AUGUST 2024

ERISA: 50 Years of Shaping the Single-Employer Defined Benefit Landscape

A Public Policy Issue Paper

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The Pension Committee would like to gratefully acknowledge the contributions of Ellen Kleinstuber for her assistance with peer review of this document, along with the following primary contributors: Mike Antoine, Rachel Barnes, Michael Bain, Margaret Berger, Elena Black, James Burke, Bruce Cadenhead, Jonathan de Lutio, Scott Hittner, Lloyd Katz, Maria Kirilenko, Maria Moliterno, Melody Prangley, Mark Shemtob, Mary Stone, Hal Tepfer, and Carol Zimmerman.

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August 2024

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Key Points:

1. The level of underfunding across defined benefit plans has declined during the past 50 years.

2. Participant benefits are better protected than before ERISA via PBGC insurance and expanded rights.

3. Defined contribution plans have supplanted defined benefit plans as the main source of retirement savings, resulting in fewer participants having annuity income from their retirement plans.

4. Overall, employer-provided defined benefit retirement plan coverage has declined, due in part to the complex and rigorous legal and regulatory requirements combined with significant changes in the economic landscape since 1974.

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Introduction

On Labor Day in 1974, President Gerald Ford signed into law groundbreaking legislation that dramatically changed the retirement landscape in the United States. *The Employee Retirement Income Security Act of 1974*, commonly referred to as ERISA, provides a broad framework for regulation and governance of most privately sponsored defined benefit (DB) and defined contribution (DC) plans. While ERISA has been amended and augmented many times over the past 50 years, it remains the foundation of U.S. retirement plan regulation.

ERISA filled a significant void confronting DB plan participants. Previously, the lack of strong minimum funding standards and the absence of a guarantor in the event of employer insolvency put private sector pensioners at significant risk. Several prominent bankruptcies brought these risks to the public's attention.

Prior to ERISA, a sponsor of a tax-qualified DB plan was not required to fund promised plan benefits, as they were earned by participants. ERISA changed that, however, by requiring DB plans to pay a minimum annual contribution. Additionally, the federal government established the Pension Benefit Guaranty Corporation (PBGC) as the insurer of last resort, ensuring that DB plan participants would receive all, or a significant portion of, their promised benefits.

The law and the vast majority of subsequent acts have helped protect covered workers' benefits through more equitable plan access, enhancements in employee rights, and DB plan solvency requirements. ERISA introduced stronger vesting rules, which greatly increased the portability of plan benefits and protected plan participants from losing valuable benefits when terminating employment after a significant period of service. The law also required most DB plans to provide death benefits to the surviving spouses of plan participants. ERISA added Section 415 to the Internal Revenue Code (Code), which imposed new limits on the amount of benefits that could be paid from a tax-qualified DB plan and the amount of contributions that could be made to a tax-qualified DC plan.

As with any complex piece of legislation, ERISA's requirements have resulted in a significant number of unintended or unanticipated outcomes over the years. Although ERISA has clearly mitigated many significant gaps in retirement security, progress has been uneven.

Most private sector, single-employer DB plans are well funded today. However, DB plans now cover a much smaller portion of the workforce than 50 years ago, with an even smaller proportion of employees in these plans still accruing pension benefits. In fact, many private sector DB plans are now "frozen" and employees do not accrue additional pension benefits. The most common approach for private employers providing retirement plans has shifted from a DB model to a DC model. This change from DB to DC shifts most of the risk related to retirement savings from the employer to the employee, which has resulted in a lower percentage of employees having access to secure lifetime income.

This paper discusses ERISA's impact, focusing specifically on single-employer plans. The paper generally treats ERISA and the related Code sections interchangeably.

History

When President Ford signed ERISA into law on the symbolic date of Labor Day in 1974, DB pension coverage had been gradually increasing in the United States over many decades. In fact, some DB pension plans existed as far back as the time of the Revolutionary War. By the mid-1870s and early 1880s, several major employers had adopted DB plans, including American Express, the Baltimore and Ohio Railroad, and the Pennsylvania Railroad.[1] DB pension coverage greatly increased during the boom years immediately following World War II. By the time of ERISA's enactment, DB pension coverage had become increasingly commonplace for employees of major corporations in the United States.

Before ERISA, DB pension plans were largely unregulated. The Internal Revenue Code of 1954 limited the maximum amount of contributions that plan sponsors could deduct from taxable income and contained several other basic requirements concerning plan coverage and nondiscrimination. The regulatory framework for DB pension plans consisted of a variety of rather weak federal and state disclosure rules, such as the 1947 Taft-Hartley Act, which attempted to limit some of the worst historic abuses in multiemployer plans. In general, DB plan sponsors had great latitude regarding how much to fund the plan, who could participate, how to structure vesting rules, and even whether to pay promised benefits. There was no requirement that employers receive actuarial guidance in funding their pension plans and there were no restrictions on who could call themselves a "pension actuary."

1 *Evolution of employer-provided defined benefit pensions*; Bureau of Labor Statistics; December 1991.

During the 1960s and early 1970s, legislators grew increasingly concerned about the security of DB plans following several high-profile DB failures. In 1963, the Studebaker Corporation discontinued production of automobiles in the United States and subsequently reduced or canceled the DB pension benefits it had promised to its approximately 4,000 workers. An August 16, 1964, story in the *New York Times* ran under the headline "Workers Finding Pensions Empty—When Plants Close, Funds Are Often Inadequate." In 1972, NBC News ran a documentary: "Pensions: The Broken Promise." That same year, consumer activist Ralph Nader said the private pension system represented "one of the most comprehensive consumer frauds that many Americans will encounter in their lifetime."[2]

At the same time, anger spread among the general public about the perceived excessive benefits paid to some corporations' senior executives. For example, when Penn Central Transportation Company filed for bankruptcy in 1970, the public learned that Penn Central's retired president was receiving an annual pension benefit of $114,000 (about $925,000 in 2024 dollars). In a series of congressional hearings in 1972, the panel heard about shortcomings in pension plans. One example was the story of George Allen, who had worked 32 years for Baldwin-Lima-Hamilton in Philadelphia but lost his entire pension benefit when his plant closed five months before he reached the plan's vesting age of 60.[3]

Many of ERISA's provisions can be directly traced to abuses like these. Its enactment was the culmination of nearly a decade of work, study, and negotiation among members of Congress of both parties and several presidential administrations.

