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Issue Brief

Enhancing Retirement Security Through Changes in Plan Design and Related Requirements

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Key Points

- Over the past few decades, DB plans in their traditional form have become increasingly unpopular. At the same time, DC plans' failure to deliver retirement income security has received more attention.
- Employers seek limited liabilities, administratively manageable requirements and operational costs, funding flexibility, and benefit plans that can better align with some of their business objectives. Employees desire plans that offer easy to use options that will help enhance their long-term retirement security.
- This issue brief explores potential modifications to DB plans that would mitigate some of their most significant shortcomings, and potential ways to incorporate some of the more desirable attributes of DB plans into DC plans.

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Introduction

Over the past four decades, many private-sector employers have closed and frozen defined benefit (DB) plans in favor of defined contribution (DC) plans.[1] Among the reasons often cited for this shift are the perceived riskiness of the plans,[2] lack of appreciation by employees, and opportunity for cost reduction. However, DB plans have many attractive attributes that would be difficult to incorporate into DC plans under current laws and regulations.

This issue brief explores two alternative approaches to enhancing retirement plan designs. First, the brief examines potential modifications to DB plans that would mitigate some of their most significant shortcomings and make them more appealing to employers. The second approach explores potential ways to incorporate some of the more desirable attributes of DB plans into DC plans. Some of what is discussed below may have implications under the *Employee Retirement Income Security Act of 1974* (ERISA).

Key DB Plan Features

Throughout the modern retirement plan landscape, many employers offer only DC plans. However, DB plans still retain some important attributes not available in DC plans.[3] DB plans can:

- Provide guaranteed lifetime income based on longevity pooling without the need to purchase insured annuities.

1 "Estreicher and Gold on The Shift From Defined Benefit Plans to Defined Contribution Plans"; Workplace Prof; April 11, 2007.
2 Private Pension Plan Bulletin Historical Tables and Graphs 1975-2020; Employee Benefits Security Administration; Department of Labor; October 2022.
3 "The pros and cons of defined benefit pensions"; Pension Bee; March 22, 2023.

- Serve as a workforce management tool allowing employers to:
  - Encourage an orderly transition of talent by facilitating retirement with guaranteed and predictable retirement income
  - Attract and retain mid-career employees who may be more attracted to a guaranteed pension at retirement
  - Influence the timing of retirements to best suit the needs of the organization through the use of incentives (i.e., early retirement windows or subsidies)
- Provide contribution flexibility, particularly for employers who have previously made contributions in excess of the minimum required
- More efficiently deploy resources to provide retirement security
  - Reduces leakage compared with DC plans that offer hardship withdrawals or loans.
  - Focus resources on retirement income more than DC plans that often are structured to provide an inheritance[4]
  - Provide more efficient asset allocation and investment management compared to individual DC accounts, since DB assets are more likely to be invested by professionals with risk spread across generations of participants.
- Provide for subsidized ancillary benefits (death, disability)
- Provide substantially more valuable benefits to late-career employees, who are more likely to value their retirement benefits.

Potential Improvements to DB Plans

As noted above, private-sector employers, particularly mid-size and larger employers, have been turning away from DB plans for decades due to significant perceived problems, including financial volatility and burdensome requirements. Some of the ways to address these challenges while retaining many of the DB plans' advantages are noted below. They are divided into two sections. The first addresses plan design through legislative or regulatory considerations; the second addresses valuation and administrative considerations.

4 Some DB plans may provide options for payments in the form of lump sums.

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Plan Designs (Through Legislative and Regulatory Changes)

Expanding Risk-Sharing Designs

Traditional DB plans provide fixed benefit amounts—or, in rare cases, amounts that are adjusted based on the change in an external index, such as the Consumer Price Index—leaving the plan sponsor to bear all investment, longevity, and other demographic risks. Risk-sharing retirement plan designs fully or partially transfer those risks to participants while retaining the ability to provide lifetime income. These plans transfer the risk by adjusting benefits based on actual investment return.

