ECONOMY does not lie in sparing money, but in spending it wisely.¹

Every year, millions of dollars flow into 401(k)-type and other savings plans. As large numbers of baby boomers begin to retire in a few short years, millions of dollars will start to flow out. Most workers will be on their own in managing their savings during retirement because most plan sponsors deliberately restrict plans to lump sum distributions. Although annuities are a well-respected technique for managing income in retirement, they are virtually absent from savings plans in the private pension system.

This chapter analyzes why savings plan sponsors shun annuities and what might be done to change the situation. It begins with a discussion of an apparent puzzle: just as the shift to savings plans in the private pension system began to accelerate in the 1990s, annuities began disappearing from savings plans. I explain how legal reforms in the early 1990s, largely intended to protect participants in defined benefit (DB) plans, increased the risk of fiduciary liability associated with annuities. Employers responded by abandoning annuities as a distribution option in savings plans wherever possible, leaving to workers the responsibility for managing their savings in retirement. I also describe how one proposal for a federal charter option for life insurance companies could hold some promise for persuading plan sponsors to put annuities back into savings plans.

Savings Plans and the Case for Annuities

The Shift to Savings Plans

In recent years, the paramount goal of the U.S. private pension system has been to encourage saving for retirement. With the retirement of

¹ECONOMY does not lie in sparing money, but in spending it wisely.
the baby boom generation approaching and other sources of retirement income such as Social Security under stress, there is a great deal of concern that millions of Americans will reach retirement without adequate resources (Eny˝o-Nagy and Reinhart Institute 2000). This concern has been prompted by a fundamental shift in the type of retirement income produced by the private pension system.

Historically, employers provided their workers with retirement benefits through DB plans. Typically financed entirely by employers, these plans provide a worker with income in retirement, usually payable for life, based on years of service and amount of compensation. But employers today prefer to offer savings plans, such as the popular 401(k) plan, to which both employers and workers contribute. Rather than generating a stream of retirement income, these plans accumulate a pool of assets based on contributions and their earnings. This trend to savings plans has largely shifted the risk of preparing for retirement from employers to workers. It is now well recognized that, in 401(k)-type savings plans, workers must take the initiative in saving. For many, their own savings will provide the bulk of retirement income along with, perhaps, some employer matching contributions. Workers must also assume investment responsibility for their savings. Now that savings plans dominate the private pension system, encouraging as many workers as possible to save as much as possible and to invest wisely has become a national priority.

A Role for Annuities in Savings Plans

The shift to savings plans, however, imposes another burden on workers that has not yet received much attention (Mitchell 2004). DB plans have traditionally provided retirement income in one standard form: monthly payments guaranteed to last for life. Workers in DB plans arrive at retirement with a known, guaranteed, lifetime stream of income. Workers in savings plans arrive instead with an account balance that must be converted into income for retirement through a process often referred to as self-annuitization. The growth in savings plans has shifted to workers the risk of living longer than their income. In order to avoid outliving their resources, workers must now learn how to manage their assets in retirement.

For most workers in savings plans, it will not be obvious how to apportion and spend their accumulated assets throughout retirement. For instance:

[i]individuals face a variety of risks in managing their assets, income, and expenditures at and during retirement. For example, retirees may outlive their pension or retirement savings plan assets. In addition, inflation may erode the purchasing power of their income, investments may yield returns that are less than expected or decline in value, and large unplanned expenses, such as those to cover long-term care, may occur at some point during retirement (Government Accountability Office 2003:10).

Deciding how to allocate resources during retirement is difficult and fraught with uncertainty. It requires workers to estimate with some degree of accuracy how long they will live and how much they will need to spend. In addition, they must continue to manage their assets to generate income in retirement. This requires deciding how to invest assets appropriately for the 20, 30, or even 40 years of retirement that are becoming increasingly common.

At least some of the financial uncertainty inevitable in retirement can be mitigated through the use of a life annuity. There are many types of annuities: variable, fixed, immediate, deferred, and so on. The focus of this chapter is on the traditional form of annuity, the life annuity, either immediate or deferred. A life annuity is an investment product available from an insurance company, purchased through a single premium payment. In exchange for the payment, the insurance company contracts to pay a guaranteed amount, usually monthly, for life. Life annuities generally provide income only for the life of the annuitant, although it is also possible to purchase joint and survivor annuities that continue to provide income for the life of a named beneficiary. Purchasing a life annuity is an irrevocable decision—there are no opt out provisions for buyers who change their minds.