Change in the Number and Type of Plans

In the decade following ERISA's enactment, DB plan coverage continued to increase. Before the number of plans began to drop in 1986, the number of single-employer DB pension plans had increased nearly 70% since 1974.[4] Many factors contributed to the decline, including new financial disclosure requirements that went into effect in 1986 under Financial Accounting Standards Board (FASB) Statement No. 87, as well as stricter funding requirements under the *Omnibus Budget Reconciliation Act of 1987* (OBRA '87). In addition, as companies matured, the size of the typical pension obligation relative to the size of the

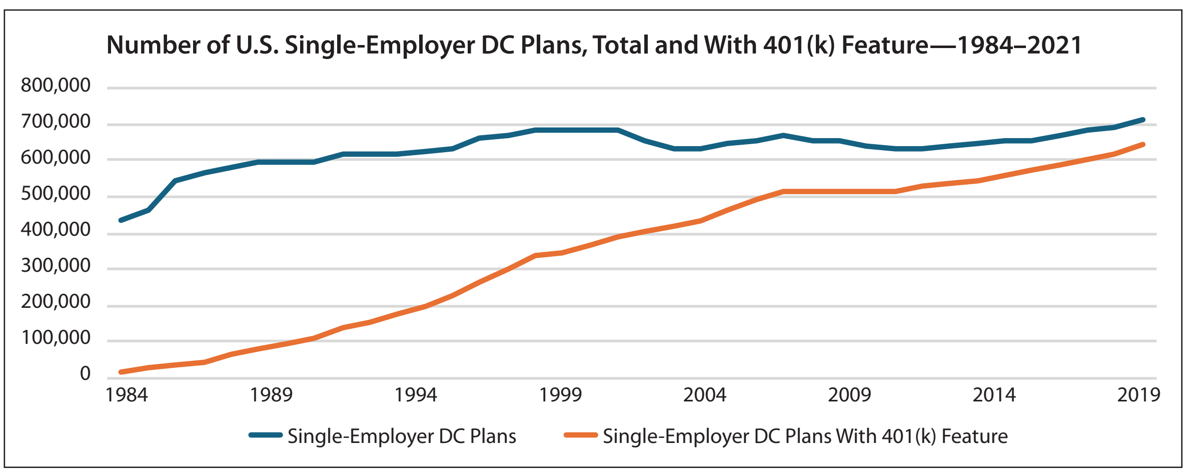
2 "Great Pension Issue"; *The New York Times*; August 10, 1972.
3 Hearings before the Subcommittee on Labor, United States Senate Committee on Labor and Public Welfare, Ninety-Second Congress, Second Session; July 17, 1972; Philadelphia.
4 Employee Benefits Security Administration; United States Department of Labor; Private Pension Plan Bulletin Historical Tables and Graphs 1975–2021; Table E1.

sponsor presented an increased risk. Sponsors of underfunded plans in certain industries found it difficult to compete with both U.S. and foreign companies that didn't have these significant legacy obligations. These changes resulted in a greater understanding and appreciation of the potential risks associated with significant pension obligations.

Over time, and especially since the *Pension Protection Act of 2006* (PPA) took effect in 2008, PBGC premiums have increased dramatically. In 1985, plans paid a flat-rate premium of $2.60 per participant. By 1991, the flat-rate premium had jumped to $19 per participant and less well-funded plans were subject to an additional variable rate premium of 0.9% of unfunded vested liability. In the decades since, further changes to funding rules and significant increases in PBGC premiums have accelerated the decline in DB pension plan coverage.

DC plans were common even before the codification of 401(k) plans. In fact, at the time ERISA was enacted, there were already about twice as many DC plans as DB plans, and the number of DC plans continued to increase dramatically in subsequent years. Internal Revenue Code Section 401(k) was enacted in 1978, explicitly permitting cash or deferred arrangements inside DC plans as long as specific requirements were met. In subsequent years, DC plans continued to grow. Despite this, DC plans usually remained supplementary to DB plans and the adoption of plans with 401(k) features was still limited. This differs from the experience today, as many employers, particularly large and mid-sized employers, have adopted a "DC-only" approach. The vast majority of current DC plans contain a 401(k) feature, as shown in Figure 1:[5]

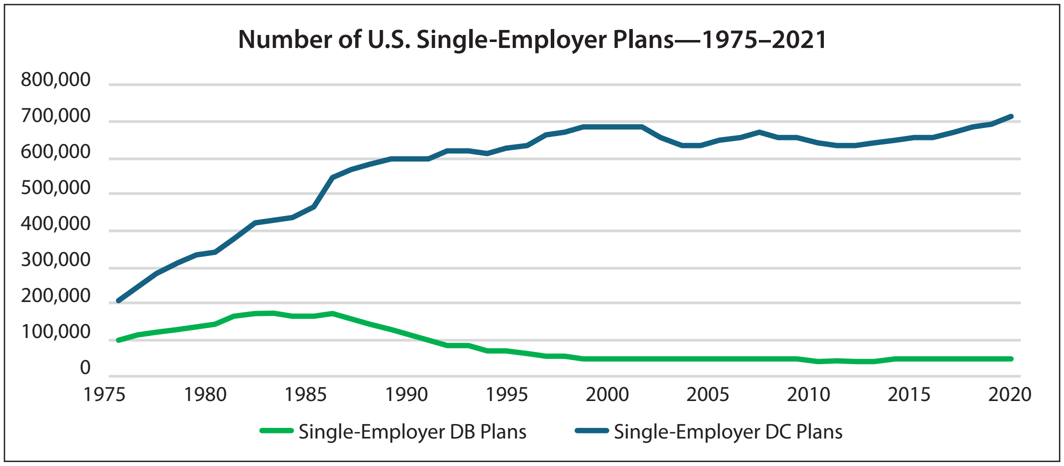
Figure 1



5 Employee Benefits Security Administration; United States Department of Labor; Private Pension Plan Bulletin Historical Tables and Graphs 1975–2021; Tables E1 and E19.

