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FIFTY YEARS OF PENSION LAW

Daniel L. Halperin[*]

I have been involved in pension law and policy for more than fifty years as a private practitioner, as a government official, as a professor, as a board member of the Pension Rights Center, and as an author of more than a dozen articles on the subject.[1] In preparation for the *Drexel Law Review* Symposium, *ERISA at 40: What Were They Thinking?*, held on October 25, 2013, I read for the first time in many years my first pension article written in 1976, a surprisingly in-the-weeds discussion, which I called *Retirement Security and Tax Equity: An Evaluation of ERISA*.[2] According to my introduction, the "article explores the problems which led to ERISA and attempts to grade Congress on its achievement."[3] I thought reading the article might help me recall what we were thinking in 1967 and 1968 when, as a Treasury staffer, I had a significant role in developing the blueprint for the initial Administration bill.

This forum seemed like a good opportunity to compare the 1976 article with my more recent work in order to examine how my concerns, and potentially the concerns of the pension community, have evolved over time. In particular, did we fail to sufficiently anticipate behavioral trends? Were mistakes made that could have been avoided? And should or could we have done anything differently?

I became an instant pension law "expert" in 1963 as a second-year associate at what was then considered a "large" New York firm. The senior associate, who was doing this work and who was the only lawyer at the firm who knew anything at all about the subject, announced he was leaving. Even though I knew absolutely nothing about pensions, I was designated as his replacement. With the help of a course in the NYU graduate program, where I "learned" the law, and one at Pace College taught by the chief of the pension section at the Manhattan Office of the IRS—which gave me a feel for actual practice—I spent a significant part of my time over the next four

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1. *See* Daniel Halperin, *Employer-Based Retirement Income–the Ideal, the Possible, and the Reality*, 11 ELDER L.J. 37, 40 n.11, 41 n.12, 42 n.15 (2003) [hereinafter *Ideal*] (listing major articles written by the author).

2. Daniel Halperin, *Retirement Security and Tax Equity: An Evaluation of ERISA*, 17 B.C. INDUS. & COM. L. REV. 739 (1976) [hereinafter *Evaluation*].

3. *Id.* at 739.

years designing pension and profit sharing plans, mostly for small business. The goal was to set aside as much of the contribution as possible (sometimes we achieved as high as ninety percent) for the business owners.

In the days before ERISA and aid from paralegals, this was hardly the most glamorous way to spend my time or to build a career as a tax lawyer. Nevertheless, I enjoyed creating plans and the freedom that came from being "in charge" when dealing with "my" clients, a status which eluded my contemporaries in the office. After four years of helping to enhance the retirement security of rank-and-file workers, I accepted the opportunity to join the Office of Tax Legislative Counsel at the Treasury. My wife and I viewed this as a two-year adventure in D.C. before I returned to a lifetime as a partner in a New York law firm. However, the challenge of policy analysis, the experience of working for Stanley Surrey, and the excitement and feeling of accomplishment from being a participant in the 1969 Tax Reform Act got to me, and I never went back.

On my second day at the Treasury, I became an instant policy "expert" as Bill Gibb took me to a meeting with Peter Henle of Labor. Bill and Peter were chairing the inter-agency task force charged with developing a legislative proposal to carry out the recommendations of the 1965 Cabinet Committee on Pension Reform.[4] Most of the major policy decisions had been made, but, as they say, the devil is in the details. Over the next year, I worked closely with Bill and Peter and our consultant Tom Paine in developing the blueprint for the first Administration bill as introduced by Labor Secretary Wirtz in 1968.[5] Although I stayed at the Treasury for two more years before becoming an academic, I played no role as the Nixon Administration developed its approach to pension reform. Instead, as Deputy Tax Legislative Counsel, I devoted my time to the Tax Reform Act of 1969,[6] working harder than in any other year of my life.

From my new perch at University of Pennsylvania Law School, I tried to follow the developing ERISA legislation as closely as I could from afar, but as I learned at this Symposium, a lot happened that I knew nothing about. However, in 1974 two major law firms in Philadelphia asked me to help in transitioning their clients' pension plans to ERISA. One firm told me they were changing their approach—which had been to assign their least valuable associates, who soon departed, to pension work—and now planned to expose

4. *Public Policy and Private Pension Programs*, 28 SOC. SECURITY BULL. 39, 39–40 (1965).
5. Pension Benefit Security Act, S. 3421, 90th Cong. (1968).
6. Tax Reform Act of 1969, Pub. L. No. 91-172, 83 Stat. 487.

all their tax lawyers to ERISA. They wanted me to serve as a tutor to their young tax associates, who were all my former Penn students, and to be available when they had questions. The other firm decided to stay with the senior associate pension model, which my former firm had used before they made me an "expert," but they wanted my hands-on active participation for guidance during the transition period. This gave me the opportunity to learn the nuts and bolts of ERISA, although I soon discovered that perhaps the most important "provision" was the "requirement" to review all of the clients' plans and correct all practices which did not comply with pre-ERISA law.