Under current rules, DB plans may only adjust benefits based on the actual investment experience of plan assets or specified market indices. Relaxing the rules to permit benefit adjustments based on mortality and other demographic experience would allow employers to transfer through the plan all investment, longevity, and other demographic risks to participants. This adjustment would further reduce volatility and balance sheet liability. Eliminating this risk for employers would also reduce the risk for the Pension Benefit Guaranty Corporation (PBGC), so premium rules could be modified to reduce the level of premium for this type of plan. Such a change could encourage the continuation of more defined benefit plans.

Please see the Academy's October 2021 issue brief *New Retirement Plan Designs: Degrees of Risk Sharing* for more detail.

Effective Surplus Utilization

The Internal Revenue Code (IRC) limits plan sponsors in how they can use excess assets in a pension plan. If a plan becomes significantly overfunded, an employer cannot access the money before plan termination, except possibly to cover retiree medical costs.[5] When a plan terminates, the sponsor is subject to an excise tax of 50% of the amount of the reversion.[6] (The employer can reduce this tax to 20% by establishing a "qualified replacement plan" or meeting other benefit-increase requirements.) The employer must pay this excise tax in addition to regular corporate income tax. These strict limitations on access and use of this "trapped surplus" discourages plan sponsors from overfunding their pension plans.

Allowing sponsors to access a plan's surplus may encourage additional funding above the minimum required amounts, which would ultimately improve the health of the DB system. One approach would be to allow sponsors of very well-funded plans to withdraw assets over a sufficiently high funding level.)[7] without any excise tax. Also, sponsors might be allowed more extensive use of surplus, such as covering the cost of matching or

5 See IRC §420.
6 See IRC §4980(d).
7 Rules around Section 420 transfers are an example of use of surplus.

profit-sharing contributions in the company's 401(k) or 403(b) plan without terminating the plan. There is a possibility that a plan with surplus has a part of the surplus withdrawn and future developments cause the plan to be no longer overfunded. Though this is true, it would not eliminate the employer's responsibility to fund the plan to pay all accrued benefits.

Tax-deferred employee contributions

Unlike defined contribution plans, single-employer defined benefit plans cannot effectively be funded through tax-deferred employee contributions. Employee contributions to qualified retirement plans are taxed immediately.[8] However, many types of plans have rules that allow employee contributions to be converted to employer contributions and receive favorable tax treatment. For example, governmental pension plans can "pick up" employee contributions to treat them as employer contributions so that they are tax-deferred.[9] In addition, employees may make pre-tax contributions to 401(k) plans in lieu of receiving the money in cash (in addition to after-tax contributions).[10] Other DC plans including 403(b) and governmental 457(b) plans allow for tax deferral of employee contributions. While multiemployer DB plans technically do not permit tax-deferred employee contributions, the mechanism through which these plans are funded essentially produces the same result. Most multiemployer DB plans operate under a collective bargaining agreement (CBA) that requires the employers to pay a fixed contribution for each hour employees work. The CBA generally determines how much of the employees' hourly wages are allocated to benefits and how much the employees receive in their paychecks. Because the fixed contribution per hour is part of the bargained total wage, that amount could be viewed as a tax-deferred employee contribution.

Effectively, single-employer DB pension plans alone may not accept tax-deductible employee contributions. Currently, requiring employees to contribute to a single-employer defined benefit plan is a tax-inefficient plan design feature for a plan sponsor to include in its retirement program. In addition, beyond the disadvantageous nature on the front end, the taxation of after-tax contributions when payments are made from a defined benefit plan is complex and administratively burdensome on the back end as well.

Although these issues are likely not a major contributor to the decline in DB plans, no theoretical justification for the distinction exists, and remedying this situation would remove a small impediment for employers including DB plans in their retirement benefits strategy.

