, Enron presents a modern twist on the pension reform issues first raised by Studebaker and the Teamsters. In a single set of circumstances, Enron combines incredibly sympathetic stories by workers of ruined retirement dreams with equally incredible stories of greed and self-enrichment by company executives at the expense of the company's 401(k) retirement plan participants. It is this combination of factors that has made Enron such a powerful symbol in the public mind of the need to reform today's pension system.

As even the most casual observer of the legislative process knows, however, strong public opinion alone does not guarantee that Congress will act. Congress enacted ERISA in 1974 because, in addition to strong public opinion, the major stakeholders in the pension system (at that time, primarily employers and unions) perceived that they each had something to gain by supporting reform measures at the federal level.[5] Ultimately, Enron's long-term effect on the modern pension system will depend on whether the numerous stakeholders in the system perceive that it is in their own best interests to support reform measures.

II. STAKEHOLDER INTERESTS AND THE CHANGING STRUCTURE OF TODAY'S PENSION SYSTEM

There are five main categories of stakeholders in today's pension system. Broadly defined, these categories are: (1) employers; (2) labor unions; (3) workers; (4) persons who assist plan sponsors (employers and labor unions) in administering pension plans (known collectively as *plan service providers*); and (5) federal regulatory agencies. Within each category, there is a broad range of players and corresponding interests.

Employers vary in size from *Fortune 500* companies, who have tens of thousands of employees and operate throughout the United States and internationally, to local small businesses with at least one employee. Employers also represent the entire spectrum of the modern American economy. Their products range from the latest high-tech innovations to labor-intensive manufactured goods that must compete with imported products from abroad.

Labor unions vary according to the types of workers and industries they represent. *Workers* vary significantly in age, compensation, education and training, job mobility, and investment knowledge.

Plan service providers include virtually every major player in the financial services industry—mutual fund companies, securities firms, banks, trust companies, and in-

[5] For a discussion and analysis of the behind-the-scenes stakeholder motivations and politics that led to the enactment of ERISA, see STEVEN A. SASS, THE PROMISE OF PRIVATE PENSIONS, CHAPTER 8 (1997), and Wooten, *supra* note 2.

surance companies. Plan service providers also include professionals such as attorneys, accountants, actuaries, and independent financial asset managers.

Government regulators include four federal agencies. The *Department of Labor* has primary enforcement jurisdiction over the provisions of ERISA that regulate plan fiduciaries and protect plan participants and their pension benefits. The *Internal Revenue Service* has primary oversight over pension plan compliance with the Internal Revenue Code requirements that entitle the employer and plan participants to very favorable income tax treatment. The *Pension Benefit Guaranty Corporation* is an independent federal agency that insures the benefits provided through traditional defined benefit pension plans[6] in the event of employer insolvency. Finally, the *Securities and Exchange Commission* indirectly regulates the pension system through its oversight of the financial markets in which plan assets are invested.

The story of the modern pension system, and the evolving nature of stakeholder interests, is truly the story of the emergence of the 401(k) plan. When Congress enacted ERISA in 1974, the 401(k) plan did not exist. The 401(k) plan became possible when Congress later amended the pension tax rules of the Internal Revenue Code by adding Section 401(k).[7] The Department of Labor describes the dramatic effect on the pension system of this change as follows:

> The Revenue Act of 1978 permitted certain types of defined contribution plans to add a cash or deferred arrangement allowing employees to defer part of their pre-tax salaries to retirement. Plans established or modified to include this arrangement are known as 401(k) plans. This legislation has radically altered the structure of the U.S pension plan system over the last 20 years, shifting responsibility for the financing and investment of benefits from employers toward employees. Since the early and mid-1980s, the number of 401(k) plans has grown at a rate that in 15 years has led them to dominate the private pension system by providing primary or supplemental plan coverage to about 70 percent of all pension covered workers.
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> With an overwhelming share of the growth in pension plan coverage over the last 15–20 years occurring under 401(k) type plans, the percentage of the pension covered work force participating in defined benefit plans (DB) has been in a slow but continuous decline. In 1998, an estimated 44% of all pension covered workers participated in a DB plan, down from 84% in 1978. In addition to the extremely low rate of new DB plan formation, the DB plan coverage rate has declined because of large numbers of terminations by small and medium sized plans and the lack of growth in employment among large unionized manufacturing firms maintaining their DB plans.

[6] The characteristics of defined benefit pension plans are described *infra* page 472.

[7] These amendments, part of the Revenue Act of 1978, became effective in 1980. *See* Revenue Act of 1978, Pub. L. No. 95-600, § 135, 92 Stat. 2763 (1987) (codified as amended at I.R.C. § 401(k)(2003)).

> Paralleling the decline in DB plan coverage has been a decline in coverage under DC plans[8] without a 401(k) plan feature. Most of this decline resulted from the adoption of a 401(k) feature by ongoing DC plans. The DC plans initially adding a 401(k) feature were generally savings plans where the employer matched a portion of post-tax employee contributions. In more recent years many of the plans adopting a 401(k) feature have been profit sharing, and money purchase plans where employer contributions are made on a basis other than a match of employee contributions.
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> In 1998, the number of 401(k) plans topped the 300,000 mark. 401(k) type plans now make up 41% of all plans, cover 51% of all active participants, and hold 38% of all pension plan assets. A major consequence of the growth of 401(k) type plans has been the shift in the financing of plan benefits from employers to employees. In 1998, 47% of all contributions to pension plans were made by employees compared to only 11 % in 1978. In real dollars, employer contributions to all types of pension plans were 18% lower in 1998 than in 1978 while employee contributions were 480% higher.[9]

The most significant trend for the future of the pension system is the growing number of workers, primarily employed at smaller firms, whose only pension plan is a 401(k) plan. The Department of Labor reports that, of the 300,593 401(k) plans in existence in 1998, 90% of these plans (covering 19,219,000 active plan participants) were the only retirement plan sponsored by the employer for its workers.[10]

The reasons for this dramatic shift in the pension system are complex.[11] One explanation attributes this shift to underlying structural change in the United States economy and labor workforce away from traditional large firms and unionized manufacturing industries, where defined benefit plans are more common, toward smaller firms and non-unionized industries, particularly in the services sector, where defined contribution plans, and 401(k) plans in particular, are the most popular. Another explanation is that the relative cost of plan sponsorship and administration for the employer is higher for defined benefit plans than for defined contribution plans. This cost differ-

[8] A Defined Contribution ("DC") plan contains an individual account for each participant. The 401(k) plan is a type of DC plan where the individual participant funds his or her own account using his or her own wages or salary. In other types of DC plans, such as a profit sharing plan, the employer funds each individual worker's account through employer contributions to the plan.

