WORKING PAPER
Executive Summary

NOVEMBER 2011, WP 2011-20

CENTER *for* RETIREMENT RESEARCH *at* BOSTON COLLEGE

THE PENSION PROTECTION ACT OF 2006 AND DIVERSIFICATION OF EMPLOYER STOCK IN DEFINED CONTRIBUTION PLANS

BY GARY V. ENGELHARDT

Over the last two decades, policymakers and academics have expressed concern over the potential risk of substantial amounts of employer stock in defined contribution (DC) pension plans. In particular, for some workers, such holdings not only introduce a substantial amount of undiversifiable risk into the retirement-asset portfolio, but can be doubly costly due to a positive correlation between company stock prices, worker earnings, employment prospects in poorly performing firms. Layoffs and steep declines in share values at companies like Enron and Global Crossing, which resulted in catastrophic job losses as well as losses in 401(k) assets, brought many of these issues to the forefront in policy debates. The Pension Protection Act of 2006 (PPA2006) allowed participants in plans with employer stock to diversify their holdings. However, stand-alone ESOPs, i.e., those that do not allow employee elective deferrals or after-tax contributions, were exempt from this provision. This paper measures the extent to which DC plans have shifted the composition of plan assets away from employer stock as a result of the PPA diversification provisions, using detailed Form 5500 financial data for stand-alone ESOPs and those that allow employee elective deferrals or after-tax contributions, so-called KSOPs, from 2003-5 (before) and 2007-9 (after) the PPA and a quasi-experimental empirical framework. The principal findings are:

- The share of plan assets in company stock fell 7 percentage points for KSOPs, because of the diversification provisions in PPA2006, a substantial decline.
- There was no change in holdings for stand-alone ESOPs.
- Most of the decline occurred in plans that had between 25-50 percent of plan assets in employer stock.
- In 2009, still two-thirds of KSOPs had more than 10 percent of assets in company stock, the statutory limit for defined benefit pension plans.

 The research reported herein was performed pursuant to a grant from the U.S. Social Security Administration (SSA) funded as part of the Retirement Research Consortium (RRC). The opinions and conclusions expressed are solely those of the author and do not represent the views of SSA, any agency of the federal government, the RRC, Syracuse University, or Boston College.

CENTER FOR RETIREMENT RESEARCH AT BOSTON COLLEGE
Hovey House, 140 Commonwealth Avenue, Chestnut Hill, MA 02467-3808
phone 617.552.1762 fax 617.552.0191 crr@bc.edu crr.bc.edu