

Private Occupational Pensions in the United States and their Regulatory and Supervisory Framework

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11 January 2002

Pension System in the United States

- Mostly a voluntary occupational system
 - the motives and incentives for employers matter a great deal
 - **proposals for mandatory component have been put forward several times but no critical political support as of yet**
 - Includes both pensions, as such, and profit-sharing (PS) plans --an increasingly blurred distinction
 - “Personal pensions” relatively limited
 - **Individual Retirement Accounts, but take-up rates are low**
 - **401-k plans are a hybrid of occupational and personal pensions that may be filling the personal pension demand**
 - **(Also recent growth in after-tax variable rate annuity market)**
- NO single “pension regulator”
 - Lots of regulators with different policy concerns, remits
- Some history, some data and then some likely debates

Before 1974...

- Tax code provisions from early 20th century for pensions and profit-sharing plans
 - revisions in 1940s as income tax was broadened
- Labor and social policy concerns
 - Wage, price controls combined with collective bargaining increased coverage in 1940s, 50s. Increasing use of trusts.
 - 1950s legislation to redress scandals about control
 - Notable pension termination with insufficient assets
 - Concerns about state law requirements and remedies
 - Encourage growth in pensions to minimize social insurance
- Kennedy era commission, Senator Javits' crusade, union pressures, committee turf issues, Nixon era activism
- Employer acceptance – growing inflation leads to de facto back-loading in defined benefit plans, so legal changes had minimal effect on distribution of DB outcomes

Employee Retirement Income Security Act (ERISA) of 1974

- Parallel labor and tax law provisions to assure clarity, certainty in implicit pension contracts between employers and workers, including rules that require:
 - Trust Instrument, or contracts with insurance company
 - Tighter funding rules, but 10 percent limit on self-investment applies only to pensions (not PS plans)
- But ERISA also codified, expanded --
 - *Fiduciary duties, reporting and disclosure, employee legal rights* -- only in the labor law provisions (Pension and Welfare Benefits Administration)
 - Broad definitions of plan assets, fiduciary; then grant regulatory exceptions
 - Pure “*nondiscrimination*” rules -- only in the tax law provisions (Treasury Tax Policy, IRS)
- Guaranty fund for defined benefit schemes with other specific regulatory provisions (PBGC)

1974 ERISA -- continued

- Creation of Individual Retirement Accounts, mostly for those not covered in occupational schemes
 - Note more generous and flexible Canadian equivalent
- Many amendments since 1974, including
 - Retirement Equity Act
 - Deficit motivated restrictions on allowable benefits, contributions, funding levels in DB schemes
 - “Minimum-minimum” funding rules and their revision
 - Surplus motivated increases in allowable benefits, etc.
- An “accidental” pension system revolution in 1980s,
 - Treasury regulations for 401-k of the tax code that now permits before-tax worker contributions to “savings” or “thrift” PS plans,
 - DOL regulations for section 404-c of ERISA (DOL title) that allowed fiduciary safe-harbor for “self-directed” DC schemes
- Deflation makes final pay DB schemes less attractive to employers and “matching” incentives in 401-k type more attractive. (So also, so-called “cash balance” DB plans.)