8 See IRC §414(h)(1).
9 See IRC §414(h)(2).
10 See regulation §1.401(k)-1.

Pooled Employer Plans

Small employers often don't have the resources to sponsor a DB plan independently, but multiple employer DB plans are currently available only to employers with a "common nexus." The *Setting Every Community Up for Retirement Enhancement (SECURE) Act* created a new kind of multiple employer DC plan called a pooled employer plan (PEP) that is accessible to a wider range of employers. Allowing DB PEPs could help ease the administrative burden of DB plans but would not address all of the issues that have made DB plans unattractive to many employers. (Discussion of alternative structures for DB PEPs are beyond the scope of this issue brief.)

DB PEPs will therefore have to offer something new to attract employer interest. In particular, they will have to substantially reduce the cost volatility associated with the typical DB plan. This is particularly important when multiple employers participate in the same plan because mismatches between assets and liabilities raise the risk of changes in contribution levels that may be difficult to allocate "fairly" between participating employers and raise the risk of healthier employers facing higher contributions due to some employer's inability to pay its share of the obligation. For this reason, DB PEPs, if permitted, could be well-served by adopting a variable annuity structure. As explained above, in a variable benefit plan, investment risk is largely borne by participants so that benefits are essentially fully funded at all times, with minimal-to-no residual investment risk for participating employers.

Non-Plan Design Changes

Administrative Burden Reduction

ERISA imposes many administrative requirements on qualified plan sponsors. These requirements tend to be greater under DB plans, where the plan sponsor is committed to providing a specified benefit level. Examples include:

- Overly complex rules around managing credit balances (prefunding and carryover balances) that create significant opportunity for missing election deadlines and producing outcomes that are clearly not in line with the plan sponsor's intent. See the Pension Committee's comment letter on Rules for Maintenance and Application of Funding Balances to the Department of the Treasury and the IRS.
- Limited ability to eliminate optional forms of payment where the plan otherwise provides a reasonable range of payment options. This can be a particular concern for plans that have merged in multiple plans with many different legacy options.
- Lack of a safe harbor for updating actuarial equivalence assumptions without having to grandfather the prior equivalence basis for benefits earned to date.

Easing some of DB plans' administrative requirements may lessen the disincentives to sponsorship.

Change PBGC Premiums to Better Reflect Risk

The PBGC was created in part "to encourage the continuation and maintenance of private-sector defined benefit pension plans."[11] However, law changes over the past decade have dramatically increased annual PBGC premiums. These increasing premium obligations have led many employers to close, freeze, or reduce the size of their plans or discontinue them altogether.[12] Changes to the premium structure may more effectively support PBGC's original objective.

PBGC variable-rate premiums depend on the plan's funded status, but not the health of the sponsor itself. Changing the premium structure to reflect a plan's risk to the system more directly would reduce the financial cost for healthier employers to sponsor DC plans instead of (rather than in addition to) DB plans. Similarly, reducing premiums for plans with lower asset-liability mismatch risk—the risk that changes in a plan's liabilities will differ from changes in asset values—would more closely tie the premium to the plan's risk to the PBGC.

There have been several laws enacted in which PBGC premium increases have offset the cost of legislation unrelated to PBGC. An increase in PBGC premiums is treated as an increase in general revenue and may be applied to offset the cost associated with unrelated governmental expenditures. Thus, even if an increase in premiums is not required or requested by the PBGC, and even though the assets of PBGC programs are available only to pay the obligations of PBGC, legislative scoring rules permit PBGC premium income to be treated as if it were available to pay for other costs in a legislative measure. Premiums are higher than they need to be to reflect the risks they insure because, due to budget rules, there is a legislative incentive to increase premiums whether needed or not.

Please see the Academy's October 2020 issue brief *PBGC Single-Employer Premiums and Their Impact on Plan Sponsorship* for more information.

Changes to Accounting Rules

The Financial Accounting Standards Board (FASB) overhauled pension accounting rules in December 1985 with the release of Statements Number 87 and 88. At that time, FASB noted that it viewed pension accounting as being in a "transitional stage," a comment that was consistent with what its predecessor said when the prior statement was released 19 years earlier.