[9] U.S. DEPT. OF LABOR, PRIVATE PENSION PLAN BULLETIN, ABSTRACT OF 1998 FORM 5500 ANNUAL REPORTS, 4 (Winter 2001–2002) (Highlights from the 1998 Form 5500 Reports). For historical data, *see* the Appendix to this essay, *infra.*

[10] *See id*. at Tables D.4 & D.5.

[11] For a discussion of these trends and a summary of the academic literature, see EMPLOYEE BENEFIT RESEARCH INST., AN EVOLVING PENSION SYSTEM: TRENDS IN DEFINED BENEFIT AND DEFINED CONTRIBUTION PLANS, ISSUE BRIEF NO. 249 (2002).

ential was exacerbated in the 1980s, when Congress enacted changes to the pension tax laws that reduced the tax incentives for small and medium-sized employers to sponsor defined benefit plans. A third explanation is that, as job insecurity and mobility increased, workers preferred the portability of retirement benefits provided by individual account plans. Finally, as the United States stock market experienced spectacular investment returns during the later half of the 1990s, workers increasingly demanded 401(k) plans to reap the benefits of a rising stock market.

Why are 401(k) plans attractive to the stakeholders in the pension system? This appeal is best understood by comparing and contrasting the fundamental features of the 401(k) plan with the traditional defined benefit pension plan.

In the traditional defined benefit pension plan, the plan provides that it will pay the participant a specific amount upon retirement, typically in the form of a monthly annuity for the life of the participant or the joint lives of the participant and the participant's spouse. These annuity payments terminate at death, leaving no opportunity for the intergenerational transfer of accumulated pension wealth. The plan typically provides this annuity benefit by using plan assets to purchase the annuity from an insurance company for the participant when the participant retires. The amount of the participant's monthly annuity benefit is determined by a formula contained in the plan, and is usually based on the participant's compensation and years of service with the employer. Under this formula mechanism, defined benefit plans provide the most generous annuity benefits to those workers with long years of service for a given employer.

The employer who sponsors a traditional defined benefit plan is responsible for funding the benefits promised by the plan at a minimum level specified under federal law. This funding obligation exists irrespective of the employer's profitability. Specialized pension tax law attorneys and actuaries are needed to assist the employer in determining and reporting to federal regulators the funding status of the plan and the amount of any additional employer contributions needed to satisfy the federal minimum funding requirements. The employer also is responsible for investing the plan's assets. Often, the employer hires a plan service provider with investment expertise to manage and invest the plan's assets for the employer. If the plan's investment returns are inadequate, the employer may be required to make additional contributions to the plan to ensure that the plan continues to meet the federal minimum funding requirements.

In contrast to defined benefit plans, 401(k) plans offer flexibility to both employers and workers. Although the employer is not required to make contributions to the 401(k) plan, many employers do make matching contributions as an incentive to encourage worker participation in the plan. In addition, 401(k) plans are often offered in conjunction with profit-sharing plans, where the employer has the option to make contributions to the individual accounts of participants in the profit-sharing plan.

The nature of the employer's business, its workforce demographics and characteristics, and market conditions often favor the flexibility offered by 401(k) plans. Businesses who want to attract a younger and potentially mobile workforce are likely to find that these employees prefer a 401(k) plan to a traditional defined benefit plan. Unlike the defined benefit plan, the 401(k) plan allows for a more flexible compensation system. The 401(k) plan allows individual workers to choose between deferring part of their earnings to save for retirement, or to receive all of their compensation as current income.

In contrast to defined benefit plans, 401(k) plans require individual workers to make several important decisions (and assume significant risks) concerning their future retirement benefits. Each worker initially must decide whether to participate in the plan at all. If the worker decides to participate, the worker must determine how much of his or her current compensation to contribute, and how to invest the assets in the account. At retirement, the worker's retirement benefit is the balance of the 401(k) plan account. This balance consists of worker contributions to the account plus accumulated investment earnings. In addition to assuming the investment risk, the worker also assumes the risk that she will outlive her retirement savings (known as the *risk of longevity*). The 401(k) plan account balance is usually distributed (or rolled over to an IRA) in the form of a lump sum at retirement. The retired worker must decide how much of this lump sum to consume for current living expenses, how much to save for future living expenses, and, possibly, how much to transfer to future generations at death.

Although the employer is not responsible for funding the 401(k) plan, the employer retains several other fiduciary responsibilities in sponsoring a 401(k). The most important fiduciary duty of the employer is selecting the menu of investment options for the 401(k) plan.[12] Most employers rely on a plan service provider in the financial services industry to assist them in this fiduciary task. The 401(k) plan's investment options usually consist of a variety of mutual funds, or, less commonly, a brokerage-type account that allows the participant to invest in individual stocks and bonds. Publicly-traded company stock of the employer also is a permissible investment option. The employer is responsible for deducting worker contributions to the 401(k) plan from current compensation and forwarding these sums to the plan's trustee in a timely fashion.

Many employers use plan service providers in the financial services industry to serve as plan trustees and plan administrators. These service providers hold the account assets and invest them pursuant to the directions of the 401(k) plan participants. A 401(k) plan service provider usually benefits financially whenever the provider's own mutual funds form part or all of the menu of investment alternatives for the 401(k) plan participants. When participants invest in these proprietary mutual funds, the service provider typically receives investment management and administrative fees. Service providers who provide brokerage services or facilitate transactions in company stock can receive commissions. The employer may, but is not required, to provide investment education or advice to 401(k) plan participants. Again, if investment education or advice is offered to the 401(k) plan participants, it is a service provider who typically provides this investment assistance to the participants.