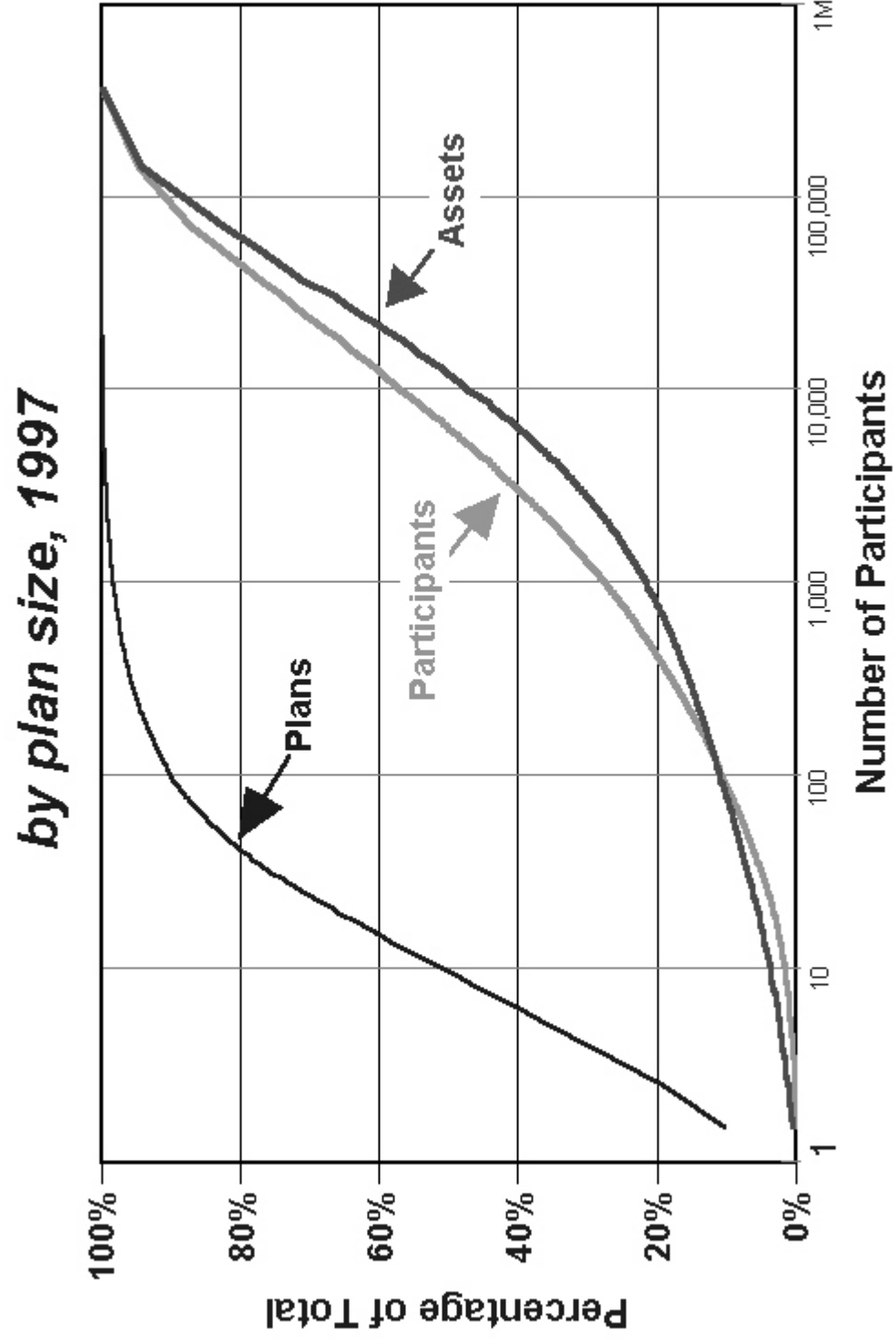
But Equally Important are ...

- Age Discrimination in Employment Act, and Equal Employment Opportunity Commission
- Financial accounting rules from Financial Accounting Standards Board backed by Securities and Exchange Commission (“internalized regulation”)
 - Standards for pension fund accounting
 - Standards for how pensions effect corporate income and balance statements
- SEC regulation of markets generally, and collective investment companies (mutual funds) in particular in light of:
 - Growth in “self-directed” defined contribution schemes, generally administered through mutual funds. 401-k plans are the dominant (but not sole) case.
- State insurance agencies
 - “Allocated” versus “Unallocated” Funding Instruments

The data indicate that ...

