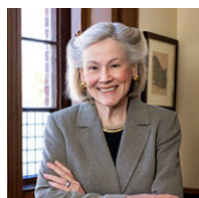


ERISA Killed Defined Benefit Pension Plans, Yale Law School Expert Argues

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How important was the 1974 legislation compared to other factors?

This year is the 50th anniversary of the Employee Retirement Income Security Act of 1974 (ERISA), so Yale Law School professor John Langbein's recent article "ERISA's Role in the Demise of Defined Benefit Pension Plans" seemed timely. My view is that a lot of factors contributed to the demise of defined benefit (DB) plans, and ERISA was just one more on the list. Langbein gives ERISA more prominence, arguing that the 1974 legislation "ultimately sealed the fate of the American DB pension system."

First, a brief history. Retirement plans date from the last quarter of the 19th century when a large prosperous transportation industry and trade unions established benefit arrangements for their workers. By the 1920s, 40 percent of union members had coverage, but the Great Depression devastated union plans and saw the enactment of Social Security. So, in the 1940s, business and labor had to recreate the pension system. Pension coverage expanded dramatically during the 1950s primarily through the establishment of new plans, and grew in the 1960s and 1970s primarily due to the expansion of employment in firms that already had pension coverage. By the 1980s, roughly half of private sector workers were covered by a retirement plan, and these retirement plans were primarily defined benefit.

Under defined benefit plans, the employer makes the contributions, pays benefits in the form of a lifetime annuity, and bears the investment and mortality risk. From the employer's perspective, defined benefit plans help manage the workforce by encouraging longer tenure and efficient retirement.

But beginning in 1980 things started to change, and by 2000 the majority of workers with coverage relied on a 401(k) plan. Here's my usual list of reasons:

- Globalization increased competition and undermined the financial stability of large corporate employers, making long-term pension obligations much riskier.
- Employment declined in large hierarchic firms and unionized industries, which typically offered defined benefit plans, and grew in high-tech firms and small, non-unionized companies, which typically did not.
- Plans became more expensive, as workers were living longer, and declining inflation raised the cost of unindexed lifetime benefits.
- The nature of the labor force changed – becoming more female, educated, and young – which reduced the appeal of lifelong careers.
- And importantly, 401(k) plans became available, just as the stock market began a two-decade climb.

Langbein doesn't disagree with these underlying factors, but rather puts considerable weight on the damage done by ERISA. The legislation was designed to save the rights of defined benefit plan participants so that a greater share of them would receive their benefits. It introduced participation and vesting standards to make it easier for workers to establish legal claims to benefits, and funding and fiduciary standards to ensure that money was available to pay the legal claims. And, should a plan terminate with inadequate assets, ERISA created the Pension Benefit Guaranty Corporation (PBGC).

While all well intended, Langbein concludes that ERISA made defined benefit plans too burdensome. At the top of his list is PBGC premiums, which he characterizes as a tax on healthy plans to subsidize sick plans, creating a major incentive for firms to get out of the defined benefit business. Second on his list is accelerated vesting rules – five years since 1986 – which are restrictive and costly and prevent sponsors from using the pension to reduce turnover. Third is forbidding employers from limiting their liabilities to the plan's assets, which led to the Financial Accounting Standards Board requiring the display of the plan's impact (with assets measured at market) on the firm's income statement and balance sheet. The final item on Langbein's list is compliance and litigation costs, especially considering that during the 1980s Congress passed significant legislation affecting defined benefit plans every few years.

It is certainly true that legislation designed to make pensions fairer also made the pension system more complex and costlier to administer. The only question is how much ERISA contributed to the decline in defined benefit plans compared to developments in the global economy, industry shifts, decline in unions, and changing composition of the workforce.