Looking Back, Moving Forward: ERISA at 50
The Origins and Evolution of ERISA: 1974 to 2024

American Academy of Actuaries Webinar

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Presenters

SPEAKERS

J. Mark Iwry
Nonresident Senior Fellow, the Brookings Institution
Visiting Scholar, The Wharton School

Former Senior Advisor to the Secretary of the Treasury and Deputy Assistant Secretary for Retirement and Health Policy, U.S. Department of the Treasury

Lloyd Katz, MAAA, FSA, EA, FCA
Vice Chairperson, Pension Committee, American Academy of Actuaries

James A. Wooten
Professor & Vice Dean for Research and Faculty Development, University at Buffalo School of Law

MODERATOR

Linda K. Stone, MAAA, FSA
Senior Retirement Fellow, American Academy of Actuaries

What we will go over during today’s program

https://www.pbgc.gov/about/who-we-are/pg/president-ford-signing-erisa-of-1974

President Gerald Ford signed the Employee Retirement Income Security Act into law on Labor Day in 1974.

The Political History of ERISA in a Nutshell

- ERISA reflected a basic change in thinking about what pension plans are for.
  - Before 1960, federal policy viewed pension plans as tools for managing workers.
  - In contrast, ERISA views pension plans as tax-subsidized vehicles for delivering retirement income to workers.

Pre-ERISA Legislation & Rulings

Legislation	Result
Revenue Act of 1913	Implements income tax following 16th amendment, plan deductions subject to general rules on ordinary & necessary business expenses
Revenue Act of 1921	Exempts Profit Sharing & Stock Bonus trusts from income tax
Revenue Act of 1926	Exempts Pension trusts from income tax
Revenue Act of 1942	Establishes coverage requirements [similar to current §410(b)] & nondiscrimination requirements [limits discrimination in favor of officers, shareholders, supervisors, and HCEs]
Labor-Management Relations Act, 1947	Established a regulatory framework for the administration of multiemployer welfare and pension plans.
Welfare & Pension Plans Disclosure Act (WPPDA 1958)	Required registration & reporting, disclosure of financial operations of welfare and pension plans

Various Regulations, Revenue Rulings, etc. provided limited requirements for plan permanence, definitely determinable benefit formulas, nondiscrimination requirements, and other rules.

The Political History of ERISA in a Nutshell

- The Studebaker-Packard Corporation played an “infamous” role in ERISA’s enactment, first by terminating the underfunded pension plan for Packard’s hourly workers in 1958 and then by terminating the underfunded pension plan for Studebaker’s hourly workers in 1964.
  - The Packard termination led the United Auto Workers to begin developing a proposal for termination insurance for pension plans.
  - In 1964, the UAW worked with Indiana Senator Vance Hartke to introduce legislation to create such a program.

The Political History of ERISA in a Nutshell

- Much of the early impetus for pension reform came from government officials in the executive branch and Congress and from academics. In particular, the Report of the President’s Committee on Corporate Pension Funds, established by President Kennedy in 1963, became a “Bible” for reformers.

The Political History of ERISA in a Nutshell

- The business community opposed the major reforms in ERISA, while the labor movement was deeply divided.
  - Unions that bargained multiemployer plans strongly opposed pension reform.
  - Unions that bargained single-employer plans strongly supported pension reform.

The Political History of ERISA in a Nutshell

- With business and most unions in opposition, comprehensive pension reform legislation would not pass unless its supporters mobilized support from the press and public. To this end, in 1970 Senators Jacob Javits and Harrison Williams undertook a publicity campaign to “dramatize” the problems of the private pension system with “horror stories” and “shocking” (and, according to Robert Myers, “appallingly misleading”) statistics.
- Javits and Williams’s effort was a complete success.

The Political History of ERISA in a Nutshell

- Federal preemption played a critical role in building the legislative coalition for ERISA's enactment.
  - Besides mobilizing support for pension reform from the press and public, Javits and Williams's campaign also persuaded state legislators to pursue pension reform. When states took up pension reform legislation, business groups quickly reversed course and supported federal legislation as a means of preempting state initiatives.