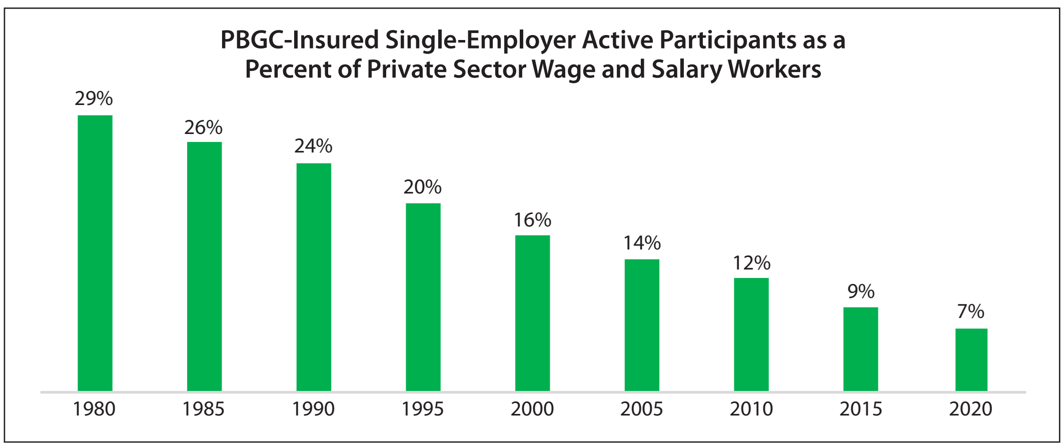
Figure 2 shows the number of plans by type since 1975, including the noticeable increase in the number of DC plans.[6]

Figure 2



The change in the number of DB plans corresponds to a rapid decrease in percentage of actively employed private sector workers in the U.S. covered by single-employer DB plans over 20 years, from 29% in 1980 to 7% in 2020[7] (Figure 3).

Figure 3



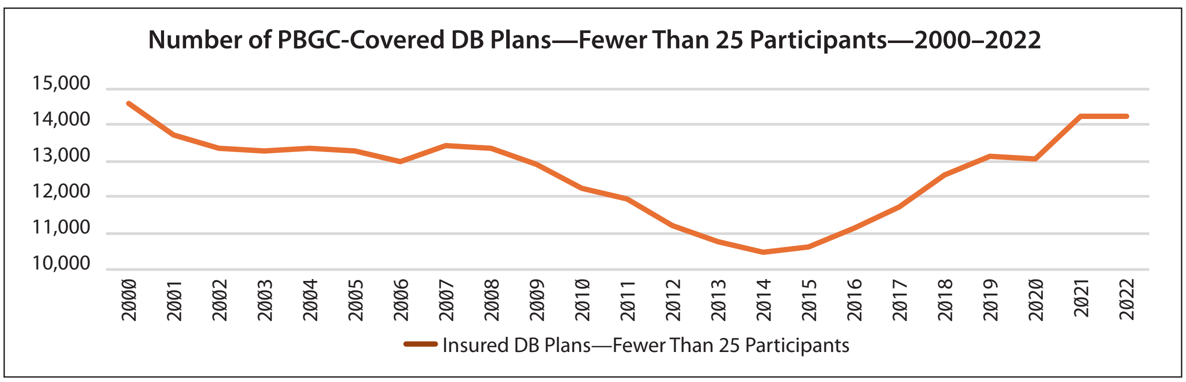
The designs of DB plans have also changed over the past 50 years. Traditionally, employers designed DB plans to provide a monthly benefit, defined as a percentage of final pay related to service at retirement or a fixed dollar amount for every year of service. In the 2000s, hybrid plans, where the benefit is defined as a lump sum account, became popular. By 2020, 40% of PBGC-insured plans were hybrid plans.[8]

6 Employee Benefits Security Administration; United States Department of Labor; Private Pension Plan Bulletin Historical Tables and Graphs 1975–2021; Table E1.
7 "Pension Insurance Data"; Pension Benefit Guaranty Corporation; 2021; Table S-33.
8 "Pension Insurance Data"; Pension Benefit Guaranty Corporation; 2021; Table S-34.

One Area of Growth for DB Plans—Small Employer-Sponsored Plans

The number of single-employer DB plans sponsored by small employers (i.e., fewer than 25 participants) decreased in number consistently with those sponsored by larger employers for much of the post-enactment period. However, the pattern has diverged in recent years, as the number of DB plans sponsored by small employers has begun to increase. These plans were strongly affected by several ERISA provisions, including the family aggregation rules and Code Section 415(e), which combined DB/DC limitations. The elimination of these requirements by the *Small Business Job Protection Act of 1996* (SBJPA), and the increase in Code Section 415 limits under the *Economic Growth and Tax Relief Reconciliation Act of 2001* (EGTRRA), played a part in stemming the decline in the number of DB plans sponsored by small employers. The number of such plans covered by the PBGC is up more than a third from 2014 to 2022, as shown in Figure 4.[9]

Figure 4



9 "Pension Insurance Data"; Pension Benefit Guaranty Corporation; 2021; Table S-31.

Pension Benefit Guaranty Corporation (PBGC)

One of the most significant contributing drivers of ERISA's enactment was the default of several pension plans, including the previously noted Studebaker plan. To enhance benefit security, ERISA established a minimum funding requirement for single-employer pension plans and created the PBGC to backstop the pension benefits from plans that cannot meet their benefit commitments.