In addition, now that pension law was a more respectable subject, I began to teach a course to law students at Penn around 1975 (a practice I continued until 2006, first at Georgetown and then at Harvard). With this combination of experience, going back fifteen years, I have always insisted (likely with much exaggeration) that just before I returned to the Treasury in 1977, I knew as much about the details of ERISA as any lawyer. This was most certainly the last time this claim could come anywhere close to being made. Returning to the Treasury, eventually as Deputy Assistant Secretary, gave me an opportunity to be involved in some ERISA regulations and Reorganization Plan 4,[7] as well as the series of events that led to 401(k)s. However, given my supervisory role, I rapidly forgot the detailed rules and never learned them again.

Perhaps to reflect this new state of affairs, when I returned to academia I eventually began to call my course "Retirement Income Policy" and my writing was more from "on high" rather than in the weeds as it had been in 1976. Of course, my interest in policy continued—as reflected in the writing of what I planned to be my last pension article on several occasions—as the landscape kept evolving and my perspective changed.

Before comparing the 1976 article with my more recent work on ERISA, I feel the need to reflect briefly on the *revolution* in the analysis of the benefits of non-qualified deferred compensation arrangements. While at a couple of points I did hint at the importance of the taxation of investments,[8] the role of matching as to the timing of the employer deduction and the executive's income was the focus in 1976.[9] Since 1986, I have maintained that matching is irrelevant and

7. *See* EXECUTIVE ORDER: REORGANIZATION PLAN NO. 4 OF 1978, UNITED STATES DEPARTMENT OF LABOR, http://www.dol.gov/ebsa/regs/exec_order_no4.html (last visited May 29, 2014).

8. *See Evaluation*, *supra* note 2, at 794, 799, 801.

9. *See id.* at 741, 783–87, 797–99.

the advantage, if any, would be a lower tax rate on investment income as compared to the tax burden on employee investments.[10] I cited the 1976 ERISA article, much to the consternation of my journal editor, as an example of the wrong-headed focus on matching in earlier writings.[11] While it is embarrassing to reread the sometimes convoluted discussion of the potential advantage of non-qualified deferred compensation, it is at the same time gratifying to confirm my contention that focusing on investment income provides a much clearer understanding of the possible tax savings. Enough of this, I will now turn to ERISA.

Of course, the major change in the landscape of qualified plans over the last forty years has been the increasing dominance of defined contribution plans and the shift to elective contributions and employee control of investment choice under section 401(k). Given ERISA's prohibition on new salary reduction plans, the danger that arrangements—which gave employees a choice whether to participate—would grow did not seem imminent in 1974 or 1976.[12] It was not anticipated that the original limited grandfather clause for existing salary reduction plans, which threatened to become permanent in 1978, had created a two tier universe that seemed intolerable. Thus, ERISA had planted the seed that made the adoption of section 401(k), just two years after the article appeared, seem inevitable.[13] In any event, I regret that we did not pay more attention to possible restrictions on 401(k), such as automatic enrollment as the default, a greater focus on security of benefits, and some level of employer contributions regardless of the employee election. This all seems obvious today.

On the other hand, the direction of the change to defined benefit plans was clearly anticipated. As I said in 1976, "[I]t is relatively certain . . . that the funding standard, the premium for plan termination insurance, and the potential employer liability will cause some shift toward defined contribution plans."[14] But importantly, I, as well as others, did not expect the magnitude of the change that actually occurred.

There are many reasons—apart from the impact of ERISA—for the decline in defined contribution plans. First, the changing nature

10. Daniel Halperin, *Interest in Disguise: Taxing the "Time Value of Money*,*"* 95 YALE L.J. 506, 520 (1986).

11. *Id.* at 520 (citing *Evaluation, supra* note 2, at 739, 741).

12. *See Evaluation*, *supra* note 2, at 759–61.