11 The PBGC mission statement is at www.pbgc.gov/about/who-we-are.
12 *Analyzing the Drivers of Pension De-Risking Activity*; PBGC; July 25, 2018.

More than 35 years later, the 1985 rules for determining liabilities and pension expense remain in effect with only minor updates, while pension plan design and prevalence has changed significantly in the interim. In September 2021, the Academy responded to an Invitation to Comment published by FASB staff earlier in the year with a number of significant suggestions and comments related to the existing rules:

- A liability measure (PBO) is mandated for most plans that reflects potential future salary increases despite the fact that these obligations may be eliminated before they are ever earned.
- At the same time, cash balance and other hybrid plans are allowed to exclude future salary obligations while conceptually similar plans are not, thus providing plan sponsors with a lower liability measure for these plans.
- Frozen plans and plans with a substantially inactive population are—counterintuitively—entitled to amortize gains and losses over a longer period of time than active and ongoing plans, creating a disincentive to maintain an existing plan.
- Investment-based plans were extremely uncommon when the current accounting rules were written, and no clear consensus exists on the application of these rules to those plans. Interpretations and applications can therefore vary significantly between companies and auditing firms.

Changes to Funding Rules for Variable Benefit or Risk Sharing Plans

Plans using investment-based or risk-sharing designs—such as variable annuity plans, market-based cash balance plans, and gain-sharing plans—face distinct challenges when calculating liabilities under the current funding rules (including the rules for determining PBGC premiums). These rules largely presuppose a traditional defined benefit plan without any of these newer features.

In November 2019, the American Academy of Actuaries released a 59-page public policy practice note[13] devoted solely to the valuation issues presented by variable annuity plans. A similar effort is currently underway for difficult-to-value plans, which comprise many other risk-sharing designs. The substantial nature of these undertakings indicates the complexity of the issues for such plans.

Generally, there are two schools of thought as to the appropriate method of valuing a pure variable annuity plan under current funding rules:

- Expected return and discount rate are the same—This is the traditional (and in the belief of some actuaries, theoretically correct) way to value a pure variable annuity plan. Benefits are projected to the payment date at the same rate used to discount them to the valuation date. The resulting liability will be independent of the plan's

13 *Variable Annuity Plans*; American Academy of Actuaries; November 2019.

investment mix and the assumed discount rate. This calculation is equivalent to valuing the current benefit at the plan's hurdle rate. The equivalence will hold as long as no interfering factors affect the underlying benefit, such as benefit guarantees, 415 limits, ceilings or floors. While this approach provides a reasonable answer, regulatory bodies have been reluctant to accept it, possibly based on their interpretation of the relevant statutes.

- Expected return and discount rates are different—Under this method, the actuary sets an assumption for projecting the benefits based on the plan's investment mix, and then uses the mandated funding discount rate (segment rates or the full yield curve) to discount those benefits to the valuation date. Because the expected return assumption differs from the discount rates, the resulting liability will never be consistent with the amount needed to fund the plan benefits and the plan will always experience a gain or loss when benefits are ultimately paid, even if the expected return assumptions are exactly realized. On the surface, this outcome would appear to be inconsistent with basic actuarial principles and as well as the widely understood intent of the *Pension Protection Act of 2006* (PPA). However, many actuaries believe that IRS regulations require this methodology.
- The recent updates to ASOP No. 4 require the calculation of a Low Default Risk Obligation Measure, which generally aligns with the PPA requirement to discount cash flows using yields on high-quality bonds but provides for an explicit exception for variable annuity and similar designs.
- The variable annuity plan is the purest form of risk-sharing design, in that in its most basic form the participant's benefit fully reflects any changes in the underlying plan assets. A market-based cash balance plan where the account balance increases based upon actual investment earnings is similar but must meet the preservation of capital requirements under Internal Revenue regulations. The degree to which these requirements should, or may, be reflected in a plan's valuation is unclear. More complicated plan designs may provide even more complexity than the application of the preservation of capital requirement.