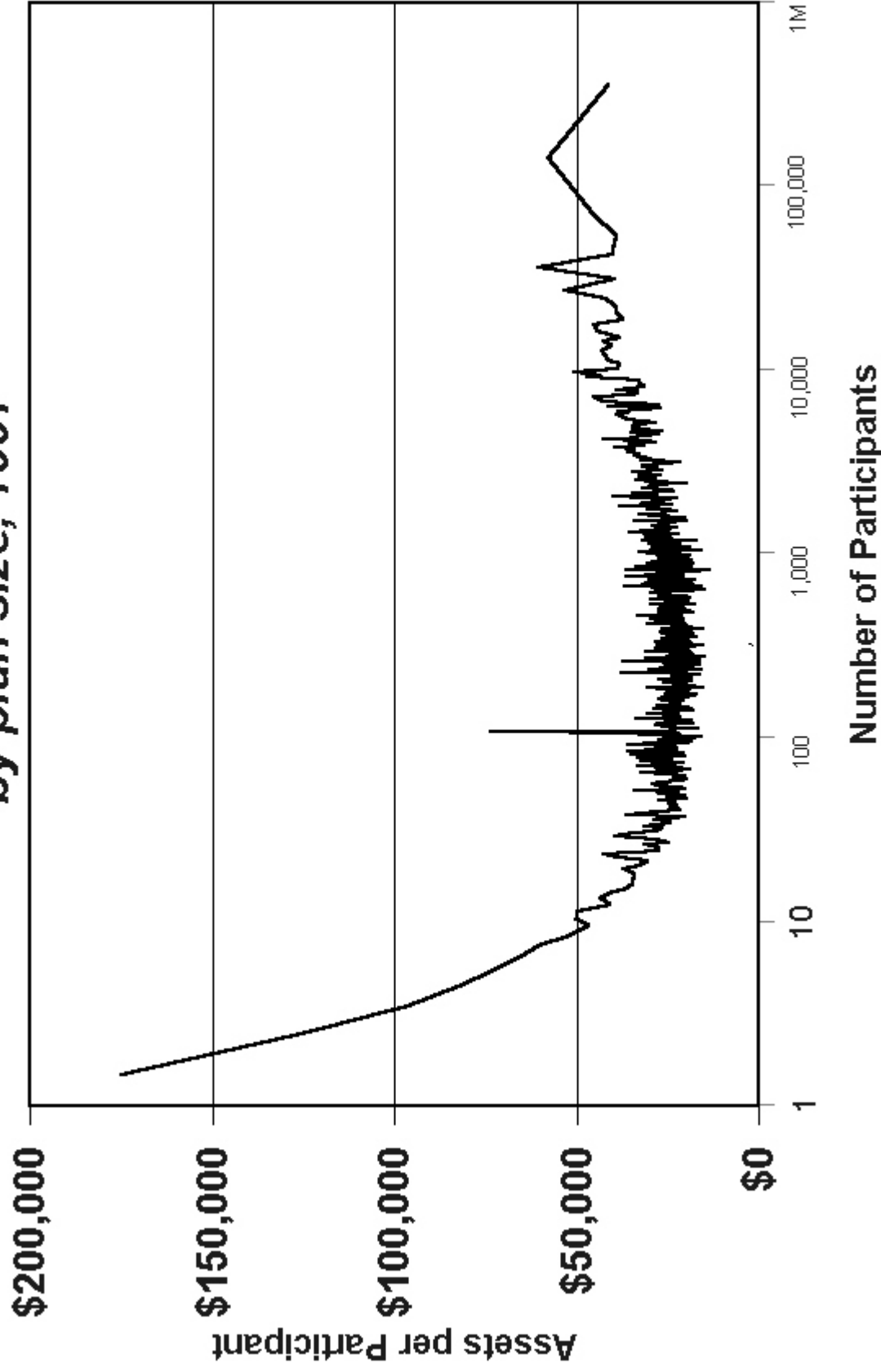
- About 4.5 to 5.5 trillion USD in 2000 (vs. GDP of about 11 trillion USD in 2000). Another 2.3 trillion USD in state/local retirement plans.
- Roughly 90 percent of the plans (less than 100 members) account for roughly 10 percent of participants, assets.
- Average asset/member amount is similar except at top and bottom end of plan size distribution – says nothing about benefits, however.
- Major shift away from DB schemes
 - reflects underlying shifts in economy (e.g., decline in manufacturing sector), and
 - interactions of regulation and macroeconomic environment
 - but DB plans still are roughly half of the assets

Figure C2. Distribution of Pension Plans, Participants, and Assets by plan size, 1997



Note: Lines show the percentage of plans, participants, and assets reported by plans having less than or equal to the number of participants shown on the horizontal axis. Includes plans reporting 2 or more participants only.
Source: Form 5500 series reports filed with the Internal Revenue Service for plan years beginning in 1997.