13. Daniel Halperin, *Cash or Deferred Profit-Sharing Plans and Cafeteria Plans*, 41 INST. ON FED. TAX'N 39 (1983).

14. *Evaluation*, *supra* note 2, at 775.

of the work force made traditional defined benefit arrangements less relevant as a means of employee retention. Second, increasing transparency of accounting rules caused defined benefit plans to lead to undesirable earnings fluctuations and may have "exposed" to management that such plans could be said to give employees the opportunity for a market-based rate of return with the risk on the employer.

Whether or not these changes were inevitable, I think we might have been better prepared and able to respond more intelligently—as suggested above with respect to 401(k)—if we had more fully understood during the development of ERISA that defined benefit (DB) plans and defined contribution (DC) plans were not two entirely different animals. I now believe it makes more sense to talk in terms of allocation of risk—for example, as to investment return, early termination of the plan or of employment, and unexpected growth in salary. These risks vary across DC and DB plans. Recognition of this overlap could have improved our approach to both nondiscrimination, including benefit and contribution limits, and security of benefits, such as plan termination insurance.[15] For example, the focus on security in DC plans is relatively recent.

Since I worried about encouraging a shift to DC plans, I did assert in 1976 that a case could be made for plan termination insurance with respect to certain types of DC plans, primarily target benefit plans.[16] Apart from a low investment return or other actuarial error, a DB plan would have a shortfall on termination because it provided for past service benefits at the inception of the plan while planning to fund these benefits over thirty years or longer. Target benefit plans are similar to DB plans based on final pay. They call for contributions that, given a projected rate of return and salary growth, would produce a benefit equal to a certain percentage of final pay for each year of service. The percentage of final pay includes service before the plan began. While the benefit will likely differ from a DB plan with a similar formula because the benefit will depend on actual investment return, the plans will be similar because, even if the projected return is realized, if the target benefit plan is terminated before an employee reaches retirement age, the accumulated funds will be insufficient to provide the promised benefit. In a target benefit plan, this would also be true on early separation from service.

15. Daniel Halperin & Marla Schnall, *Regulating Tax Qualified Pension Plans in a Hybrid World*, 58 INST. ON FED. TAX'N-EMP. BENEFITS AND EXEC. COMP. 5 (2000).

16. *See Evaluation*, *supra* note 2, at 777.

Prior law placed the burden of a shortfall in both DB plans and target benefit arrangements on employees. Finding this practice to be unacceptable, ERISA imposed the burden on the employer (originally only up to 30% of its net worth) to guarantee the annual benefit, up to a specified limit, with a back-up of plan termination insurance (PTI) from the Pension Benefit Guaranty Corp (PBGC). Employer liability and PTI were not applied to DC plans—including target benefit plans—presumably because there were no specific benefit guaranties. I saw no reason for this difference as to past service benefits and suggested in 1976 that target benefit plans should, perhaps, be required to include insurance against loss of these benefits in the event of early termination.

Conversely, and more appealing to me as time went by, I suggested that if target benefit plans were appropriate, we should allow a traditional DB to operate in the same manner, as if there were no past service benefits.[17] All benefits would be earned *pro rata* over future service from plan inception (ERISA allowed this approach only for plans funded by individual insurance contracts, which a number of my clients had utilized). Assuming no actuarial error, there would be no shortfall on termination. It seemed to me that limiting employer responsibility in this way was more consistent with what the employer understood to be its commitment on establishing the plan, as these benefits were generally being funded over thirty years. True, the employee would bear some of the burden of any shortfall, but considering that the employee had no protection before the plan was adopted, it could be unreasonable to rely on full protection immediately or even after five years. As the cost of plan termination insurance escalated, threatening the viability of the PBGC and DB plans, I renewed the suggestion for increasing the risk on employees in such plans.[18]

Many opposed plan termination insurance from the beginning because the claimed plan termination insurance was not an insurable risk. It is no doubt difficult to guarantee benefits—which would have gone unpaid under prior law—without undue expansion of terminations, as employers will take advantage of the insurance and will no longer struggle to keep plans going. In order to limit this risk, the idea in 1968 was to limit protection to involuntary terminations, such as a facility closing or severe financial hardship.[19] For

17. *Id.* at 776–78.

18. Daniel Halperin, *Retirement Security After the Fall*, 2009-11 NYU REVIEW OF EMPLOYEE BENEFITS AND EXECUTIVE COMPENSATION (2009) [hereinafter *After the Fall*].