These valuation issues may also affect calculations for:

- Amount of lump sum under IRC Section 417(e)
- PBGC variable premium amounts
- The 110% rule for "High-25" restrictions under Internal Revenue nondiscrimination regulations

The lack of clarity regarding the appropriate way to value these risk-sharing plans has made some employers reluctant to adopt them, but statutory or regulatory attention could provide firm support for these designs. Uncertainty discourages plan sponsors from establishing plans that could prove problematic, even if they could be otherwise valuable to the sponsors and participants. Resolution of these valuation issues by regulators or Congress could encourage sponsors to adopt these kinds of plans.

Improving DC Plans

Although DC plans have become the dominant employer-provided retirement vehicle, they suffer from several shortcomings when it comes to securing participants' retirement. Below we discuss several structural changes to DC plans that could improve retirement security.

Structuring DC Plans to Offer Retirement Income

Traditional DB plans are structured to provide lifetime income, but DC plans generally do not provide in-plan annuities nor even facilitate the purchase of an annuity from an insurance company. The SECURE Act introduced a safe harbor for plan sponsors choosing an annuity provider, but it's too soon to know to what extent plan sponsors will make insured annuities available—and, if so, whether retirees will buy them. Though retirees indicate that they prefer lifetime income, they are generally reluctant to purchase annuities for a variety of reasons including high fees, loss of value upon early death, product complexity, and the use of conservative investments and life expectancy factors needed to guarantee a fixed income level. Below are three ideas that might increase the availability of lifetime income from DC plans.

Non-insured systematic withdrawals: As an alternative to offering a true annuity, DC plans could offer systematic withdrawals, for instance a fixed percent of the account balance or a fixed dollar amount each year. Unlike insured lifetime income options, these payouts don't provide a guaranteed income for life; however, they provide a structured method of distribution that offers a high probability of lasting for the participant's lifetime. Of course, participants can use this method even if their retirement savings are stored elsewhere (e.g., in an IRA). However, employer-sponsored retirement plans have access to lower-fee investments and greater investment selection expertise[14] than most individuals can secure on their own. In addition, by offering these options within plans, employers can help simplify participants' transition to retirement since the transaction does not require initiating a rollover to another financial institution.

14 Professional managers use modern portfolio theory, hedging, and alternative investments.

Although structured withdrawals are permissible under current rules, employers may be hesitant to offer them because of potential fiduciary liability concerns as well as the additional costs and administration involved with providing recurring payments. A new safe harbor offering fiduciary protection might encourage more employers to offer the option. The Federal Thrift Savings Plan offers non-annuity payouts and could serve as a potential model for such a safe harbor. The 2017 Academy Position Statement includes support for plans offering structured retirement income solutions.

Changes to QLACs: Currently, Qualified Longevity Annuity Contracts (QLACs) must provide a fixed guaranteed income (possibly with an annual increase).[15] As a result, insurers hold the underlying assets in low-risk securities, making QLAC payouts unattractive to the purchaser on a price-to-benefit basis in a low interest rate environment. The accumulation period of these contracts (between premium payment and the first benefit payment) can be as long as 15 or 20 years. Few retirees may wish to lock in their future retirement funds for such a long period with an unattractive internal rate of return. Allowing variable QLACs in addition to fixed QLACs could potentially provide greater benefits. As an example, over a 15-year period the difference in the accumulation of funds between a 3% and a 5% rate of return would result in a 33% larger benefit. The regulation creating QLACs notes that the Department of the Treasury has the authority to allow changes such as to permit variable and indexed QLACs without further legislation.[16] The Academy's 2015 letter to the Department of Treasury describes this suggestion in greater detail.