Before ERISA's enactment, benefits were not guaranteed when plans terminated with insufficient funds. ERISA created the PBGC to:

- Encourage the continuation and maintenance of voluntary private pension plans for the benefit of their participants;
- Provide for the timely and uninterrupted payment of pension benefits to participants and beneficiaries under covered plans; and
- Maintain premiums at the lowest level consistent with carrying out its obligations.[10]

PBGC termination insurance markedly strengthened participant benefit security. One significant impact has been increased confidence in pension promise sustainability. According to the 2023 PBGC Annual Report, the PBGC's single-employer program protects about 20.6 million participants in approximately 23,500 plans. Nearly 1.4 million current and future retirees rely on the PBGC for their pension benefits. The multiemployer program protects an additional 11.0 million workers and retirees in approximately 1,360 pension plans.

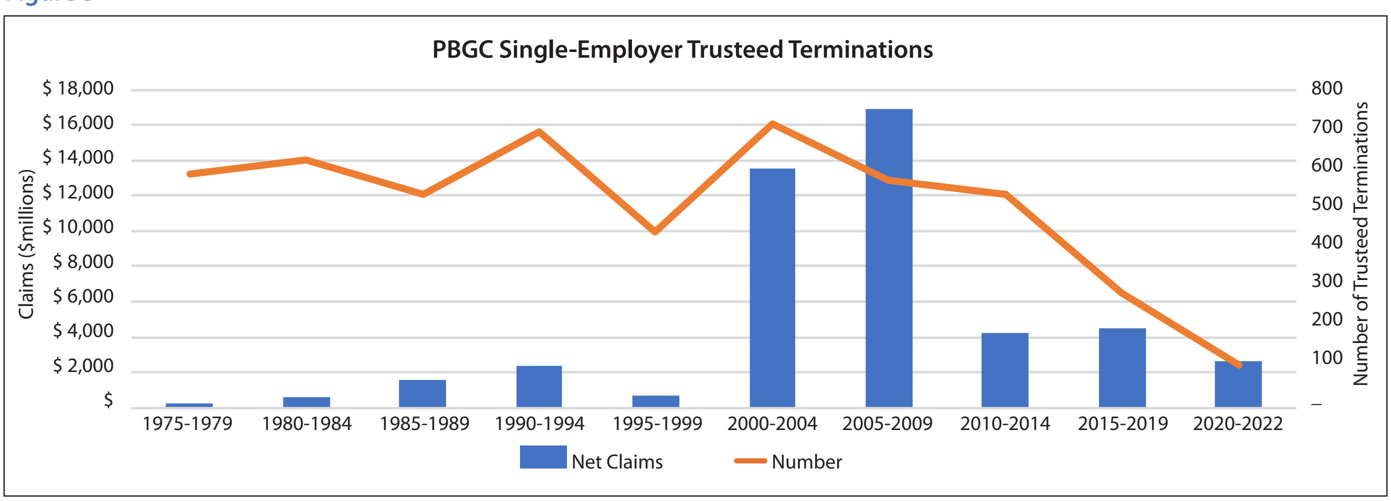
Since PBGC's inception, single-employer and multiemployer plans have separate premium structures and benefit guarantees. Initially, single-employer plans paid a premium of $1.00 per participant. Premium rates have increased dramatically over the past 50 years, to $101 per participant in 2024. (For reference, $1 in 1974 equates to approximately $6.29 in 2024.) The *Consolidated Omnibus Budget Reconciliation Act of 1985* established an additional single-employer premium, based on a plan's unfunded vested benefits (UVB). This additional variable-rate premium was initially set at 0.6% of UVB in 1988. By 2024, that amount had risen to 5.2% of a plan's UVB, capped at $686 per participant.

10 *Strategic Plan—FY 2022-2026*; Pension Benefit Guaranty Corporation; undated.

Some economists note that the termination insurance concept creates moral hazards that may weaken pension funding discipline over time. Research suggests the presence of a backstop guarantee may encourage plan sponsors to take greater portfolio risks, knowing that the PBGC will step in if substantial losses occur.[11] Several high-profile corporate bankruptcies and insufficient funding on the part of some sponsors saddled the PBGC with liabilities exceeding premium revenues. In the early 2000s, seven large organizations terminated their single-employer DB pension plans and the PBGC took them over. The claims from these seven plans represent 43% of the PBGC's total single-employer claims[12] and caused the PBGC single-employer program's net financial position to decline from a $9.7 billion surplus in 2000 to a $22.8 billion deficit by 2005. The deficit peaked at $29.1 billion in 2012.[13] This rapid decline in the net financial position of the PBGC insurance program led to sharp premium increases in an effort to return the PBGC to a secure financial position. It is important to note that not all of the subsequent increases have been tied to the PBGC's financial position.

In response to the plan terminations, the PPA was enacted to significantly overhaul pension funding rules. The PPA instituted new funding requirements for underfunded pensions, intending to force sponsors to pay down funding shortfalls at an accelerated pace. It also implemented stricter liability measurement assumptions to curb rising underfunding. PBGC employer premiums rose considerably, despite the introduction of a per-person variable rate premium cap. Together, these reforms aimed to improve DB system solvency while addressing moral hazard concerns. In the decade following the PPA, rates of new claims on the insurance fund stabilized, as shown in Figure 5.[14]

Figure 5



11 *The Economics of Pension Insurance*; Richard Ippolito; 1989.
12 "Pension Insurance Data"; Pension Benefit Guaranty Corporation; 2021; Table S-5.
13 "Pension Insurance Data"; Pension Benefit Guaranty Corporation; 2021; Table S-1.
14 "Pension Insurance Data"; Pension Benefit Guaranty Corporation; 2021; Table S-3.