19. *Evaluation*, *supra* note 2, at 774 & n.192.

protection, ERISA eventually covered (1) all terminations relying on employer liability, (2) a five year phase-in for covered benefits, and (3) a limited level of covered benefits, especially for owners or shareholders. I described this as an "effort to design a guaranty program that is protective without being subject to excessive abuse" and suggested "[o]nly experience will tell whether ERISA has sufficiently protected the insurance fund against abuse."[20] The answer to that question would seem to be no (although abuse is perhaps not the appropriate word), even with the elimination of the limit on employer liability to 30% of net worth. There is no way of knowing if it would have made a difference, but I do wish we had at least focused on the possibility of a longer phase-in during the development of ERISA.

Of course, the obvious harm to employees covered by a final pay DB who departed before retirement led some to applaud a tilt toward DC plans right from the start.[21] Nevertheless, I thought DBs were superior in achieving retirement security. In addition to the investment risk, very few employees could accurately estimate the expected DC benefit as a percent of final pay.[22] Further, the advantage of accrued benefits on early separation is not inherent in all types of DB or DC plans. In fact, it is now clear that protecting employees against early termination of employment or of the plan itself does not require a DC plan.

Employers can still guarantee the investment return, as in a cash balance arrangement with level contributions. This gives the employee more certainty even if she continues to absorb the salary risk, which is the risk the projected benefit will be inadequate to replace final pay because earnings increased faster than anticipated. Furthermore, I have now come to believe that all qualified plans, with a possible exception for some traditional final pay plans, should generally be required to provide for equal contributions as a percentage of pay and should not be able to test for nondiscrimination on the basis of equal benefits. If an exception was made for a traditional DB plan, the computation of the accrued benefit should not be entirely based on nominal salary at separation. Some allowance should be made for expected increases.

In 1976, I described ERISA as "a kind of 'truth in pension' Act."[23] First, employers should not be allowed to promise a pension unless

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20. *Id.* at 775.
21. *See id.* at 786 & n.248.
22. *Id.* at 787.
23. *Id.* at 742.

there is a fairly good assurance that the promise will be kept.[24] Second, and perhaps more important, some promises should not be allowed. Educating employees about the conditions that may deny them a benefit would limit disappointment, but if understood and acted upon, could lead to unnecessary double savings, which would defeat the purpose of the employer plan. I still believe this is a fair description of the goal. Thus, although the article suggested tightening the nondiscrimination rules and discussed whether ERISA was likely to increase or decrease participation in employer plans, that was not the focus of the piece because it was not the focus of the interagency task force or, for that matter, Congress. More recently, my focus has shifted to these concerns.

In 2003, I wrote *Employer-Based Retirement Income–the Ideal, the Possible, and the Reality*, which suggested, with respect to qualified plans, that the reality, and probably the possible, is a long way from the ideal.[25] According to that article, the "ideal" plan would, after a short waiting period, cover all employees in a line of business (including more part-time workers), and those employees would be immediately vested.[26] Contributions, with limited exceptions, would be an equal percentage of pay, elective contributions would not be required for participation unless significant non-elective contributions were provided, and all pre-retirement distributions would be made to an IRA, rather than to the employee.[27] In 2009, in *Retirement Security After the Fall*, I repeated these proposals, and suggested that pre-retirement distributions be prohibited.[28] The 2003 article suggested that all benefits be indexed for inflation or offer an inflation-indexed annuity,[29] something I do not recall being discussed during the development of ERISA.

These suggestions were decidedly more stringent compared to what I proposed in 1976.[30] The 1976 article did not suggest coverage of all employees in a line of business, which I presumably viewed as way too radical. It described relatively minor improvements to the discrimination rules.[31] The article noted that employers would be required to provide some coverage of part-time and seasonal work-

24. *Id.* (discussing the effects of ERISA on employee retirement plans).
25. *Ideal*, *supra* note 1.
26. *Id.* at 45–48.
27. *Id.* at 45–58.
28. *After the Fall*, *supra* note 18, at 11–18.
29. *Ideal*, *supra* note 1, at 60.
30. *See Evaluation*, *supra* note 2, at 800–01.
31. *Id.* at 757, 760–62.

ers,[32] and would be prohibited from isolating the employees the employer wished to cover in a different member of an affiliated group, a practice favored by some of my New York clients.[33] I also condemned the rules allowing so-called integration with Social Security for permitting complete exclusion of employees earning less than the Social Security wage base.[34] These so-called excess only plans, which continued until 1986, were probably the chief engine for reaching my goal in New York securing 90% of the benefits for company owners.