Experience-sharing annuities: One potential approach that has been suggested would allow DC plans to offer non-insured annuity options, under which payments would be periodically adjusted up or down for the pooled actual investment and longevity experience of all retirees electing the option. Programs using experience-sharing annuities can use floors and ceilings as a way to minimize volatility in the payouts since they will be subject to increases and decreases based on investment and mortality experience. This would help to even out the payments, making it easier for retirees to budget. In the U.S., some non-ERISA church plans and CREF variable annuities provide experience-sharing annuities. This approach could be used within large employer plans and PEPs. The concept of retiree risk pooling in an IRA-type account was advanced by Sen. Harkin under the USA Retirement Funds proposal in 2014 (see the Academy's assessment of the Harkin proposal).

15 A QLAC is a type of annuity contract specifically designed to keep individuals from outliving their retirement assets by providing a guaranteed stream of income later in life. In addition, they reduce the retirement account withdrawals mandated at age 72, helping to defer some income taxes.

16 "[T]he final regulations provide that a QLAC does not include a variable contract under section 817, an indexed contract, or a similar contract. However, the final regulations also provide that the Commissioner may provide an exception to this rule in revenue rulings, notices, or other guidance published in the Internal Revenue Bulletin." "Longevity Annuity Contracts"; *Federal Register;* July 2, 2014.

Helping Employees Covered by DC Plans Estimate Retirement Income Levels

Because DC plans generally only report current account balances on periodic employee statements[17], employees often have difficulty figuring out what level of retirement income they could obtain from their balances. Starting in 2022, plans must provide participants with estimated annuity amounts under the SECURE Act's lifetime income disclosure provisions. However, these will likely be inadequate to help most participants plan for their retirement.

DOL issued an interim final regulation (IFR) on the lifetime income disclosures in 2020. DOL expected to issue final regulations before the IFR took effect in September 2021, but those regulations have been delayed. Below we discuss some concerns with the disclosures under the IFR. An Academy comment letter addresses the concerns in greater detail and provides other suggestions.

- **Growth in account balance using investment earnings and future contributions:** The current requirement ignores future investment growth as well as growth based on future contributions. A more useful projection would reflect increases to the current account balance from anticipated investment growth and future contributions.

- **Use of multiple retirement ages:** Providing information at least at two retirement ages would illustrate the potential financial impact of deferring retirement to a later age.

- **Account balances to income conversions at retirement:** The lifetime income illustration would be more valuable to retirees if it used actual sex-distinct annuity purchase rates. The DOL could periodically—e.g., monthly or quarterly—publish these rates, based on the publicly available rates. To provide even more value as a planning tool, the benefit statement could also provide retirement income projections using noninsured systematic withdrawal approaches.

- **Updating the Employee Benefits Security Administration (EBSA) Lifetime Income Calculator.** Participants rarely keep all their retirement savings in a single plan. Adding language in the benefit statement referring participants to the EBSA Lifetime Income Calculator to estimate the projected income value of other retirement savings (e.g., IRAs) would be helpful. Updating the EBSA calculator to reflect the same assumptions and methodologies used for required lifetime income disclosures would provide consistency.

17 Many plans do provide access to modeling tools; however, they are not always easy to use and many employees may not even be aware they exist.

- **Education**. DC plan participants must make many complex decisions. Providing accessible education at different points of the work cycle is important in improving retirement outcomes. The education can be best provided through the employer, but DOL-supplied materials could also be a valuable resource.

Improving Plan Design to Encourage Employee Behavior

One of the challenges of the DC plan design is that it requires participant involvement. Participants must decide how much money to contribute and how to invest their funds and must then manage a large pool of money after they terminate employment, which may be years before retirement. In addition, "leakage"—when participants take money intended for retirement and use it for non-retirement purposes—is a serious problem in DC plans, which often permit hardship withdrawals and loans. However, changes to DC plan design features could mitigate these problems as addressed in a 2022 Academy issue brief on aligning plan designs to encourage employee engagement.