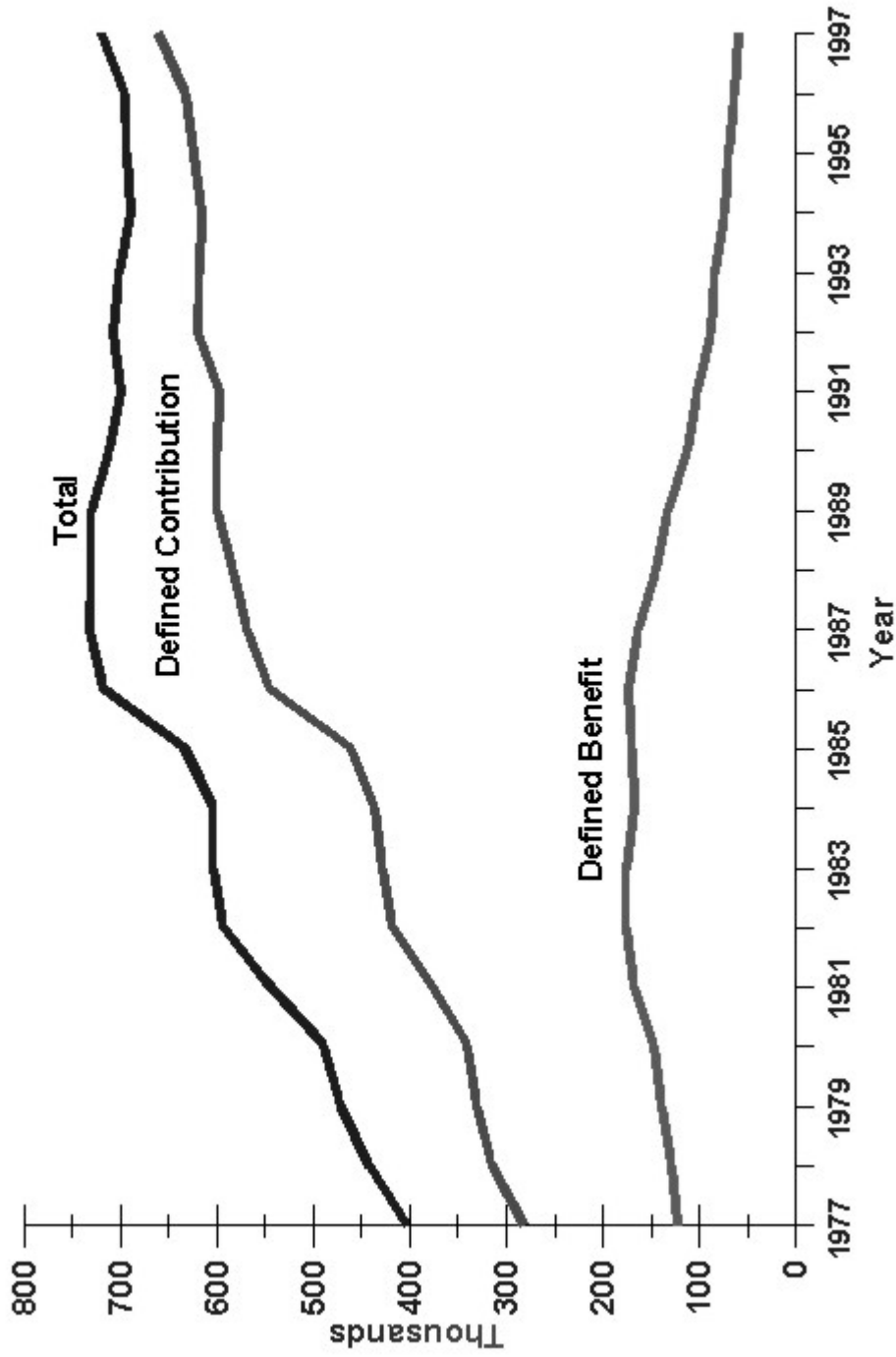
**Figure C1. Average Assets per Participant
by plan size, 1997**



Note: Each point shows the average assets per participant among plans reporting specific numbers of participants. For plans having more than 318 participants, averages are computed over participation intervals just wide enough to include at least 60 plans.