[12] For a detailed discussion of the employer's fiduciary responsibilities under ERISA in selecting the 401(k) plan's menu of investment options, *see* Colleen E. Medill, *Stock Market Volatility and 401(k) Plans,* 34 U. MICH. J. L. REFORM, 469, 479–513 (2001).

The employer-controlled defined benefit and the participant-directed 401(k) plan represent two distinct models for the future of the pension system. The defined benefit plan represents a *paternalistic model.* Under this paternalistic model, employers bear the funding costs and market investment risk of providing retirement benefits to their workers. In contrast, the participant-directed 401(k) plan represents an *individual responsibility* model, where each worker is responsible for planning and providing for the worker's own retirement benefit.[13]

These two contrasting models lie at the heart of Enron's implications for the future of the pension system. Enron illustrates, in dramatic fashion, the potential retirement wealth polarization effect of the individual responsibility model. Some workers, particularly astute investors, will be retirement "winners." Others will be retirement "losers." Viewed from the broader perspective of the pension system as a whole, Enron raises the question of whether this polarization effect is an inevitable, and acceptable, byproduct of the individual responsibility model.

How policymakers respond to this question will profoundly affect the stakeholders in the pension system. More significantly, the answer to this fundamental question poses far-reaching consequences for the federal budget, the American taxpayer, and the future of American society. The tax subsidy that supports and promotes the pension system represents money that is not collected as tax revenue by the federal government. (In technical terms, this tax subsidy is known as a *tax expenditure.*[14]) For 2002, the tax expenditure for employer pension plans was $87.9 billion, the single largest tax expenditure in the entire federal budget.[15] The underlying public policy rationale for

[13] Although many employers offer a matching contribution to encourage participants to participate in the 401(k) plan, the modest levels of most employer matching contributions are insufficient to fund a significant portion of the worker's retirement benefit. Enron was an unusual situation because the employer matching contribution, made in company stock, greatly appreciated in value over a relatively brief period of time. Thus, the matching contribution account came to represent a significant percentage of each participant's total plan benefit. When the stock price fell sharply, so did the future retirement benefits of many of the 401(k) plan participants, because the Enron 401(k) plan prohibited them from selling the Enron stock held in their matching contribution accounts until age 50.

[14] STAFF OF THE JOINT COMMITTEE ON TAXATION, ESTIMATES OF FEDERAL TAX EXPENDITURES FOR FISCAL YEARS 2002–2006, 1–4 (Joint Comm. Print 2002) [hereinafter ESTIMATES OF FEDERAL TAX EXPENDITURES].

[15] ESTIMATES OF FEDERAL TAX EXPENDITURES, *supra* note 14, Table 1. This estimate is based on the provisions of the tax law as enacted through December 31, 2001. *See Id.* at 1. The estimate does not include the increased contribution and benefit limits for pension plans enacted by the Economic Growth and Tax Relief Reconciliation Act of 2001, Pub. L. No. 107-16, 115 Stat. 38, 41 (2001) (codified at scattered sections of 26 U.S.C.) ("EGTRRA"), which are effective for taxable years beginning after December 31, 2001. *See* ESTIMATES OF FEDERAL TAX EXPENDITURES, *supra* note 14, 10. To put the private pension system tax subsidy into perspective, the second and third largest tax expenditures in the federal budget for 2002 were for employer contributions for health care, health insurance premiums, and long-term care insurance ($69.1 billion) and the home mortgage interest deduction ($66.5 billion). *See* ESTIMATES OF FEDERAL TAX EXPENDITURES, Table 1.

the pension system tax expenditure is to encourage employers and workers to sponsor and participate in pension plans so that retirees will have an adequate income during retirement and not be dependent on their Social Security benefits as their sole source of retirement income. To the extent the pension system fails to achieve this public policy goal, the pension tax subsidy potentially represents forgone tax revenues that could have been used to fund other federal budget priorities.

If the pension system fails to provide adequate retirement income to future generations of retired workers, additional political and financial pressure will placed on maintaining and funding the traditional Social Security system. As the baby boomer generation attains age 65 (between 2010 and 2030), the traditional Social Security system is projected to place increasing fiscal pressure on the federal budget.[16] A few statistics illustrate the magnitude of the future demographic problem and the critical role of the pension system in resolving it. Persons age 65 and older represented 12.4% of the United States population in 2000.[17] By 2030, there will be about 70 million persons age 65 and older, or about twice the number in 2000.[18] The average annual income of persons age 65 and older in the United States in 2000 was $20,851. Of this amount, the average elderly person received $8,617 annually in Social Security benefits and $3,981 from pensions and annuities.[19] If the pension system is successful at generating retirement wealth for the baby boomer generation and beyond, it will lessen the current financial dependence of elderly Americans on the traditional Social Security system. If the pension system fails, there will be significant political pressure from retired elderly Americans (who vote in disproportionately high numbers for their demographic group) to increase the Social Security payroll tax to maintain the level of traditional Social Security benefits. In turn, an increase in the Social Security payroll tax will require younger workers to pay a greater percentage of their current income to fund the Social Security benefits of retirees. When placed in this demographic context, it becomes clear that every American taxpayer—young and old—has a personal financial stake in ensuring the future success of the pension system, not just for themselves as future retirees, but also for the system as a whole.

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[16] *See* BOARD OF TRUSTEES, FED. OLD AGE AND SURVIVORS INS. AND DISABILITY INS. TRUST FUNDS, THE 2003 ANNUAL REPORT OF THE BOARD OF TRUSTEES OF THE FEDERAL OLD-AGE AND SURVIVORS INSURANCE AND DISABILITY INSURANCE TRUST FUNDS (2003). According to estimates by the board of trustees for the Social Security program, Social Security benefit expenditures are expected to exceed payroll tax revenues starting in 2018. It is at this point that Social Security will be in direct competition with other federal programs for annual funding in the federal budget. *Id.* at 2.