- **Contribution rates**: Automatic contribution arrangements, especially with automatic escalation, significantly increase participation and overall contribution rates, leading to increased retirement savings for participants. The SECURE Act raised the cap on auto-escalation features from 10% to 15% of pay. SECURE 2.0 further expanded both auto-enrollment and auto-escalation to increase coverage. Additional law changes could further encourage plan sponsors to incorporate these features, especially for plans that don't provide matching contributions (and so likely have lower participation rates). Also, improved lifetime income disclosures illustrating the impact of increased employee contribution rates could demonstrate to participants the value of raising their contribution levels.

- **Investment selections:** Target-date funds and other diversified asset allocation investment alternatives are particularly helpful to DC plan participants with little knowledge of investing. Although many plans offer these funds, not all plans do. Encouraging more plans to offer such options may help participants make better investment choices.

- **Distribution options**: Traditionally, DC plans have paid out retirement benefits only in a lump sum, forcing retirees to manage their money in retirement even if they are ill-equipped to do so. As discussed above, new safe harbors offering fiduciary protections could encourage more sponsors to offer systematic withdrawals as a distribution alternative. However, only offering these may not be enough to change employee behavior. Additional participant education regarding longevity risk might overcome some resistance to these options.

- **Portability and leakage:** Determining how to manage a lump sum can be a significant challenge for terminating participants, who may have many years left before retirement and lack access to competent financial advisers. Transferring funds to another employer plan is not always easy or possible. Individuals that lack personal investing experience may have trouble with transfers to IRAs. Though SECURE 2.0 has provisions to improve portability, future legislation could make further improvements. This is especially true for smaller balances that may often be taken as a taxable distribution at termination and spent immediately (referred to as leakage). Different approaches to streamlining portability and reducing leakage have been proposed. One way would be to facilitate the consolidation of all retirement funds within a single account. Such an account could offer several low expense and easy-to-use diversified investment options with varying asset allocations. A 2020 Academy issue brief on portability addresses some of these concerns and ideas.

Building Up Assets Under DC Plans on a Non-Allocated Basis

Cash flows for many employers are subject to business cycles. In cash-rich years, DC plan sponsors would likely appreciate having the option to put extra money into their plans on a tax-deductible basis. By contributing on a tax-deductible basis more than the amount to be allocated in the current year, the employers could build up a "balance" they could use to offset contributions in a future year. (Whether such a "balance" would be permitted to revert to the employer would need to be considered.) However, under current law, ERISA-covered DC plans generally can't hold funds that aren't allocated to individual participants' accounts (with an exception for amounts transferred from terminated DB plans that had excess assets). Eliminating this restriction would give sponsors greater flexibility:

- **Prefund future contributions:** Allowing employers to prefund plans (subject to limitations) may help them continue to provide employer contributions in years with challenging cash flow issues. For example, during previous economic downturns, some employers suspended matching contributions. If they had been able to prefund the plan in earlier years, they may have continued the match.

- **Workforce management:** DB plans can offer special benefits to encourage changes in the workforce, such as early retirement windows where increased retirement benefits are offered for a limited period of time to a segment of the workforce. In a DB plan, these increased benefits can be funded with future contributions or from already existing surplus. No similar options exist for DC plans. To offer enhanced benefits, the sponsor would need to come up with the funds immediately. However, if an employer were permitted to make unallocated contributions, such amounts could be accumulated over time and used to provide enhanced benefits for a select group of employees to encourage early retirement if needed.[18]

Conclusion

Over the past few decades, DB plans in their traditional form have become increasingly unpopular. At the same time, DC plans' failure to deliver retirement income security has received more attention. Employers want limited liabilities, administratively manageable requirements and operational costs, funding flexibility, and benefit plans that can better align with some of their business objectives. Employees want plans that offer easy to use options that will help enhance their long-term retirement security. This issue brief has examined several policy and law changes that could mitigate some of the challenges facing DB plans and enhance DC plans, improving retirement security for millions of Americans.

18 May also require changes to maximum annual addition limits under Section 415 of the IRC.

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