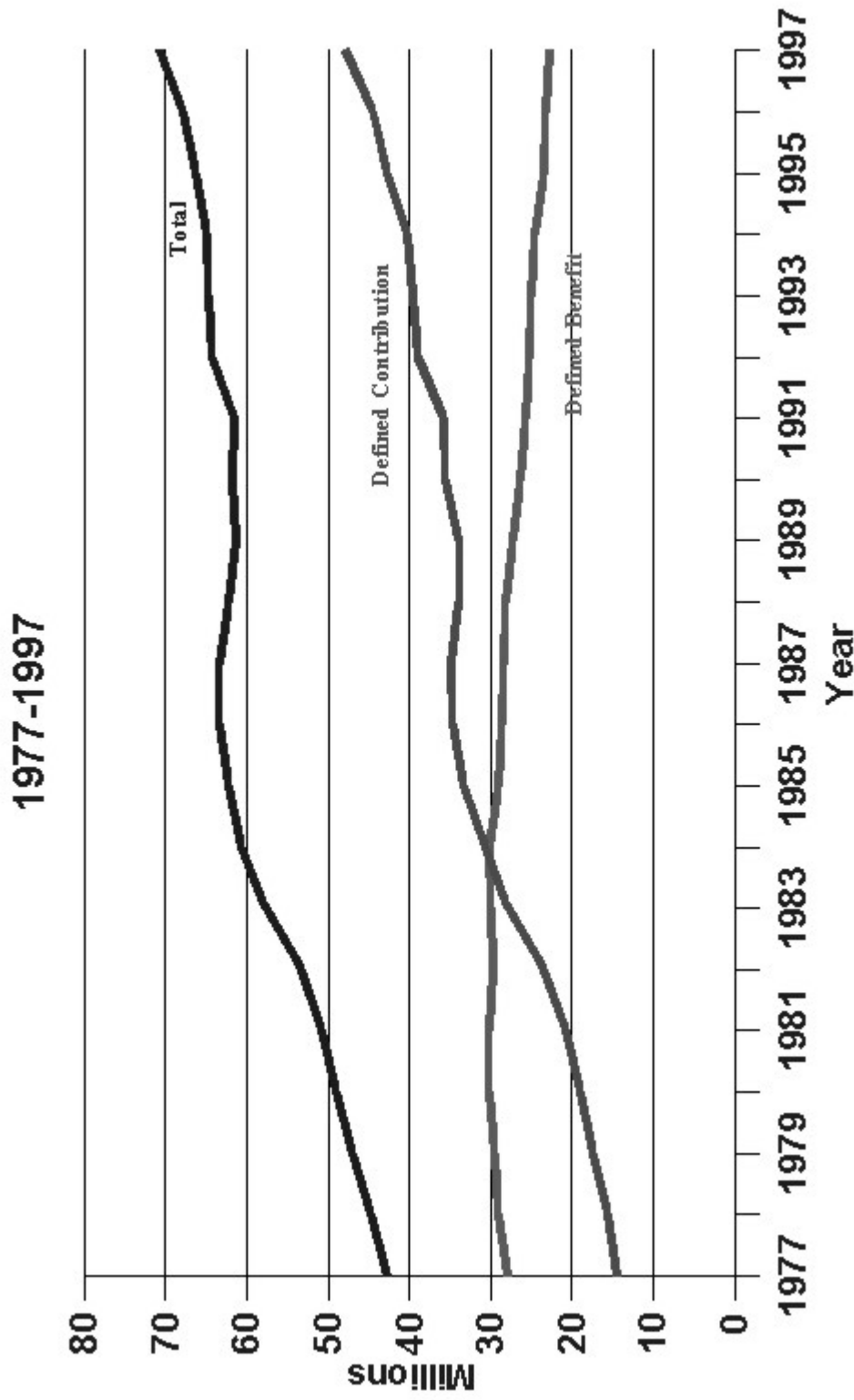
Source: Form 5500 series reports filed with the Internal Revenue Service for plan years beginning in 1997.

**Figure E1. Number of Pension Plans,
1977-1997**



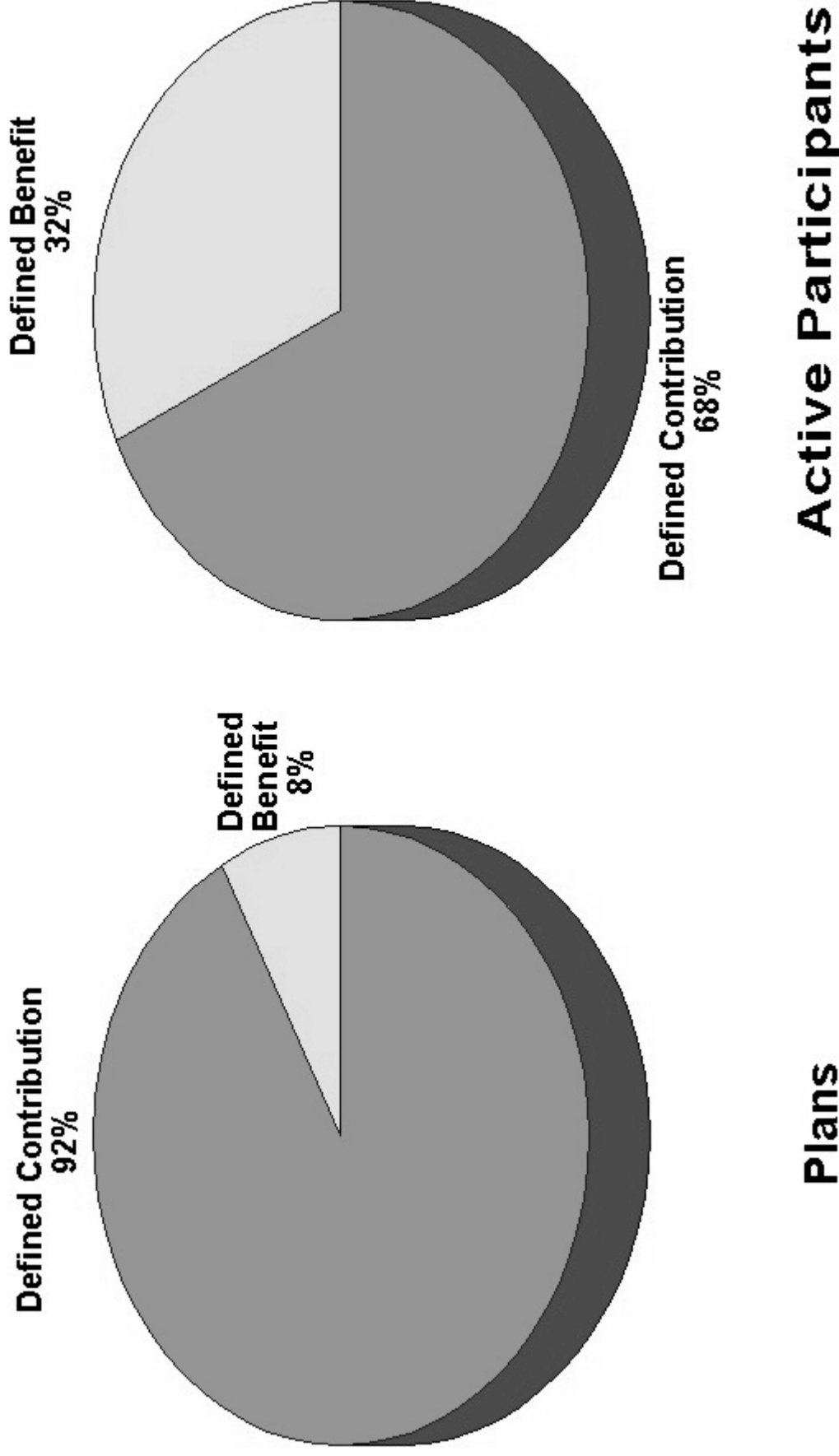
Reference: Table E1.
Source: Form 5500 series reports filed with the Internal Revenue Service for 1977-1997 plan years.