The Political History of ERISA in a Nutshell

- The demand for federal preemption led Congress to pass more sweeping reforms than it might otherwise have done.
  - In each chamber of Congress, the tax and labor committees both claimed jurisdiction over pension reform. While the tax committees were more conservative and more powerful, the congressional rules defining committee jurisdictions gave the labor committees control over Congress’s power to preempt state employment laws. This increased the labor committees’ leverage in deliberations over the content of federal pension reform legislation.

The Political History of ERISA in a Nutshell

- Besides ERISA, the Ninety-Third Congress was also busy with Watergate. On several occasions, supporters of pension reform were greatly concerned that Congress's investigation of the Watergate break-in and the impeachment proceeding against President Richard Nixon might knock pension reform off the congressional agenda. Nixon's resignation on August 9, 1974 cleared the way for ERISA's enactment, which President Gerald Ford lauded as "a good reflection on the relationship between the executive branch on the one hand and the legislative branch on the other."

Studebaker & Packard

- Studebaker:
  - Premier manufacturer of horse-drawn carriages since mid-19th century
  - Entered automobile business in early 20th century
  - One of four “independent” automakers in early 1950s
  - At its height, sold 320,000+ cars in 1950, just behind Dodge & ahead of Chrysler
  - Rapidly declined thereafter, causes included:
    - Pricing pressure from “Big 3” [GM, Ford, Chrysler]
    - Quality control issues
    - Higher labor costs & breakeven point than other manufacturers
  - Merged into Studebaker-Packard in 1954

Studebaker & Packard

- Packard:
  - Founded 1899, top selling luxury car brand in mid to late 1920s
  - Survived Depression by producing lower priced “Junior” models
  - One of four “independent” automakers in early 1950s
  - Did not have resources to keep up with Cadillac & Lincoln
    - Dated styling
    - Lack of V8 engine until 1955
    - Quality control issues related to factory move in 1954
  - Bought Studebaker & formed Studebaker-Packard in 1954
    - Studebaker was in horrible financial condition, far worse than Packard thought!
    - Plummeting sales led to last real Packards in 1956, “Packardbakers” thereafter

Notable Pension Failures Pre-ERISA

- Studebaker-Packard (dropped the "Packard" in 1962)
  - Studebaker & Packard Plans had been merged
  - Split into separate plans when labor agreements expired in 1958
  - **Packard plan** then terminated – no active employees were covered so union local couldn't negotiate, though International complained
    - Retirees got 85¢ on the dollar
    - Small lump sums for those eligible to retire
    - All others – out of luck
  - **Studebaker plan** terminated in 1964 after US car production stopped
    - Retirees & eligibles 60+ got 100%
    - Vested < 60 got lump sums = 15% of benefit value
    - All others – out of luck

Notable Pension Failures Pre-ERISA

- Horn & Hardart
  - Famed for its “Automat” restaurants in New York, Philadelphia, and other cities
  - Philadelphia based company failed in 1971
  - Non-union pensions were discontinued entirely
  - Widely reported in NY Times & other publications

“Original” ERISA – 9/2/1974

- Eligibility
  - Set 1000 hour requirement
  - Age 25 & 1 Year of Service (or 3 years, if 100% vested)
- Required Survivor Benefits – QJSA
- Vesting rules – 3 options:
  - 5 – 15 Year Graded Vesting (25% @ 5 years, 50% @ 10, 100% @ 15)
  - 10 Year Cliff Vesting
  - Rule of 45 (sum of age & service, but full vesting in 15 years at most)

“Original” ERISA – 9/2/1974

- Fiduciary Standards
  - Asset diversification – no > 10% in company securities
  - Prudent person rule
- Reporting & Disclosure
  - Annual reports (5500, SAR, SSA) required (including audits for larger plans)
  - Summary Plan Description (SPD)
  - Notice if benefits denied, & right to bring suit in Federal Court
- Individual Retirement Accounts
  - Up to 15% of pay or $1,500
  - Investments – US 6% bond, annuity starting @ 59-1/2, bank or insurance company trust
- Increased benefit amounts for self-employed

“Original” ERISA – 9/2/1974

- Implemented limits on benefits from DB plans & contributions to DC plans [Code §415]
  - DB limit = $75,000 as single life annuity @ age 55, adjusted for inflation, not > 100% of Compensation for High 3 Years
  - DC limit = $25,000, not > 25% of compensation
  - There was also a combined limit (repealed effective 1/1/2000)
  - Modern limits are considerably lower after inflation taken into account