While I worried about pre-retirement distributions and loans endangering retirement security, I focused my ire on the favorable tax treatment of lump sum distributions, which I felt provided an unfortunate incentive for forgoing lifetime distributions.[35] This was clearly not the only driver of early distributions.[36] Special treatment of lump sums has been eliminated but, unquestionably, lifetime pensions are less frequent.[37]

While noting my concern that the vesting standard (full vesting after ten years or gradual vesting from five years to as much as fifteen) was inadequate,[38] I was not ready for immediate vesting or, perhaps, even full vesting after five years, which is now required. I made no proposal, I merely suggested that "once a significant accrued benefit had been earned under the plan, it should not be lost for lack of vesting."[39]

I was influenced by a feeling that lack of vesting "is less of a problem if those who forfeit benefits are younger employees . . . [who] would not have ordinarily saved for retirement" during the period,[40] and by the fact that the ERISA standard was not only a substantial improvement over prior law, but also compared favorably to the cabinet committee proposal as well as most of the proposals that had surfaced along the way.[41] These reflections now seem quaint.

It is relatively easy to describe the ideal plan. It is not clear, however, that doing so provides a path to more widespread coverage in light of the reality that if plans had to conform to the ideal, they

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32. *Id.* at 758.
33. *Id.*
34. *Id.* at 762.
35. *Id.* at 767–68.
36. *Id.*
37. *Id.*
38. *Id.* at 748.
39. *Id.* at 747, 800.
40. *Id.* at 747.
41. *Id.* at 748.

would be considerably less likely to be adopted. Even in 1976, I was skeptical that a voluntary private system could ever provide adequate coverage.[42] I concluded the article by stating "there are only two feasible alternatives if the goal of adequate retirement income is to be achieved. If Social Security will not be improved to achieve this objective on its own, a compulsory private system must be considered."[43] Stating that public discussion of this option had been limited and work was needed on the details, I paid little attention to the idea. Tentatively, I suggested that perhaps a tax credit should be considered if low income workers are not using IRAs to a desired extent.[44]

I became increasingly skeptical of the viability of a tax incentive for qualified plans in fostering retirement income security. Thus, in 1993, I wrote *Special Tax Treatment for Employer-Based Retirement Programs: Is It "Still" Viable as a Means of Increasing Retirement Income? Should It Continue?*[45] Although I put "still" in quotes to suggest special tax treatment may never have been viable, I expressed concern that the combination of lowering tax rates and limiting benefits (both reducing the incentive for the higher paid), and tighter discrimination rules (requiring greater benefits for the rank and file) would definitely have an impact on the attractiveness of these arrangements.[46]

Ten years after describing the ideal plan, I turned to the possibility of encouraging more employers to adopt such plans because of the reality that if plans had to conform to the ideal, they would be considerably less likely to be adopted. I wrote that "[t]he only sensible way to improve retirement benefits for low-income households may be to increase their lifetime income through some redistributive device which would enable low-income workers to have more retirement income without a significant cut in their wages during their working years."[47] Mandated employer plans, which eventually led to a reduction in current earnings, seemed to me to not be politically viable and potentially an unwise reduction in current earnings for already strapped workers.[48]

42. *Id.* at 767–68.
43. *Id.* at 804 (suggesting ERISA would cause fewer plans to be adopted).
44. *Id.* at 801.
45. Daniel Halperin, *Special Tax Treatment for Employer-Based Retirement Programs: Is It "Still" Viable as a Means of Increasing Retirement Income? Should It Continue?*, 49 TAX L. REV. 1 (1993).
46. *Id.* at 15–16.
47. *Ideal*, *supra* note 1, at 70.
48. *Id.* at 69–70.

Thus, in addition to increasing the minimum Social Security benefit, I suggested additional government benefits for low-earners. This included increasing the Savers Credit, making it refundable, and possibly making direct government contributions into retirement accounts.[49] These steps could provide full replacement for the lowest earners and alleviate the need for coverage of these workers in employer plans. That may make such plans more viable as vehicles for providing retirement security for higher level earners who would have the capacity to forgo some current income.[50] In 2009, I suggested much of this could be paid for by limiting those benefits for the higher earners, which made very little contribution to retirement security.[51]

In short, the agenda for today is to achieve a third level of benefits between Social Security and employer plans,[52] and greater protection for employees in a DC plan against a market decline.[53] This is a long way from my concerns in 1976.[54]

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49. *Id.* at 71–72; *see also After the Fall*, *supra* note 18, at 11–9.

50. *See After the Fall*, *supra* note 18, at 11–7, 11–10.

51. *Id.* at 11–19.

52. *See id.* at 11–18 (describing the Retirement USA proposal for a Universal Secure and Adequate Retirement).

53. *See id*. at 11–12, 16.

54. *See generally Evaluation*, *supra* note 2 (discussing the author's original concerns).