Figure E3: Pension Plan Active Participants, 1977-1997



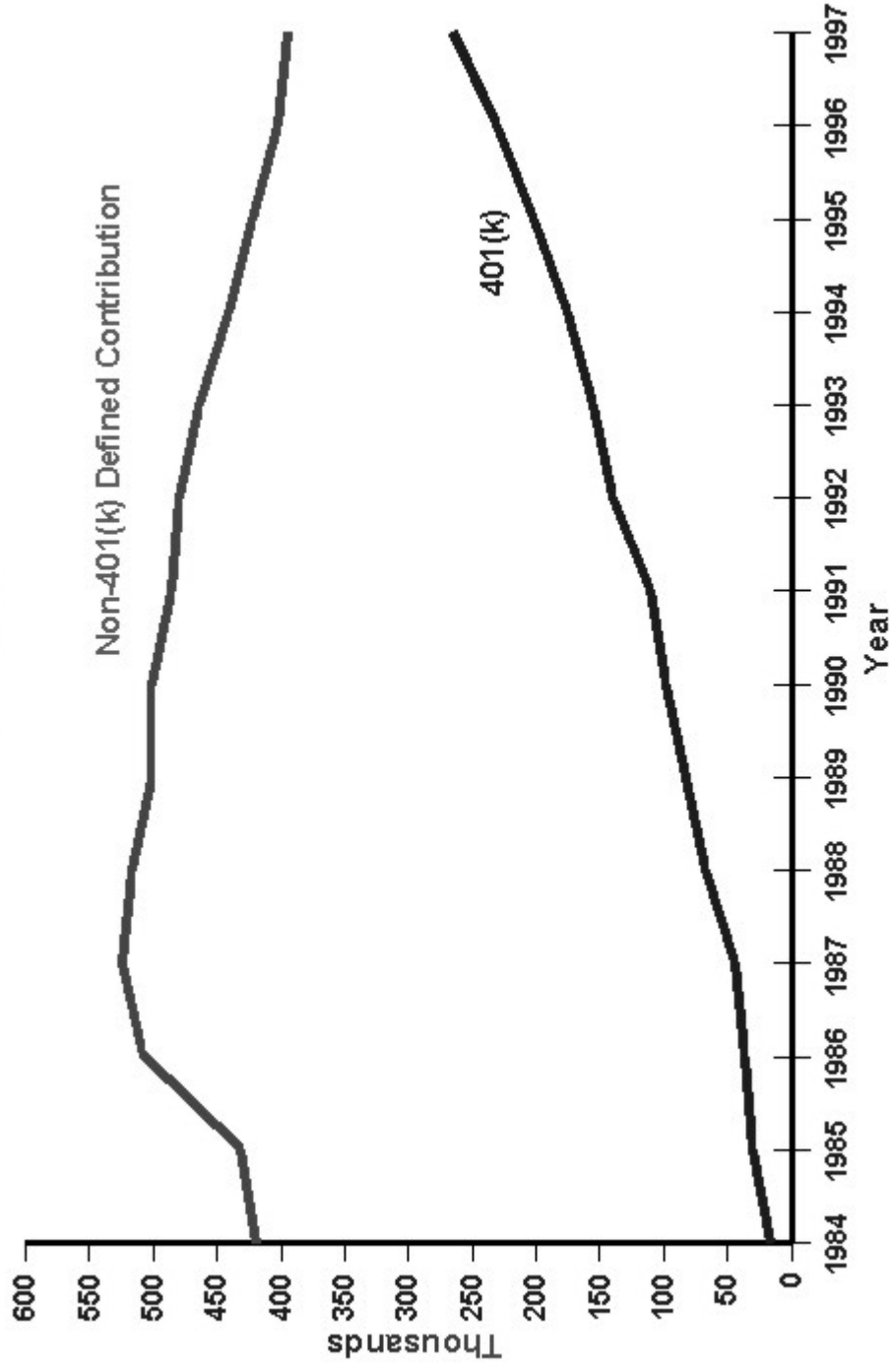
Reference: Table E8
 Source: Form 5500 series reports filed with the Internal Revenue Service for 1977-1997 plan years