“Original” ERISA – 9/2/1974 - PBGC

- Act established the PBGC
- Insures both single employer and multiemployer DB plans
- Initial premiums were very low:
  - $1 per participant for single employer plans
  - 50¢ per participant for multiemployer plans
- In 50 years, premiums have increased dramatically:
  - $101 fixed per participant premium for single employer, plus a variable premium of 5.2% of unfunded (max $686), nearly 800 times higher
  - $37 per participant for multiemployer (74 times)
- $1 in 1974 approximately = $6.17 in 2024

“Original” ERISA – 9/2/1974 - PBGC

- Insured single employer benefits initially $750 per month for life annuity at age 65
    - Currently $7,107.95 in 2024
- Multiemployer guarantees are much lower ($1,072.50 per month with 30 years of service), varies with:
    - Plan benefit level
    - Service under plan
- Once a plan terminates in a standard termination, PBGC coverage ends

“Original” ERISA – 9/2/1974 - Funding

- Required annual funding for ALL defined benefit plans, both single and multiemployer
  - Exemptions for nonqualified plans, insurance backed plans, and a few others
- Eliminated pay-as-you-go & other nonactuarial methods
- Actuary chose:
  - Discount rate
  - Mortality table
  - Funding method (e.g. Unit Credit, Projected Unit Credit, Entry Age Normal, Aggregate, Frozen Initial Liability, Attained Age Normal, etc.)

“Original” ERISA – 9/2/1974 - Funding

Normal Cost, PLUS

Amortization of (in years):

	Single Employer	**Multiemployer**
Initial Unfunded Liability	40 (30 for plans started 1/1/74 & later)	40
Plan Amendments	30	40
Gain/(Loss)	15	20
Assumption Change	30	30

- Above adjusted for:
  - Interest to end of plan year
  - Waiver amortization bases
  - Full funding limit
  - Alternative funding standard account

“Original” ERISA – 9/2/1974 - Funding

- Went into effect for existing plans in 1976 plan year
- Impact, particularly on long established underfunded plans, was strong & immediate
    - For example, a client of mine:
        - Established plan in April 1917
        - Operated on pay-as-you-go basis until 1960
        - Still very underfunded at time of ERISA
        - Had Final Average Plan
        - By 1979, decided plan will “bust this company”
        - Suspended accruals for one year & adopted less valuable career average formula

Funding Since ERISA (Single Employer)

- Trend since 1974 has been even stronger funding rules, but with loosening in recent years when sponsors couldn’t comply:

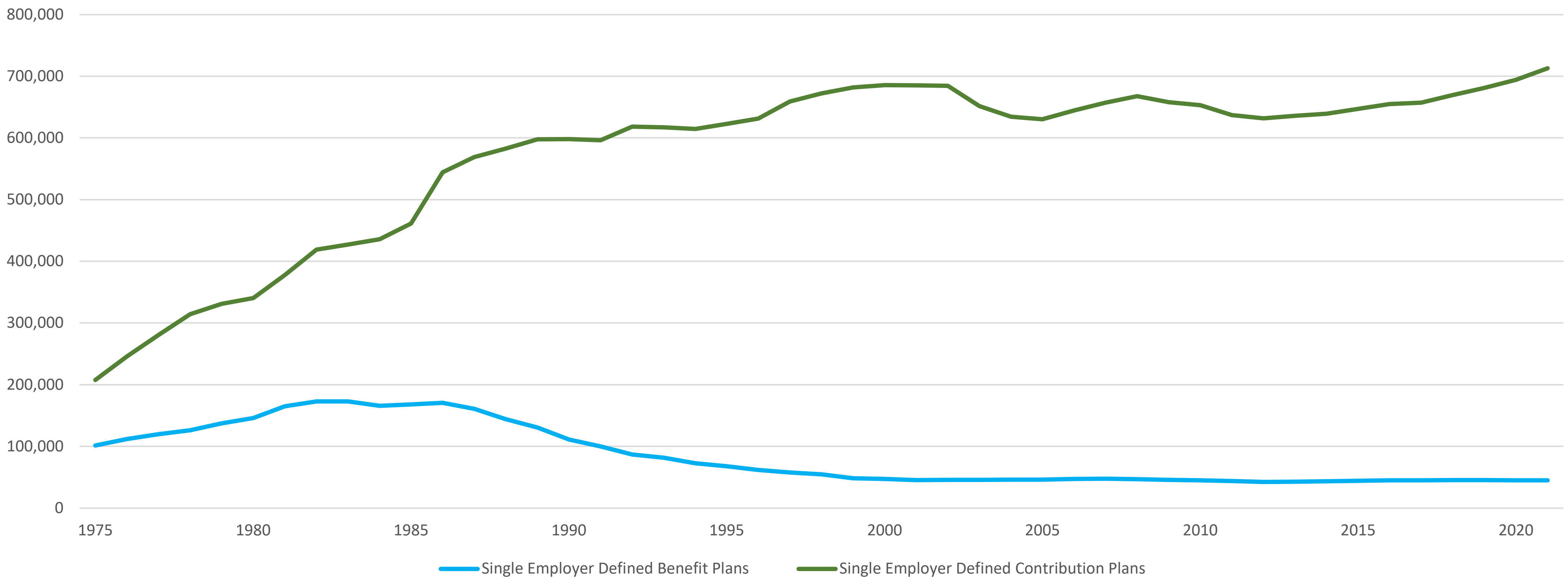
Tax Reform Act of 1986	Shortened amortization periods for gains/losses, assumption changes
Omnibus Budget Reconciliation Act of 1987 (OBRA 87)	Required additional contributions for certain larger underfunded plans on “current liability” basis
Retirement Protection Act of 1994 (RPA)	Strengthened OBRA 87 requirements, use of specified mortality table
Pension Protection Act of 2006 (PPA)	Rewrote rules in their entirety – mandating discount rates (based on bond yields), unit credit funding, and specified mortality table. 7-year amortization.
Subsequent legislation (WRERA, PRA, MAP-21, HATFA, BBA, ARPA)	Relaxed requirements, including modifications to bond yield averages to allow higher rates, longer amortization periods.

ERISA – 50 Years

- Many changes, at least some the result of ERISA:
  - DB plan funding has greatly improved, BUT at the cost of a huge decrease in the number of plans & % of people covered
  - PBGC has stepped in to provide benefits for numerous plan participants who otherwise would have lost them
    - As of 11/23, 920,000 retirees receiving benefits & 473,000 with deferred benefits
  - Most Americans with retirement benefits covered through DC plans
  - The "do-it-yourself" idea is common – 401(k) plans
  - Benefits are more portable
  - Vesting requirements ensure even short-term employees get benefits
  - Many Americans (44% of private employees) still lack coverage