[17] Administration on Aging, U.S. DEPT. OF HEALTH AND HUMAN SERVICES, A PROFILE OF OLDER AMERICANS: 2002, 1 (based on 2000 Census data), *available at* http://www.aoa.gov/aoa/stats/profile/profile.pdf (last visited March 13, 2003).

[18] *Id.*

[19] EMPLOYEE BENEFIT RESEARCH INST., INCOME OF THE ELDERLY (2002), *available at* http://www.ebri.org/facts/0602fact.pdf (last visited March 13, 2003).

III. WHAT ARE THE "LESSONS" OF ENRON FOR THE PENSION SYSTEM?

As the materials by Professor John Langbein indicate,[20] the superficial problem that Enron represents and its solution both seem clear. When given a choice, publicly-traded employers who sponsor 401(k) plans will use company stock for matching contributions and as an investment option for plan participants. Plan participants, in turn, will choose to invest in company stock, a retirement investment strategy fraught with risk, rather than pursuing a diversified investment strategy. As Professor Langbein notes, one obvious solution to this problem is to limit the amount of company stock that participants can own through their retirement plan accounts.

At a deeper level, however, Enron represents a crossroads for the future of the pension system and its stakeholders. Should the pension system return to the employer-controlled paternalistic model? Or is it inevitable that the individual responsibility model will dominate the pension system of the twenty-first century? If the latter course is followed, is there an appropriate role for paternalism in the form of greater regulatory constraints on the behavior of the stakeholders in the system? These fundamental policy issues, and the ideological perspectives they represent, are likely to be the subject of vigorous and ongoing public debate. The following discussion and the notes and questions section highlight several of the most contentious issues in this debate. As you read the materials below, place yourself in the roles of the various stakeholders in the pension system. As a particular stakeholder, what would be your perspective on these issues?

A. Promoting Defined Benefit Plans

Advocates for the paternalistic model claim that the federal government needs to do more to promote defined benefit plans. Proposals to promote defined benefit plans vary. Some proponents of defined benefit plans claim that all employers should be required to sponsor defined benefit plans for their employees. Others claim that an employer who sponsors a 401(k) plan should be required to offer a defined benefit plan as the "primary" retirement plan for employees.[21] Still other proponents of the paternalistic model claim that greater tax incentives are needed to encourage employers voluntarily to sponsor more, and more generous, defined benefit plans.

These proposals can be seen as sharing a common philosophical approach, namely, that corporate decision-makers should consider the welfare of their workers and the interests of society as well as the interests of shareholders when determining whether and what type of retirement plan to offer to employees. This philosophical approach is

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[20] *See* John. H. Langbein, *What's Wrong with Employer Stock Option Plans, this book* at 487–494.

[21] Under this approach, the alternatives for an employer who wanted to sponsor a retirement plan, but who did not want to sponsor a defined benefit plan, would be some other type of individual account plan that is funded by the employer, such as a profit-sharing plan, a money purchase pension plan, or an employee stock ownership plan.

sometimes framed as an argument that employers have a moral or ethical obligation to ensure that their workers enjoy a financially secure retirement. The implicit assumption underlying this argument is that a 401(k) plan cannot provide adequate retirement income security, particularly for low-wage workers.

Requiring employers to sponsor defined benefit plans is controversial for several reasons. Historically, the hallmark characteristic of the pension system established by ERISA has been that the employer's decision whether or not to sponsor a retirement plan, and if so, the type of plan to sponsor, is *voluntary*. This approach provides employers with the flexibility to tailor their retirement benefits (or lack thereof) to meet the demands of both a competitive market and the employer's workforce.

Defined benefit plans today typically are sponsored by large employers. Several provisions of the Economic Growth and Tax Relief and Recovery Act of 2001 ("EGTRRA")[22] are designed to encourage small employers voluntarily to sponsor defined benefit plans. EGTRRA increased the employer's maximum possible tax deduction for contributions to a defined benefit plan. EGTRRA also authorized a simplified defined benefit plan that reduces the administrative complexity (and related costs) of defined benefit plans for small employers.

Will such incentives promote the growth of defined benefit plans? Skeptics argue that the employer's assumption of investment risk for funding a defined benefit plan is simply too great a deterrent to be overcome by increased tax incentives and greater administrative simplicity. Particularly for smaller employers and less established companies with variable earnings, the financial unpredictability associated with defined benefit plans is a significant deterrent to sponsoring them Requiring employers to sponsor a defined benefit plan could cause fewer companies to go into, or stay in, business. The recent experience of *Fortune 500* companies who sponsor defined benefit plans illustrates the financial volatility associated with defined benefit plans. As of 2002, approximately 360 of the 500 companies comprising the Standard and Poor's Index ("S&P 500") sponsored a defined benefit plan for their workers. During the bull market of the 1990s, investment returns on defined benefit plan assets were sufficiently high that these employers were not required to make annual funding contributions to their defined benefit plans. Moreover, under the rules for pension plan accounting, these corporations were allowed to report projected investment earnings that exceeded minimum federal funding requirements as operating revenues.[23] Thus,

[22] Economic Growth and Tax Relief and Recovery Act of 2001, *supra* note 16.

[23] Even though these projected "excess" investment earnings are reported as operating revenue for the corporation, ERISA requires that the assets of the plan must remain inside the trust for the plan and cannot be withdrawn or otherwise used by the corporation for its operations or be distributed as dividends to shareholders. These pension accounting rules are the target of reform measures designed both to reduce the financial volatility associated with current pension accounting standards and to make the financial reporting and disclosure process concerning defined benefit pension funding liabilities more transparent to the investing public.

sponsoring a defined benefit plan during this period of a rising stock market served to boost reported corporate earnings and increase shareholder value.[24] Measured by book value, as of the end of 2000, these 360 companies reported a cumulative pension asset surplus of $263 billion.[25]

Over the next two years, the combination of a dismal stock market and low interest rates[26] resulted in a dramatic funding reversal for these companies. By the end of 2002, these 360 corporations reported a cumulative plan funding deficit of $216 billion, despite having voluntarily contributed almost $46 billion to their defined benefit pension plans during 2002.[27] This cumulative funding deficit, and lower projected rates of future investment returns for defined benefit plan assets, are likely to play a significant role in reducing reported corporate earnings for these companies in the future.[28]