Today, the PBGC single-employer program's net financial position has improved to reflect a $44.6 billion surplus at the end of fiscal year 2023. Many employers pay contributions exceeding minimum funding requirements to limit the PBGC premiums, avoid funding-based benefit restrictions, or limit the unfunded pension liability reported in their accounting statements, thus reducing the likelihood their plans will need future financial support from the PBGC. For employers where the additional funding to avoid these requirements are too large, or the premium is limited by the variable rate premium cap, there is less incentive to fund in excess of minimum requirements. The flat rate premium provides an incentive for all employers to reduce participant counts, and that incentive is amplified for employers for which the variable rate premium is limited by the per-person variable rate premium cap.

While the PBGC has had a positive impact for participants in covered plans, the cost of coverage—particularly in the context of the PBGC's current surplus position—has contributed both to the decrease in the number of single-employer DB plans and the rising trend toward DC plans. More information on the impact of PBGC premiums can be found in the Academy's issue brief *PBGC Single-Employer Premiums and Their Impact on Plan Sponsorship*. Although the sharp increase in variable premium rates led some plan sponsors to better fund their plans, others lowered liabilities by reducing benefit accruals, closing their plans to new hires, and reducing the number of covered participants through lump sum cashouts, annuity purchases, and plan terminations. These actions are arguably at odds with the PBGC's fundamental purpose. The Academy's issue brief *Aligning the PBGC's Single-Employer Premium Structure With Its Objectives* discusses ways to address these concerns.

Funding History Post-ERISA

ERISA's funding rules require ongoing funding of accruals earned each year and include a maximum amortization period for paying the plan's unfunded liability. DB plans must employ enrolled actuaries[15] to perform certain required services, including certifying the plan's minimum required contribution and the PBGC variable rate premium. The statute requires actuaries to use reasonable assumptions to measure the plan's liabilities.

Early on, ERISA gave plan sponsors lengthy amortization periods to fund even significant benefit increases due to plan amendments or other events triggering highly subsidized benefits, such as plant shutdowns. However, this buildup of unfunded liabilities made pension plans and their sponsors vulnerable to changes in economic conditions, such as interest rates and competition from employers, without the legacy liabilities. Eventually, this led to some significantly underfunded pension plans being transferred to the PBGC, straining the insurance system.

The funding rules in place led to a large divergence of funded levels. In 1985, when the discount rate used to measure plan liabilities was about 9.75%, the aggregate funding ratio of underfunded plans' vested benefits insured by the PBGC was 72%, while the aggregate funding ratio of overfunded plans' vested benefits was 176%.[16] The underfunded plans likely improved benefits along the way and had not fully funded those improvements. At the other end of the spectrum were pay-based plans, mostly final-pay plans, where the funding approach considered benefits not yet vested and were generally well-funded on this basis.

In the 1980s, some employers with well-funded plans terminated those plans and stripped out excess assets for various reasons,[17] such as financing corporate takeovers.[18] These actions reduced financial security for plan participants if the pension plan was not replaced. At ERISA's outset, assets that exceeded a terminated plan's liability and reverted to the plan sponsor were subject only to income tax, making this strategy possible.

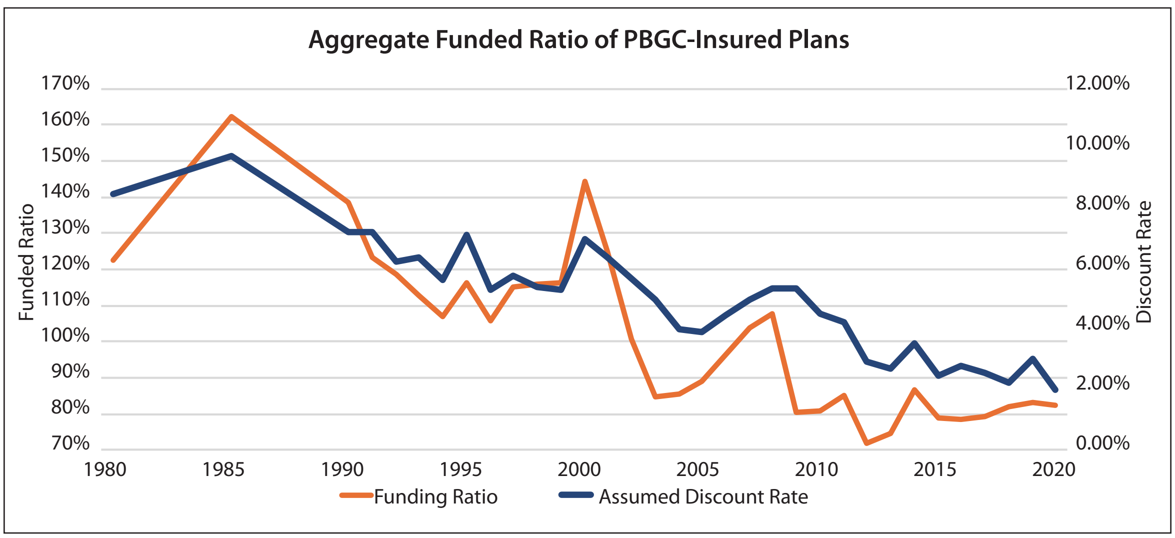
In response, Congress made numerous changes to strengthen the funding rules from the mid-1980s through the mid-1990s. These changes included reducing the amortization period for unfunded liabilities, implementing additional funding requirements for

15 As defined by the IRS, an enrolled actuary is any individual who has satisfied the qualifications set forth in the regulations of the Joint Board for the Enrollment of Actuaries and who has been approved by the Joint Board to perform actuarial services under the Employee Retirement Income Security Act (ERISA) of 1974.
16 "Pension Insurance Data"; Pension Benefit Guaranty Corporation; 2021; tables S-44 and S-45. For purposes of this measure, liabilities reflect vested accrued benefits, while funding rules generally targeted a liability measured on projected increases in future pay, which would lead many plans to appear overfunded on this basis.
17 *Pension Plans—Termination of Plans With Excess Assets*; U.S. Government Accountability Office; April 1986.
18 For example, the purchase of the A&P supermarket chain by Tengelmann Group in 1979 using the surplus in the A&P pension plan.

underfunded plans based on prescribed assumptions, and creating a liquidity contribution requirement that generally requires a reserve of liquid assets to cover three years of benefit payments. Congress also made changes that indirectly affected plan funding, including the imposition of a reversion tax intended to curb the practice of stripping excess pension assets. The unintended consequence was that the potential to incur the reversion excise tax if a plan becomes substantially overfunded made some employers hesitant to fund pension plans at too high a level.