**Figure A1. Distribution of Pension Plans and Participants
by type of plan, 1997**



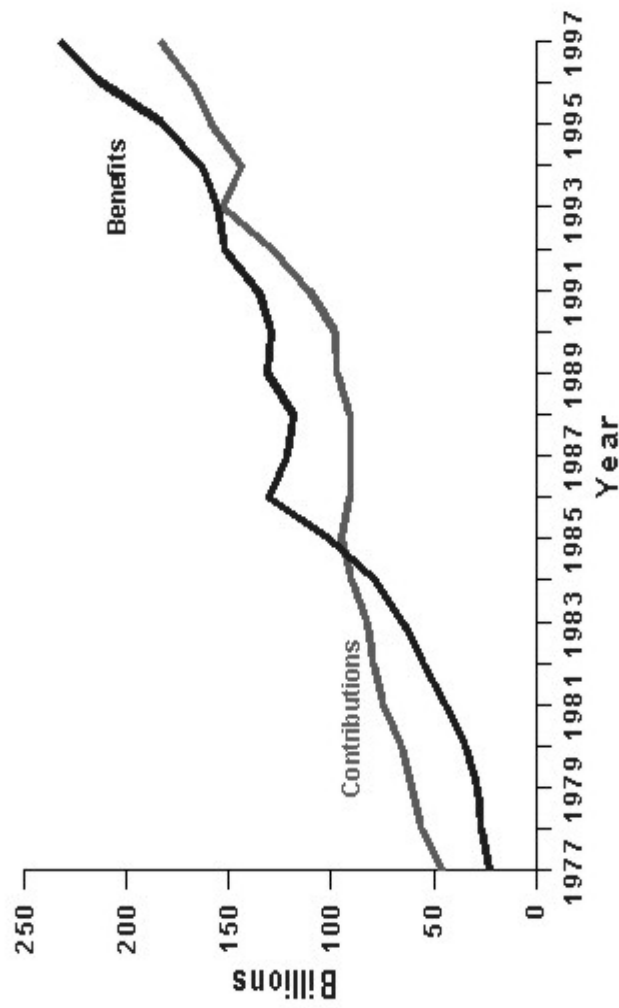
Reference: Table A 1.
Source: Form 5500 series reports filed with the Internal Revenue Service for plan years beginning in 1997.

**Figure E2. Number of Defined Contribution Plans,
1984-1997**



Reference: Table E.23.
Source: Form 5500 series reports filed with the Internal Revenue Service for 1984-1997 plan years.