Observers of the pension system predict that the stock market's decline is likely to result in fewer and fewer *Fortune 500* companies who continue to sponsor traditional defined benefit plans. For smaller employers who do not sponsor a defined benefit plan, the lesson from the *Fortune 500* experience is particularly sobering. The plan assets of defined benefit plans sponsored by *Fortune 500* companies typically are invested and managed by professional investment managers. This expertise is unavailable to most small employers, either because the assets of the plan are insufficient in size to attract the best investment managers, or because the price of professional investment services is cost-prohibitive. Despite this investment expertise, *Fortune 500* companies suffered significant funding deficiencies due to uncontrollable interest rate and investment risk. Given these circumstances, it seems unlikely that additional tax incentives for small employers to sponsor defined benefit plans will be sufficient to overcome employer concerns about the financial unpredictability and uncertainty associated with defined benefit plans.

B. Achieving Retirement Income Security Through 401(k) Plans

Researchers have begun to study whether participants in 401(k) plans can achieve a level of retirement income security comparable to participants in defined benefit plans. Some of these studies indicate that it may be possible for participants in 401(k) plans to achieve a level of income during retirement that is equal to or greater than the level

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[24] Christine Dugas, *Pension Revenue Can Mislead Investors*, USA TODAY, Sept. 5, 2002, at 1B.

[25] Allen Sloan, *Pension Funds' Risky Business*, NEWSWEEK, Dec. 9, 2002, at 59.

[26] Interest rates play a crucial role in estimating future defined benefit plan liabilities and then discounting these future liabilities to present value to determine the current level of required minimum funding for the plan. The lower the interest rate, the higher the level of current funding required. As of the end of 2002, interest rates were at a 40-year low.

[27] CREDIT SUISSE FIRST BOSTON, THE QUARTERLY REPORT, 4 (April 14, 2003).

[28] *See id.* at 8–12.

of retirement income for participants in defined benefit plans.[29] These studies also confirm what stakeholders in the pension system have long known intuitively. There are two behavioral barriers that must be overcome for workers to achieve retirement income security through a 401(k) plan. First, beginning early in their careers, workers must regularly contribute sufficient amounts to the plan. Second, workers must invest their 401(k) plan accounts wisely.

Reform proposals concerning the individual responsibility model seek to encourage this type of desirable behavior among workers. Reform focuses primarily on two areas: investment education and investment advice for 401(k) plan participants, and greater government regulation of the investment options available to 401(k) plan participants. To fully appreciate the potential ramifications of these reform proposals for the stakeholders in the pension system, it is useful to have a basic understanding of the rules that currently govern these issues, as well as the findings of researchers who have studied the investment behavior of participants in 401(k) plans.

The rise to prominence of the 401(k) plan in the pension system began in 1992, when the Department of Labor issued final regulations governing 401(k) and other individual account plans for which the participants direct the investment of their own individual plan accounts.[30] These regulations are commonly known as the "404(c) Regulations."[31] The 404(c) Regulations provide that if the employer's plan was structured to comply with these regulations, the employer would not be liable for investment losses resulting from the participant's investment directions. There are two general requirements of the 404(c) Regulations that are relevant for this discussion. These requirements concern: (1) the information that the employer must provide to plan participants, and (2) the types of plan investment options that the employer must make available to plan participants.

The 404(c) Regulations require that participants must receive general information concerning the plan, and specific financial information concerning the plan's investment options.[32] This financial information concerning the plan's investment options

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[29] *E.g.*, EMPLOYEE BENEFIT RESEARCH INST., CAN 401(K) ACCUMULATIONS GENERATE SIGNIFICANT INCOME FOR FUTURE RETIREES?, ISSUE BRIEF NO. 251 (2002), *available at* http://www.ebri.org/pdfs/1102ib.pdf (last visited March 13, 2003); Andrew A. Samwick & Jonathan Skinner, *How Will Defined Contribution Pension Plans Affect Retirement Income?* (Oct. 2001). For a contrary view, *see* EDWARD N. WOLFF, ECONOMIC POLICY INSTITUTE, RETIREMENT INSECURITY (2002), *available at* http://www.epinet.org/books/retirement.pdf (last visited March 13, 2003).

[30] *See* Colleen E. Medill, *The Individual Responsibility Model of Retirement Plans Today: Conforming ERISA Policy to Reality,* 49 EMORY L. J. 1, 33–35 (2000).

[31] The 404(c) Regulations are codified at 29 C.F.R. § 2550.404(c)-1. The 404(c) Regulations derive their popular name from ERISA Section 404(c), 29 U.S.C. § 1104(c)(2001), the statutory authority under which the regulations were promulgated.

[32] *See* Medill, *Individual Responsibility Model, supra* note 30, at 34–36 and accompanying footnotes.

is provided in the form of (and at the sophistication level of) a securities prospectus required under federal securities laws. Significantly, the 404(c) Regulations do *not* require the employer to provide investment education or investment advice to the 401(k) plan participants. Although many employers today do voluntarily offer some form of investment education to 401(k) plan participants, very few employers offer investment advice.

The 404(c) Regulations require that the plan must offer at least three investment options. The employer who sponsors the plan is responsible for selecting these investment options. In performing this task, the employer acts as a fiduciary and is subject to two ERISA fiduciary duties. These duties are the duty of prudence and the duty to act exclusively for the benefit of the plan participants (also known as the fiduciary duty of loyalty).[33]

The range of investment alternatives offered by the plan must offer materially different risk and return characteristics, and must provide participants, even those with small account balances, the opportunity to diversify their investments and minimize the risk of large investment losses. Most employers select a set of three core mutual funds—a stock fund, a bond fund, and a money market fund—to satisfy these requirements. Other investment options, such as more specialized industrial sector mutual funds, employer company stock, or even a brokerage feature allowing the participant to invest in the individual stock of other companies, can be added to this group of core funds. The average 401(k) plan today offers ten to twelve mutual fund investment alternatives.