A long period of steady declines in interest rates began in the 1990s and continued until 2022, as shown in Figure 6.[19] For much of that period, pension plan funded ratios fell in lockstep with discount rates. Overfunding as a percentage of all liabilities in the single-employer system dropped from 44% in 1990 to 1% in 2010.[20] However, in the mid-2010s, plan sponsors began to aggressively employ liability-hedging strategies, reduced or froze benefit accruals, and made significant catch-up contributions to plans. These tactics stabilized funding ratios even as discount rates continued to fall.

Figure 6



The magnitude of liabilities and assets in the single-employer system has increased substantially, even as the number of plans has decreased by 75%[21] and the number of participants covered by single-employer plans has decreased by 20%[22] from 1980 to 2022. Aggregate liabilities in 1980 were $212 billion with $260 billion in assets supporting those liabilities. Aggregate liabilities in 2020 were $3.1 trillion with $2.6 trillion in assets supporting those liabilities, a 10-fold increase in 40 years.[23]

19 "Pension Insurance Data"; Pension Benefit Guaranty Corporation; 2021; Table S-44.
20 Ibid.
21 "Pension Insurance Data"; Pension Benefit Guaranty Corporation; 2021; Table S-31.
22 "Pension Insurance Data"; Pension Benefit Guaranty Corporation; 2021; Table S-30.
23 "Pension Insurance Data"; Pension Benefit Guaranty Corporation; 2021; Table S-44.

Pension Protection Act of 2006

The PPA represented the largest overhaul in pension funding rules for single-employer plans after ERISA's enactment. This act intended to put single-employer pension funding on a mark-to-market basis by requiring the use of a funding method based directly on participants' accrued benefits, interest rate assumptions based on current bond rates, and the current market value of assets.[24] The PPA also required amortization of past service liabilities over a period of seven years and limited employer flexibility to reduce required contributions by using credit balances, amounts that arose from making excess contributions in prior years. Additionally, poorly funded plans were subject to accelerated funding requirements.

The PPA also imposed broad funding-based benefit restrictions on underfunded plans to limit further deterioration in funded status. These included restrictions on payments of lump sums, annuity purchases, and other accelerated forms of payment; amendments increasing benefits; and unpredictable contingent events benefits, such as plant-shutdown benefits.[25]

Challenging economic conditions, beginning with the financial crisis in late 2008, made the transition to the PPA single-employer funding rules onerous for many plan sponsors. Stock prices fell almost 50% from October 2007 to March 2009.[26] As stock prices collapsed, the Federal Reserve initiated its quantitative easing program, purchasing securities in the open market and cutting interest rates. Medium- and long-term interest rates declined dramatically, which led to a decrease in the interest rates used to measure pension liabilities and a corresponding increase in those liabilities and minimum funding requirements, all at a time when many plan sponsors were suffering from financial difficulties.

Congress responded with a series of laws, each of which was intended to provide sponsors with temporary funding relief. The *Pension Relief Act of 2010* gave sponsors additional time to amortize losses arising from the 2008 financial crisis. In 2012, the *Moving Ahead for Progress in the 21st Century Act* stabilized interest rates by applying a corridor around them based on a 25-year average of corporate bond rates. This relief was extended several times afterward, most recently by the *American Rescue Plan Act of 2021*, which also lengthened

24 Multiemployer pension funding rules also changed significantly under PPA, diverging from the funding rules applying to single-employer plans.
25 Plans that are not at least 80% funded are generally subject to restrictions on the ability to amend the plan to increase benefits and to pay full lump sum benefits. More severely underfunded plans—those below 60% funded—are prohibited from providing additional benefit accruals and paying lump sums other than small amounts.
26 "Stock Prices in the Financial Crisis"; Federal Reserve Bank of Atlanta; September 2009.

the amortization period for unfunded liabilities from seven to 15 years. Thus, what was originally intended as temporary relief has become a longer-term modification that provides more flexibility, especially in times of rapidly changing economic conditions.

Many sponsors have found the PPA rules, particularly the complex rules around managing the credit balances that arise from past overpayments and the funding-based restrictions on plan benefits, to be inflexible, creating considerable administrative challenges and discouraging ongoing plan sponsorship.

The Academy's Pension Committee sent a comment letter to the U.S. Department of Treasury and the Internal Revenue Service on increasing flexibility relating to maintenance and application of funding balances, identifying several ways the credit balance rules could be improved. The committee also sent a separate comment letter addressing potential improvements to the rules around benefit restrictions.

The Academy issue brief *The Pension Protection Act: Successes, Shortcomings, and Opportunities for Improvement* provides a more in-depth assessment of the PPA's successes and failures.

Limitations of Current Funding Rules

As the retirement landscape continues to evolve, additional plan types are emerging to better satisfy the needs of a mobile workforce and mitigate employer risk related to a traditional pension plans' financial volatility. In particular, there is growing interest among both employers and employee representatives in risk-sharing designs, such as market-return cash balance plans and variable annuity designs. Both reduce plan sponsor risk while allowing for effective long-term investment strategies. These designs retain some of the key advantages of DB plans, such as lifetime retirement income and pooling of longevity risk. However, the DB funding rules have not yet been clarified to fit the underlying economics of these plans. Ensuring that the legal and regulatory framework for DB plans supports these hybrid, risk-sharing plan designs is essential to encouraging the continuation of DB plans and fulfilling ERISA's primary goal of protecting access to an efficient source of lifetime income benefits for workers.