According to economic theory, life annuities enable workers to manage their consumption appropriately in retirement and help mitigate financial uncertainty. By trading a stock of wealth for a life-contingent stream, a healthy individual is able to sustain a higher rate of consumption than in the absence of annuitization . . . If an individual does not have access to annuitization then she must allocate her wealth in a manner that trades off two competing risks. The first is the risk that if she consumes too aggressively, she increases the likelihood of facing a future period in which she is alive with little or no income. The second is that if she self-insures by setting aside enough wealth to be certain it cannot be outlived, then she risks dying with assets that could have been used to increase consumption while alive. (Brown and Warsadowsky 2004)
By purchasing a life annuity, workers transfer at least a portion of their mortality risk, that is, the risk of living longer than their assets, to the insurance company in exchange for a stream of income that continues for the rest of their lives, no longer how long they live. In addition, the amount they will receive from the insurance company is both known and guaranteed. A life annuity also helps workers reduce at least a portion of their investment risk, the risk their savings will produce less than their anticipated income in retirement.

Life annuities are one means by which workers in savings plans could obtain the lifetime, guaranteed stream of income produced by DB plans. But life annuities are not a popular or well-understood insurance product in the United States today. More popular forms of annuities are purchased as investment products, in part because they enjoy special tax benefits (Mitchell 2004). A "deferred annuity" can be obtained in either a variable form, where its value fluctuates according to the investments chosen by the policyholder, or a fixed form, where the insurance company promises a specific rate of return. Under tax law, an individual can invest any amount in an annuity contract and postpone tax on its increased value (its "inside build-up") until it is paid out to the policyholder. This gives annuities tax advantages similar to those in an employer-based savings plan but without annual limits on contributions. Few purchasers of investment annuities convert the value of those contracts into life annuities: fewer than 1% of such contracts are ever converted into fixed annuities (Beatrice and Drinkwater 2004; Beatrice 2005).

Industry analysts believe that the market for life annuities holds great potential. [The annuitization market remains underdeveloped. According to one estimate, the annuitization market among the currently retired has the potential to exceed $114 billion. . . . Both the need for annuitization already exist. Half of all individuals aged 65 to 75 with household financial assets of $50,000 or more will need to tap into savings during retirement in order to pay for basic living expenses. . . . Nearly half of those people are interested in converting some of their savings into guaranteed lifetime income. If all these people eventually annuitize a portion of their assets, the total amount annuitized would exceed $200 billion. (Sondergeld and Drinkwater 2004)]

But at the present time, life annuities represent a small fraction of the industry's sales. For example, in 2004 there were $212.4 billion in new individual annuity sales, but fixed immediate life annuities accounted for only $5.6 billion of that amount (Bernard 2005; Whitehouse 2005).

Research into the unpopularity of life annuities typically focuses on two sets of factors: people and their individual needs, and problems with the product itself. The research indicates that some potential purchasers have liquidity concerns and are reluctant to commit their savings irrevocably to an annuity. Others are unsure about their health and question whether buying the lifetime income provided by an annuity is a good investment for them (Brown and Warshawsky 2004). Many potential purchasers try to conserve their assets for bequests to their families or to charity and therefore find an annuity unappealing. Still others prefer to rely on Social Security for a guaranteed income stream in retirement (Ameriks and Yakobowski 2003). The life annuity market is still developing, and the product is perceived to have a number of problems. For example, the issue of whether life annuities are fairly priced is an open one (Ameriks and Yakobowski 2003), leading some to question whether annuities are an attractive investment. And the market currently lacks an annuity product that protects against inflation (Brown and Warshawsky 2004).

Missing in Action: The Employer

These factors explain some of the unpopularity of annuities, but there could be another important but generally overlooked factor: the absence of annuity options in savings plans. For many people, the most significant source of information about and support for retirement planning is their employer's savings plan. Employers are important intermediaries in saving. They provide a plan and payroll deduction services, educate workers about the need to save, select a menu of investment options, and, often, encourage additional saving through financial incentives such as matching contributions. Most workers learn about and implement saving for retirement through their employers' plans.

Employers, however, deliberately play a hands-off role in educating workers about managing their savings in retirement. A Government Accountability Office (GAO) study observed that [plan sponsors . . . generally did not provide information on considerations relevant to managing pension and retirement savings plan assets at and during retirement. . . .] Plan sponsors generally do not discuss the potential pros and cons of available payout options as related to managing pension assets during retirement. . . . [They typically do not discuss risks retirees may face in managing their assets during retirement or provide information on how to assess needs at or during retirement]
Not only do employers not provide advice or education about managing assets in retirement, savings plans in particular typically constrain workers to a lump sum of cash when leaving. Government Accountability Office (2003). As Table 1 illustrates, the available data suggest that only a minority of savings plan offer annuities as a distribution option, and even then that number appears to be shrinking over time.

The absence of annuities from savings plans does not mean that workers have lost their only opportunity to purchase one. They can always use a lump sum distribution of their plan account to buy an annuity directly from an insurance company or purchase one later through an individual retirement account (IRA). But with the employer sitting on the sidelines, both workers and the life annuity market have lost the services of an important intermediary. Workers do not learn about the benefits of annuities or receive help in obtaining one through their savings plan, and the life insurance industry has lost an important ally. If savings plan sponsors do not expand the distribution options in their plans to include annuities, the rate of annuitization may not increase significantly in the future. But, as I go on to describe, recent developments in the law have discouraged plan sponsors from offering annuities.