If the company stock of the plan's sponsoring employer is publicly traded, the 404(c) Regulations expressly permit such company stock to be included as a permissible investment option in the employer's 401(k) plan. Although only 3% of 401(k) plans offer company stock as an investment option, these plans are sponsored by some of the nation's largest employers.[34] Consequently, plans where company stock is an employer matching contribution or an optional participant investment option represent 23 million plan participants.[35] To offer company stock as an investment option, the plan must provide for certain additional safeguards against improper employer influence over the participant's investment decisions concerning company stock.[36] The plan must have some procedures in place to protect the confidentiality of participants who buy and sell company stock. The plan also must designate a fiduciary to monitor compliance with these confidentiality procedures. If necessary, a third-party independent fiduciary must be appointed to handle 401(k) plan transactions in company stock. This situation typically arises when the company is engaged in a merger or acquisition, or when there is a contested election of company directors.

[33] 29 U.S.C. § 1104(a) (2001). For a detailed discussion and analysis of how these fiduciary duties apply in the context of 401(k) plans, *see* Medill, *Stock Market Volatility, supra* note 12, at 481–521.

[34] *See* Olivia S. Mitchell & Stephen P. Utkus, *The Role of Company Stock in Defined Contribution Plans*, 10–11, Pension Research Council (Working Paper 4, Aug. 2002) *available at* http://rider.wharton.upenn.edu/~prc/PRC/WP/WP2002-4b.pdf (last visited March 13, 2003).

[35] *See id.*

[36] *See* Medill, *Stock Market Volatility, supra* note 12, at 524–25.

Several research studies have examined the investment behavior of 401(k) plan participants. The largest ongoing empirical study to date has been conducted by the nonpartisan Employee Benefit Research Institute ("EBRI Study").[37] The EBRI Study, which began in 1996, covers 35,367 401(k) plans, with 11.8 million active participants and $579.8 billion in plan assets. This study has consistently found that, when company stock is offered as an investment option, participants strongly tend to select company stock in lieu of a more diversified equity mutual fund. The EBRI Study also found that many 401(k) plan participants do not follow sound retirement investing principles. For example, the 2000 study results showed that, although the average 401(k) plan account was invested 51% in equity mutual funds, the accounts of individual 401(k) plan participants varied widely around this average. Of 401(k) plan participants in their 20s, 28.3% of this group of participants was *zero percent* invested in equity mutual funds.[38] Although this percentage dropped to 23.5% for participants in their 30s, it rose steadily thereafter, from 26.0% for participants in their 40s, to 29.9% for participants in their 50s, to 41.9% for participants in their 60s. The study results for prior years reported similar findings.

Researchers have identified several reasons why participants are strongly attracted to company stock as a 401(k) plan investment. First, participants *minimize the investment risk of company stock.*[39] Rather than breeding contempt, familiarity leads participants to underestimate the investment risk associated with company stock. Employees feel that they understand the company's business and that, by their labor, they have some degree of influence over the future financial fortunes of the company. Second, when the employer makes matching contributions in the form of company stock and also offers company stock as an elective investment option, participants *perceive that the employer is endorsing company stock* as a "good" investment option.[40] Participants view the employer's decision to make matching contribution in company stock as an implicit form of investment advice. Third, participants *simplify what they perceive to be a complex investment decision* by investing disproportionately in company stock.[41] If numerous other investment options are offered along with company stock, participants tend to simplify their decision-making process by investing heavily in the investment with which they are most familiar—company stock.

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[37] EMPLOYEE BENEFIT RESEARCH INST., ISSUE BRIEF NO. 239, 401(K) PLAN ASSET ALLOCATION, ACCOUNT BALANCES, AND LOAN ACTIVITY IN 2000 (2001) *available at* http://www.ebri.org (last visited March 13, 2003).

[38] *See id.* at Table 7, p. 12.

[39] *See* Gur Huberman, *Familiarity Breeds Investment*, 14 REV. OF FIN. STUD. 659 (2001).

[40] *See* Nellie Liang & Scott Weisbenner, *Investor Behavior and the Purchase of Company Stock in 401(k) Plans—The Importance of Plan Design,* N.B.E.R., Research Working Paper 9131 (Sept. 2002); Shlomo Benartzi, *Excessive Extrapolation and the Allocation of 401(k) Accounts to Company Stock*, J. OF FIN., 1747 (Oct. 2001).

[41] *See* Shlomo Benartzi & Richard H. Thaler, *Naive Diversification Strategies in Defined Contribution Saving Plans*, THE AM. ECON. REV., March 2001, at 79.

Other researchers have explored the effect of providing investment "education"[42] to 401(k) plan participants on investment behavior. Recent research in this area has found that providing investment education to 401(k) plan participants may not be effective in influencing their investment behavior.[43] After receiving investment education, participants may *say* they are going to change their contribution amounts and investment allocations, but few 401(k) participants actually *implement* these changes. This research is consistent with earlier studies of investment behavior finding that, in general, *there is a strong bias among 401(k) plan participants in favor of maintaining the status quo.*[44] In other words, 401(k) plan participants are great procrastinators when it comes to changing their contribution amounts and investment allocations. Researchers attribute this status quo bias to two root causes—the high indirect cost of gathering and analyzing the information necessary to make an investment decision, and problems of self-control.[45]

As an alternative to investment education, reform proposals have focused on making technical amendments to ERISA's rules that financially deter plan service providers from providing investment advice to 401(k) plan participants.[46] Assuming for purposes of discussion that these technical amendments eventually are enacted, two unresolved, and controversial, issues remain. First, who should bear the cost of providing investment advice to plan participants: the employer who sponsors the plan, or the plan participants themselves? Second, should employers continue to have *discretion* to decide whether or not to offer investment advice to 401(k) plan participants? Or should federal law *require* employers to make investment advice available to 401(k) plan par-

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[42] Investment "education" is a term of art in the ERISA field, and is often used as a contrast with another related term of art, investment "advice." In theory, the difference between these two legal concepts is that education involves general information concerning investment theory and plan investment options, whereas advice consists of specific investment recommendations tailored to the unique circumstances of the individual participant. *See* Medill, *Individual Responsibility Model; supra* note 30, at 28–30, 51–54. In practice, the difference between education and advice oftentimes is unclear, particularly from the perspective of the plan participants. The Department of Labor has issued guidance in the form of regulations attempting to clarify what types of information and methods of presentation will constitute investment "education." *See id.* at 51–54.