Participant Benefit Security and Fairness

ERISA and subsequent laws introduced additional rules specifically intended to protect participants. The protections include strict vesting provisions, prohibitions against retroactive benefit changes, and disclosure requirements that allow participants to make informed decisions about their benefits. Rules preventing plans from excessively favoring highly compensated employees were also expanded.

Participation & Vesting

ERISA set minimum participation and vesting requirements for pension plans. The law defines the maximum age and service conditions a plan can use in order to determine an employee's eligibility to begin participating in a pension plan, as well as the time until benefits vest. Plans can apply more generous participation and vesting requirements but may not apply stricter rules.

Participation Requirements

Before ERISA, corporate pension plans imposed a wide variety of participation requirements based on age and service. These ranged from one year of service to more stringent requirements, such as entry at age 30. ERISA specified that tax-qualified plans must generally allow participation no later than completion of one year of service and attainment of age 25. The *Retirement Equity Act of 1984* later changed this condition to age 21, with one year of service.

DC plans are generally subject to the same minimum participation requirements as DB plans. However, many DC plans apply more liberal participation requirements, particularly for employee deferrals. Many plans automatically enroll newly hired employees at a moderate level of employee deferrals, with a choice to opt out. Going forward, the *SECURE 2.0 Act of 2022* (SECURE 2.0) requires most new 401(k) plans to have an auto-enrollment feature.

Vesting

Vesting provisions provide a pension plan participant with a nonforfeitable right to the benefits funded by the employer's contribution after a minimum period of service. A participant vests in benefits funded by their own contributions immediately.

Prior to ERISA, most plans provided some sort of vesting schedule for participants who terminated prior to normal retirement age. However, those vesting provisions often required many years of service and/or termination at an age close to retirement. A small percentage of participants were in plans that provided no vesting at all, prior to age 65. ERISA initially prescribed a maximum vesting period of 15 years and, over time, the maximum vesting periods have been shortened to five years for cliff-vesting schedules for traditional DB plans (three for DC plans and hybrid DB plans) and to three- to seven-year graded vesting schedules for traditional DB plans (two- to six-year graded vesting schedule for DC plans).

Benefit Accruals

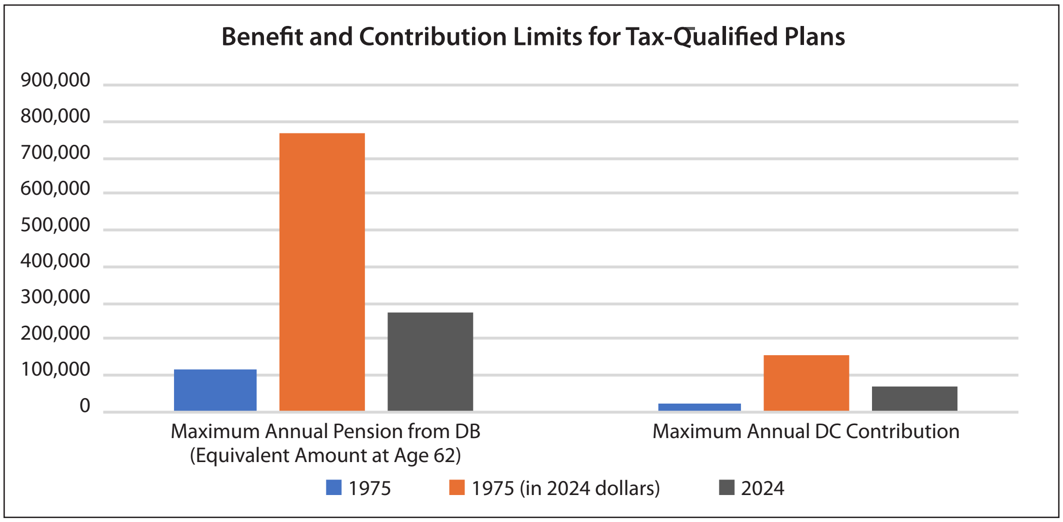
Pre-ERISA nondiscrimination requirements limited the extent to which tax-qualified retirement plans could provide highly compensated employees with more generous benefits than those given to non-highly compensated workers. These rules initially had two goals: "1) to eliminate pension plan tax avoidance schemes, and 2) increase pension and retirement coverage of rank-and-file workers."[27] These requirements encourage more equity between the tax-favored benefits that highly and non-highly compensated employees receive. Since the enactment of ERISA, the nondiscrimination requirements have been made more detailed and strengthened on several occasions.

Before ERISA, tax-qualified pension plans could provide unlimited benefits. To limit deductions for funding benefits to highly compensated employees, ERISA limited the annual pension provided by a pension plan to $75,000 per year at age 55 and the annual contribution to DC plans to $25,000 per year. Since then, the limitations have been tightened by reducing the dollar amounts, raising the payment age for DB plans, and suspending inflation indexation for a time in the 1980s. Despite inflationary indexing, this resulted in a significant reduction in the maximum benefit that can be paid by a qualified retirement plan. A comparison of 1975 to 2024 limits is provided in Figure 7.

27 *Benefits, Rights and Features Nondiscrimination Testing and Phased Retirement Programs;* Georgetown University Law Center; 2010.

An additional limitation was added in the mid-1980s to limit the amount of compensation that can be considered in pension formulas. ERISA allows employers to provide benefits that exceed these limits, but those benefits must be provided through a nonqualified plan and are not eligible for PBGC guarantees. The people most affected by the limitations of qualified plans are often the executives who decide whether to support the continued sponsorship of a DB plan in their organization. Today, many of them lack a connection to the value of the DB plan because they are not participating in or accruing a benefit in the plan.