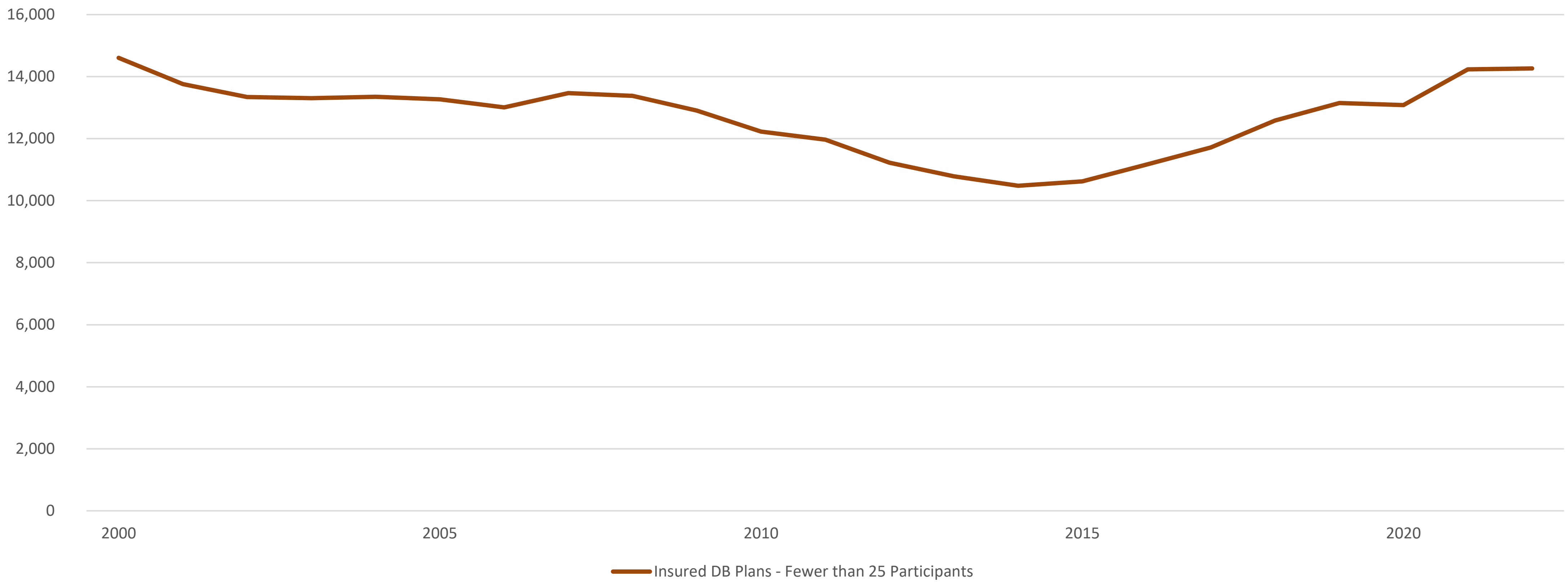
Number of US Single Employer DB Plans

1975 - 2021



Employee Benefits Security Administration, United States Department of Labor, Private Pension Plan Bulletin Historical Tables and Graphs 1975 – 2021, Table E1

Number of PBGC Covered DB Plans – Fewer than 25 Participants
2000 - 2022



Pension Benefit Guaranty Corporation, 2021 Pension Insurance Data Tables, Table S-31

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The US Private Pension System Since Enactment of ERISA

Glass half full:

- Voluntary, tax-favored private pension system has provided meaningful, reliable retirement income to tens of millions of middle-income workers and their spouses
- US retirement assets total ca. $37 trillion - largest pool of investment capital in the world

Note: Some portions of the following slides are based on "SECURE 2.0 and the Past and Future of the U. S. Retirement System" by J. Mark Iwry, David C. John and William G. Gale (Brookings Institution. Retirement Security Project, Jan. 2024)

US Private Pension System Since Enactment of ERISA

Glass half empty:

- Coverage gap: 55 to 60 million US workers left out of system, disproportionately Black, Hispanic, women, lower-income
- Retirement and associated tax benefits skewed to higher-income households
- Major shift away from employer-sponsored pensions (mainly DB), which were dominant when ERISA was enacted and focus of ERISA

The Decline of Private DB Pension Plans

- ERs had increasing concerns about traditional DB plans
  - More stringent and volatile funding demands
  - Volatility of financial statements/reported earnings
  - Long-term liability in era of global competition
  - Increasing ratio of retirees to active workers in declining firms/industries
  - Increasing PBGC premiums
  - Regulatory complexity

The Decline of Private DB Pension Plans

- Macro factors
  - Increasing longevity raises financial dependency ratio of retiree person-years to worker person-years
  - Decline of union market share and manufacturing
- Other drawbacks of DBs for EEs
  - Less tangible, liquid, flexible, portable – and less control
  - Back-loaded final average pay formulas often concentrated major benefits in a smaller group of employees
  - Many small business DBs delayed vesting, accrual for staff to minimize benefits, then terminated when owner retired

The Rise of the Do-It-Yourself 401(k)

- As in other countries, US saw marked shift away from traditional DB pensions beginning in later 1970s and in 1980s.
- But in US in 1980s and thereafter, 401(k) retirement saving plans and individual retirement accounts (IRAs) are in the ascendant, driven partly by rise of mutual fund industry
- Was the systemic shift from DB to DC?
  - Not shift to classic DCs such as ER-funded traditional profit-sharing or money purchase pension or target benefit plans
- More of a transfer of financial risks from ERs to workers, from both ER-funded and ER-managed defined benefit and defined contribution plans to undefined benefit and undefined contribution do-it-yourself saving account arrangements like 401ks and IRAs