[43] *See* James J. Choi, David Laibson, Brigitte C. Madrian, & Andrew Metrick, *Defined Contribution Pensions: Plan Rules, Participant Decisions, and the Path of Least Resistance*, N.B.E.R., Working Paper 8655 (Dec. 2001).

[44] *See* Brigitte C. Madrian & Dennis F. Shea, *The Power of Suggestion: Inertia In 401(k) Participation and Savings Behavior*, Q. J. OF ECON., 1149–1187 (Nov. 2001); James J. Choi, David Laibson, Brigitte C. Madrian, & Andrew Metrick, *For Better or for Worse: Default Effects and 401(k) Savings Behavior*, N.B.E.R., Working Paper 8651 (Dec. 2001).

[45] *See* Madrian & Shea, *supra* note 44.

[46] How ERISA discourages plan service providers from rendering investment advice under current law is a highly technical subject, even for ERISA experts. For an introduction to this topic, see Medill, *Individual Responsibility Model, supra* note 30, at 38–46. In brief, participants do not receive investment advice because of the fiduciary prohibited transaction rules of ERISA. Reform proposals in Congress aim to exempt plan service providers who provide investment advice from ERISA's prohibited transaction rules, thereby encouraging them to provide investment advice to plan participants.

ticipants? Resolution of these contentious issues is likely to be the subject of a vigorous future debate among the stakeholders in the pension system.

Other reform proposals have focused on increased government regulation of the investment options available to participants in 401(k) plans. As a practical matter, the 404(c) Regulations impose a minimal level of constraint on the employer's fiduciary discretion in selecting the plan's investment options. To date, government regulation of 401(k) plan investment options primarily has been indirect, through enforcement of the employer's fiduciary duties of prudence and exclusive loyalty to the plan participants.

Interpretation and enforcement of these fiduciary standards by the federal courts and the Department of Labor are likely to change in the future as a result of Enron and the other corporate fiascoes that contributed to the general decline of the stock market. From 1992 through 1998, during the period that 401(k) plans were rapidly expanding throughout the workforce, the stock market also experienced significant gains, particularly in the later half of the 1990s. As a practical matter, this rising stock market made it unnecessary for employers to consider the prudence of their investment option selections, and in particular, the wisdom of including company stock as an investment option for 401(k) plan participants. Under these market conditions, almost any investment option (including company stock) generally made money, which in turn made for satisfied 401(k) plan participants.

Starting in 1999, however, the stock market began to fall. By the end of 2002, the stock market recorded its third consecutive year of losses, an extended period of decline unprecedented since before World War II. Although the investment losses experienced by the participants in the Enron 401(k) plan were the most dramatic, during this same period, millions of other 401(k) plan participants also experienced significant losses due to the general downturn in the stock market. Such losses, in turn, have led plan participants to scrutinize more closely the employer's selection of investment options for their 401(k) plan. In egregious cases such as Enron, such scrutiny has led to federal class action lawsuits where the 401(k) plan participants have alleged that the employer's choice of company stock as a 401(k) plan investment option constituted a breach of fiduciary duty under ERISA.

The primary focus of these cases to date has been on the employer's breach of the duty of loyalty to 401(k) plan participants in the context of company stock as an investment option. The underlying legal principles of fiduciary prudence and loyalty, however, are not unique to Enron-like circumstances. For example, many businesses fail honestly. Given this fact, and combined with the research evidence concerning participant investment behavior for 401(k) plans that offer company stock as an investment option, is it prudent for any employer today to include company stock as an investment option for its 401(k) plan? The fiduciary principle of prudence in selecting and monitoring the 401(k) plan's investment options also raises significant issues concerning the types of mutual funds offered by the plan. For example, is it prudent for the employer to include narrow industrial sector mutual funds, such as funds that invest solely in the stock of high-technology companies, as investment options? To select mutual funds with above-average investment management fees? To retain mutual funds that have consistently underperformed their peers?

These questions illustrate the difficulty of regulating 401(k) plan investment options indirectly through ERISA fiduciary litigation. In the final analysis, the most enduring lesson of Enron for the pension system may be that more direct government regulation of 401(k) plan investment options is necessary for sound retirement policy. The retirement income security of 401(k) plan participants is heavily dependent upon the investment earnings generated by their 401(k) plan accounts. Even with the best of investment advice, 401(k) plan participants cannot invest successfully unless they have the opportunity to choose from a menu of "good" investment options. Thus, the employer's choice of investment options is critical to the future success of the individual responsibility model, and ultimately the success of the modern American pension system.

Rather than opposing more direct government regulation of plan investment options, such reform measures eventually may be welcomed by the stakeholders in the pension system. Relying on expensive and time-consuming ERISA fiduciary litigation to indirectly regulate 401(k) plan investment options is inefficient for all of the stakeholders. Employers and other fiduciary plan service providers lack clear guidance concerning their fiduciary responsibilities in selecting plan investment options. This lack of clear guidance results in uncertainty at best and, at worst, ERISA fiduciary liability. Professional ERISA advisors are frustrated by their inability to give definitive compliance advice. Finally, as evidenced by Enron, 401(k) plan participants, the very group of stakeholders for ERISA was supposed to protect, clearly suffer under the current system. Perhaps it is only by passing through a post-Enron period of ERISA fiduciary litigation misery that the necessary stakeholder consensus can be forged to modernize the pension system for the twenty-first century.

APPENDIX

Table 1 below summarizes the extent of the fundamental shift in the structure of the pension system away from the defined benefit plan toward the defined contribution plan in general, and the 401(k) plan in particular.