Figure 7[28]



ERISA implemented "anti-cutback" protections, which prevent plan sponsors from retroactively reducing a participant's accrued benefit. These rules also protect certain other plan features, such as early retirement subsidies, optional form subsidies, and the availability of different optional forms. ERISA also strengthened the rules regarding how benefits can accrue over a participant's career, requiring relatively even accruals throughout a participant's career. Previously, some plans had significantly "backloaded" formulas, where much of the benefit accrued at the end of a participant's career. This meant that participants leaving employment before normal retirement age might receive only a small portion of the full-career benefit. Later changes to ERISA prohibited plans from reducing benefit accrual rates due to a participant's attainment of a certain age.

28 1975 DB limits adjusted from age 55 to 62 using 5% and the 2024 417(e) mortality table.

Survivor Benefits Under ERISA

ERISA introduced the requirement that DB and money purchase plans must offer a qualified joint and survivor annuity (QJSA) to married participants upon their retirement. The QJSA provides a benefit payable to the surviving spouse of at least 50% of the benefit payable during the joint lives of the participant and the spouse. Generally, it must also be no less than the actuarial equivalent of a single life annuity payable to the participant.

The *Retirement Equity Act of 1984* (REA) tightened the QJSA requirement by requiring spousal consent for a form of payment other than the required QJSA or a joint and survivor annuity with a higher survivorship percentage. The law also required plans to provide qualified pre-retirement survivor annuities (QPSAs) to pay death benefits to surviving spouses of vested participants who die before retirement. REA also added Section 414(p) to the Internal Revenue Code, creating qualified domestic relations orders (QDROs) to provide spousal rights to retirement benefits in the event of divorce.

Although DC plans must pay the vested account balance to the spouse upon the death of the participant unless spousal consent for another beneficiary is obtained, those plans generally are not required to obtain spousal consent to a participant's distribution request upon termination from employment or retirement.

Optional Forms of Benefit

Pension plan benefits define a "normal form" of benefit as a monthly payment for the participant's lifetime. Plans must offer certain optional forms to cover spouses and may offer other optional forms of benefit, such as an annuity that provides a payment with a guarantee period or in a single lump sum payment. Conversions from the normal form to the optional form use the plan's actuarial equivalence definition. A plan may have several different actuarial equivalence definitions for different purposes. The Internal Revenue Code requires plans to use at least a minimum basis for calculating lump sums and certain other accelerated forms of payment. When choosing between optional forms of benefit, participants must also receive a disclosure of the relative value of each optional form to the normal form. These requirements have evolved over the past 50 years to address emerging concerns about employee protections.

Disclosure Requirements

ERISA requires plans to provide participants with notices containing important information about the plan and about the participant's benefits. Annual notices, such as the original Summary Annual Report (generally replaced with the Annual Funding Notice) and the Summary Plan Description, notify participants about the financial status of the plan, major events that have happened during the year, and current benefit provisions, including major changes in those provisions. Participants must also receive statements of their benefits in the plan. The rules require that these disclosures be provided in non-technical language so participants can understand what is being communicated. The rules also prescribe deadlines for each disclosure.

Retirement Income

The trend toward account-based plans, including DC plans as well as cash balance and other hybrid DB plans, has accustomed participants to thinking of and taking distribution of their retirement benefits as a lump sum instead of a lifetime annuity. When a retiree chooses to forgo an annuity for a lump sum, they take on the investment risk and longevity risk associated with converting that lump sum into retirement income. Unfortunately, many retirees do not have the necessary financial expertise to effectively manage these risks. Without the longevity risk pooling that an annuity provides, a prudent retiree needs to plan for a longer-than-average lifetime. This will produce lower monthly retirement income. Further, participants taking lump sums from DB plans before normal retirement age may often forfeit the values of early-retirement subsidies available in the annuity form, because plans are not required to include those subsidies in the lump sum.

Although DB plans must offer participants annuity options, except for very small benefits, DC plans have no such requirements. A 2022 survey by the Bureau of Labor Statistics showed that only 14% of private sector employees have access to DC plan lifetime annuity options.[29] Both the *Setting Every Community Up for Retirement Enhancement Act of 2019* (SECURE) and SECURE 2.0 included provisions intended to encourage lifetime income options in DC plans, the effectiveness of those provisions remains to be seen. Related to this point, the Academy published a position statement regarding the importance of *Retirement Income Options in Employer-Sponsored Defined Contribution Plans* in 2017.

29 "How do retirement plans for private industry and state and local government workers compare?" U.S. Bureau of Labor Statistics; January 2023.

Conclusion

Since its enactment in 1974, ERISA has clearly improved the security of America's private-employer retirement system for those workers who participate in DB plans.

This issue paper highlights the various protections that ERISA provides through:

- The creation of PBGC-insured benefits that are available should a plan sponsor be unable to maintain its plan;
- Pre-funding rules that have reduced the number of employers requiring such protection; and
- Establishing specific protections for benefits, such as more stringent vesting rules and spousal benefits.

However, ERISA has not been successful in ensuring that most workers have access to retirement plans or secure lifetime income, as 31% of private sector employees lack plan coverage altogether and only 7% accrue benefits under a DB plan.[30] In DC plans, only 14% of private sector employees have access to annuity options.[31]

Moreover, ERISA has also created some significant challenges for DB plan sponsors, such as high PBGC premiums, complex funding rules, and myriad administrative requirements. These challenges have contributed to the decline of DB plans over the years. Many employers now rely substantially or exclusively on 401(k) plans, which shift risk to employees and do not generally allow for efficient pooling of those risks. While ERISA has strengthened protections for individual participants in single-employer DB plans, far fewer workers benefit from those protections today than did at ERISA's adoption 50 years ago.

30 "Pension Insurance Data"; Pension Benefit Guaranty Corporation; 2021; Table S-33.
31 "How do retirement plans for private industry and state and local government workers compare?"; Op. cit.

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