Figure E9. Pension Plan Contributions and Benefits 1977-1997

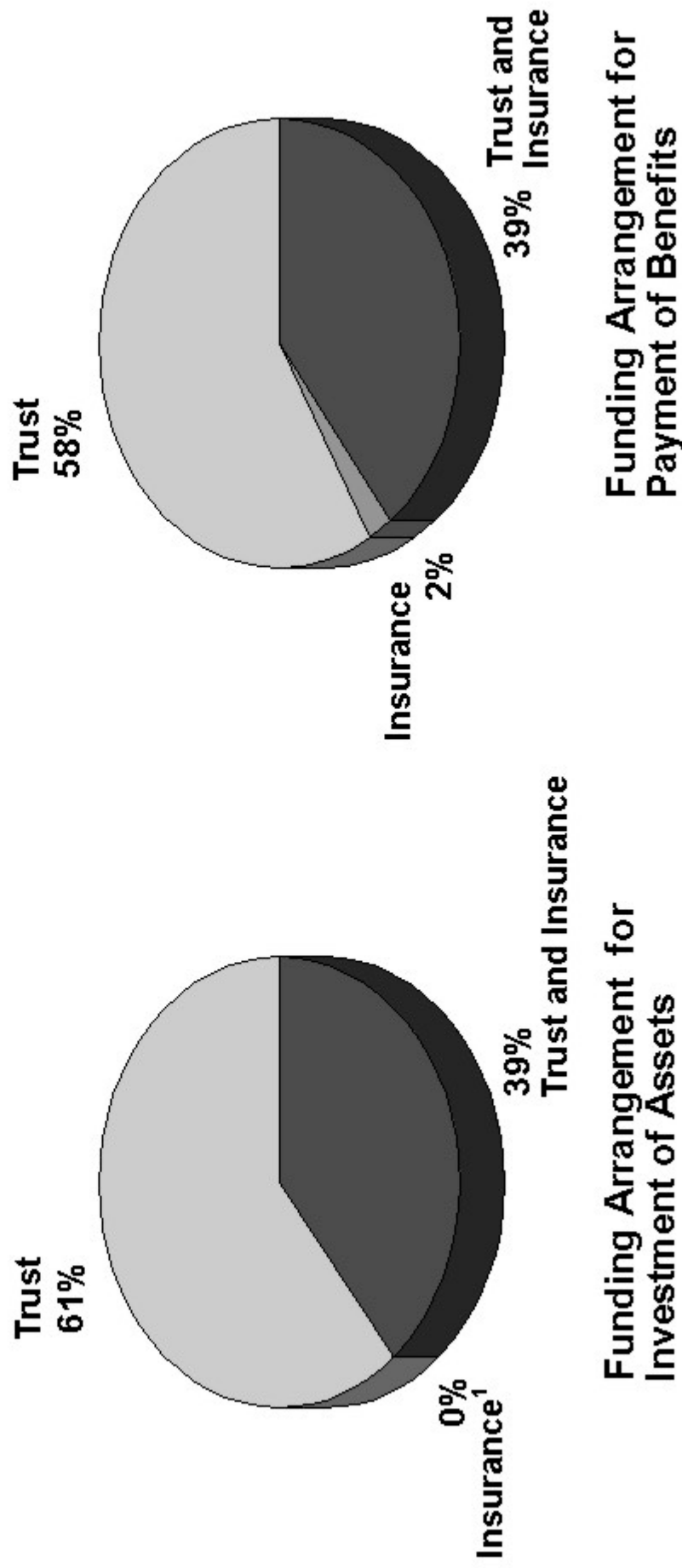


Reference: Tables E14 and E17.
SOURCE: Form 5500 series reports filed with the Internal Revenue Service for 1977-1997 plan years.

and indicate that ...

- Large firms often have both DB/DC, even DC/DC combinations – esp. 401-k *supplemental* plans.
- Due to 401-k plan popularity, small and medium size firms increasingly likely to sponsor a tax-qualified plan, but workers' choosing not to participate has kept effective coverage largely unchanged at about 50%.
- Record gains in market returns allowed benefit outlays to consistently exceed contributions.
- Insurance industry remains an important actor, but more as providers of a variety of financial sector instruments versus traditional allocated “pension insurance” products.
 - Roughly 45 percent of life insurers' reserves are for “annuity” products to tax-qualified plans, but
 - at least half represents DC style accounts or general asset administration for DB plans.

**Figure A3. Distribution of Assets
by method of funding, 1997**



Reference: Table A5.

¹ Less than one percent.

And Some Likely Debates ...

- Enron case may lead to debates about
 - Should there be limits in “profit-sharing” plans on sponsor assets like those in “pensions”?
 - Workers’ own contributions
 - Employer matching contributions
 - Conflicts in fiduciary duties to plan participants versus shareholders in DB investment policy
- Growth in 401-k type plans may lead to greater sorting out of respective regulatory roles of Labor Department, SEC and other regulatory bodies
- Role of accountants, actuaries in reporting irregularities
- Effects of accounting standards on markets
- Effects of down markets on accounting practices for earnings statements and on contributions
- Small plan inefficiencies and oversight; encourage coverage and participation