Table 1. Number of Pension Plans[47]

Year	Total	DB Plans	DC Plans	401(k) Plans
1979	470,921	139,489	331,432	Not available
1985	632,135	170,172	461,963	29,869
1990	712,308	113,062	599,245	97,614
1995	693,404	69,492	623,912	200,813
1998	730,031	56,405	673,626	300,593
2001	758,000	51,000	707,000	361,000

[47] Data for years 1979–98 are from U.S. DEPT. OF LABOR, PRIVATE PENSION PLAN BULLETIN, ABSTRACT OF 1998 FORM 5500 ANNUAL REPORTS, Table E1, E23 (Winter 2001–2002). Data include both single- and multi-employer plans. The figures given for DC plans include 401(k) plans. Data for 2001 are estimates made by Olivia S. Mitchell and Stephen P. Utkus, *The Role of Company Stock in Defined Contribution Plans*, Table 1, Pension Research Council Working Paper 2002-4.

Table 2. Number of Active Plan Participants (thousands)[48]

Year	Total	DB Plans	DC Plans	401(k) Plans
1979	46,929	29,440	17,489	Not available
1985	62,268	29,024	33,244	10,339
1990	61,831	26,344	35,488	19,548
1995	66,193	25,531	42,662	28,061
1998	73,328	22,994	50,335	37,114
2001	78,000	22,500	55,500	43,800

Table 3. Plan Assets ($ millions)[49]

Year	Total	DB Plans	DC Plans	401(k) Plans
1979	445,430	319,595	125,835	Not available
1985	1,252,739	826,117	426,622	43,939
1990	1,674,139	961,904	712,236	384,854
1995	2,723,735	1,402,079	1,321,657	863,918
1998	4,021,849	1,936,600	2,085,250	1,540,975
2001	4,000,000	1,900,000	2,100,000	1,700,000

NOTES AND QUESTIONS

1. *Achieving Stakeholder Consensus on Reform Legislation.* Discuss the perspectives of the stakeholders for modernizing the pension system. Are they likely to agree or conflict? How likely is it that these groups will reach the level of consensus necessary to pass reform legislation in Congress?
2. *The Voluntary Nature of the Pension System.* Should the pension system continue to be voluntary? If you were a business owner, would you voluntarily sponsor a pension plan for your workers? If so, what type? What factors would you consider in making this decision?
3. *Providing Investment Assistance to 401(k) Plan Participants.* Numerous research studies have found that many workers are financially illiterate. Should the law require employers who sponsor 401(k) plans to provide investment education or investment advice to their workers? Does the employer have a moral or ethical obligation to go beyond the minimum legal requirements to assist financially illiterate workers in achieving retirement income security? Alternatively, should

[48] Data for years 1979–98 are from U.S. DEPT. OF LABOR, PRIVATE PENSION PLAN BULLETIN, ABSTRACT OF 1998 FORM 5500 ANNUAL REPORTS, Table E8, E23 (Winter 2001–2002). Data include both single and multi-employer plans. The figures given for DC plans include 401(k) plan participants. Data for 2001 are estimates made by Olivia S. Mitchell and Stephen P. Utkus, *The Role of Company Stock in Defined Contribution Plans*, Table 1, Pension Research Council Working Paper 2002-4.

[49] Data for years 1979–98 are from U.S. DEPT. OF LABOR, PRIVATE PENSION PLAN BULLETIN, ABSTRACT OF 1998 FORM 5500 ANNUAL REPORTS, Table E11, E23 (Winter 2001–2002). Data include both single and multi-employer plans. The figures given for DC plans include 401(k) plan assets. Data for 2001 are estimates made by Olivia S. Mitchell and Stephen P. Utkus, *The Role of Company Stock in Defined Contribution Plans*, Table 1, Pension Research Council Working Paper 2002-4.

the federal government assume this responsibility? If the federal government takes over the responsibility of educating employees, what might such an education program look like? How should such a program be funded?

4. *The Employer's Role in Selecting 401(k) Plan Investment Options.* The pension system's reliance on employer discretion in selecting 401(k) plan investment options stands in stark contrast to the regulatory approach advocated by President Bush's Commission to Strengthen Social Security ("Bush Commission") concerning personal Social Security accounts. The Bush Commission recommended that small accounts (under $5,000) be limited to a choice of nine indexed, low fee mutual funds. The assets of these nine mutual funds would be invested and managed by professional investment managers selected by government officials. Large accounts (over $5,000) could be invested in additional mutual funds offered by the private sector, but only if such funds were "balanced and diversified" across all industrial sectors of the economy. These additional mutual fund investment options would have to be approved by government officials before workers could invest their personal Social Security account assets. Under the Bush Commission's recommendations, industrial sector and firm investment risk are effectively eliminated. Workers would not be allowed to invest their personal Social Security account assets in the stock of individual companies, or in mutual funds that consist of the stock of companies in narrow industrial sectors. As an individual participant in a 401(k) plan, which approach to the selection and regulation of your plan's investment options would you prefer? Which approach is the better public policy?
5. *Prohibiting Company Stock As An Investment Option.* Is it sound public policy to prohibit 401(k) plans from offering company stock as an investment option? Or would prohibiting company stock as a 401(k) plan investment option merely exacerbate the differences between company executives who receive stock options and rank-and-file workers who, without access to company stock through a 401(k) plan, are less likely to share in large stock market gains if the company does extraordinarily well?
6. *Allocating Oversight Responsibility Among Competing Federal Regulatory Agencies.* When Congress originally enacted ERISA, Congress's focus was primarily on defined benefit pension plans for union workers. This original focus made the Department of Labor a natural fit for primary regulatory supervision of plan sponsors who managed pension plan assets and enforcement of the rights of 401(k) plan participants. In contrast, under today's individual responsibility model, the security of each participant's eventual retirement benefit is tied much more directly to the integrity of the financial markets, and, in the case of company stock, to the financial integrity of the employer itself. Given the paradigm shift in the pension system that has occurred since Congress enacted ERISA in 1974, should the Department of Labor continue to retain primary regulatory authority? Or would the Securities and Exchange Commission be better equipped for this task?