From DB Pensions to Undefined Savings

- Shift from ER-funded and managed DB and DC plans to new retirement saving accounts involving decline in collective risk bearing and risk pooling
- Drivers:
  - ER cost shift from defined ER contributions to undefined tax-favored EE contributions, often matched by ER at lower cost
  - Enabled ERs to de-risk by up-risking EEs.
  - Competitive success of mutual funds (for diversified plan investments)
  - Positive EE perception of 401(k) plans

Expansion of DIY 401(k)

- 401(k) evolves from supplemental to DB pension to primary plan
- 401(k)s offer tangible, visible accounts, employee control, more portable, flexible, and liquid to meet different employee needs
- But from mid-1980s to late 1990s, 401(k) largely do-it-yourself
- Originally, 401(k)s provided little guidance or protection for EEs:
  - Whether to participate, how much to contribute, how to invest, when and how to draw benefits, and how protect against outliving savings
- ER selected investment menu but EE choices are self-directed (thanks to lobbying in ERISA): nondiversification, market timing

Reforming the DIY 401(k)

- Late '90s inflection point: strategy at US Treasury to shift paradigm by transplanting valuable attributes of ER-funded DB pensions to newly prevalent 401(k)s
- To increase 401(k) participation and reform DIY 401(k), Treasury/IRS 1998/2000 guidance defines, approves, promotes auto enrollment and auto investing, and later, auto escalation
- Defaults, other behavioral strategies to eventually "automate" all phases of 401(k) saving cycle beyond enrollment to participate:
  - Automatic annual contribution increases
  - Default investments: professionally guided, asset-allocated, diversified investing
  - Payout phase: automatic rollovers, potentially retirement income

The Automatic 401(k)

- Auto enrollment into retirement savings accounts especially powerful in encouraging participation by lower-income, Black, Hispanic, female workers
- From 1998 to 2006 auto enrollment and investment expands to more than 40% of large 401(k) plans
- Default investment in 401(k) market shifts from principal preservation to balanced or life cycle/target date funds
- Then Pension Protection Act of 2006 removes other obstacles, spurs further expansion of auto features via explicit qualification of modern default investment options (QDIAs)

Expansion of IRAs

- Meanwhile: IRAs fill gap for saving by nonemployees and receive tax-free transfers ("rollovers") from plans
- IRAs are least regulated retirement vehicle in US. Generally exempt from ERISA and qualified plan rules
- No ER contributions, no nondiscrimination rules, no spousal protections
- Create opportunity for financial competitor firms to grab long-accumulated plan assets by rollover to IRA
- IRAs now have more assets under management in US ($13T) than either DB plans or DC plans

The Automatic IRA

- How to expand coverage to those not eligible -- major coverage gap: 55 to 60 million mainly lower-paid, with racial/ethnic/gender gap in coverage/savings, income, and wealth
- All along, legislative changes increased employer incentives to sponsor plans (tax credits simplifications)
- Iwry and John put forward Automatic IRA legislative proposal – Retirement Security Project and Heritage Foundation (2006)
- Auto IRA uses 3 building blocks from current system
  - Payroll deduction saving
  - Automatic enrollment
  - Federally tax-favored retirement saving accounts (IRAs)

The Automatic IRA (cont'd)

- Proposed federal legislation would require ERs that do not sponsor a plan to facilitate Auto IRAs for their EEs
- ER supporting Auto IRA would avoid contributing, avoid fiduciary exposure and responsibility for investments, and avoid plan sponsorship (need not comply with ERISA or qualified plan rules)
- Default type of IRA is Roth, default investment is target date fund
- Beginning to realize the hope that Auto IRAs induce ERs to sponsor a plan instead
- Cross-ideological and bipartisan congressional support when first proposed, but after party-line passage of Affordable Care Act with ER mandate, further progress in Congress impeded by rising political partisan polarization
- State-based auto IRAs providing proof of concept

Questions and Answers

Please enter your Question(s) in the "Ask Question" box on your screen.

The presenters will answer as many questions as time allows.

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- SECURE 2.0 and the Past and Future of the U.S. Retirement System. Retirement Security Project at Brookings, January 2024.

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Academy Issue Brief on PPA

- The Pension Protection Act: Successes, Shortcomings, and Opportunities for Improvement (April 2018)

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Philip Maguire, Policy Analyst, Retirement maguire@actuary.org

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