Why Savings Plan Sponsors Avoid Annuities

Several factors explain the absence of annuities in savings plans. First, while DB plans are required to provide annuities, savings plans are generally exempt from this requirement. Under Internal Revenue Code (IRC) § 401(a)(1)(B)(iii) and the Employee Retirement Income Security Act (ERISA) § 205(b)(1)(C), most DC plans are not required to offer annuities as long as the spouse of a deceased participant inherits the decedent’s account automatically under the terms of the plan. The exception to this rule is a type of DC plan that is not a savings plan known as a money purchase plan. Most savings plan sponsors thus are not obliged to offer annuities as distribution options. Second, as researchers have observed, plan sponsors avoid annuities to minimize their administrative and regulatory burdens (Brown and Warszawsky 2004). But legal advisors know the real reason why plan sponsors don’t offer annuities: because those advisors strongly counsel clients against them. In their view, annuities expose plan sponsors to a significant and long-term risk of fiduciary liability, a risk that can be avoided by not offering annuities in employee savings plans. And plan sponsors, more often than not, heed that advice.

ERISA and Fiduciary Liability

The fiduciary liability associated with savings plans arises out of the legal requirements under ERISA, administered by the Department of Labor (DOL), that set standards for savings plans. The rules set forth in ERISA control how a plan should be operated and impose penalties for breaching those standards. ERISA § 401 holds individuals with discretionary authority over the operation and administration of a plan to a high standard of conduct as fiduciaries. ERISA § 404 requires a fiduciary, when acting on behalf of a plan, to act solely in the interests of the participants and beneficiaries, for the exclusive purpose of providing benefits to participants and beneficiaries and defraying the reasonable expenses of administering the plan, and with the care, skill, prudence, and diligence that a prudent person would use under similar circumstances.

Fiduciaries are personally liable to make a plan whole for any losses it suffers when they breach that standard of conduct. In addition, a fiduciary involved in a settlement agreement or lawsuit as the result of a fiduciary breach is also subject to a 20% special civil penalty. The DOL is required to assess this penalty unless it finds that the fiduciary acted reasonably or in good faith, or will suffer severe financial hardship without a waiver or reduction of the penalty under ERISA § 502(j).

Under ERISA, a plan sponsor is not acting as a fiduciary when it chooses the distribution options in a plan, because plan design is considered to be a business, rather than fiduciary, decision. Plan sponsors thus have complete discretion when deciding to include or exclude annuities from their plans. Liability potentially arises only when a participant
chooses an annuity in a plan that offers them, and the plan sponsor or other fiduciary must decide how the annuity will be provided. This is less of an issue with ongoing DB plans because annuities are typically paid directly from the plan. DC plans, however, are different. If a participant chooses an annuity form of distribution, the plan must purchase an annuity from an outside provider. The choice of annuity provider is an investment decision, subject to the fiduciary standards of ERISA. This distinguishes DB annuities from other forms of distribution, such as lump sum or installment distributions, for which the participant, not the plan, makes all investment decisions. Any plan official who makes a discretionary decision to make an annuity purchase for a participant is therefore acting as a fiduciary and is liable for that decision unless he or she exercised due care when making it and put the best interests of the participant first.1

1 Executive Life and Its Aftermath

Until the early 1990s, the fiduciary liability associated with annuities did not seem particularly problematic, and many savings plans offered them. But, just as the shift to savings plans was accelerating in the late 1980s and 1990s, a number of large insurance companies failed, including Executive Life Insurance Company of California and Mutual Benefit Life of New Jersey (Government Accountability Office 1992a, 1992b; Government Accountability Office 1995). At that time, as the GAO (Government Accountability Office 1991) has estimated, about one-third of all pension plan assets were invested in insurance company products, and some 3 to 4 million retirees held annuities purchased from insurance companies. The failure of these companies caused a crisis within the private pension system whose repercussions are still being felt today.

Most affected by the crisis were DB plans, primarily those that had purchased group annuity contracts for retirees or for terminating plans. Savings plans were affected only secondarily, but, ironically, not because of the annuities they provided. Instead, some savings plans became vulnerable because they or their participants had invested in such insurance company products as guaranteed investment contracts that could not pay their promised return. Even though the life annuities offered by savings plans were not generally implicated, the crisis exposed regulatory weaknesses that persuaded savings plan sponsors that annuities were too risky. In addition, although the crisis with life annuities was largely confined to DB plans, the regulatory response was overly broad, increasing the administrative burden and fiduciary risk associated with annuities even for savings plans.

The first regulatory weakness exposed was within the insurance industry itself. In the United States, the insurance industry is largely regulated by states rather than the federal government. States license insurance companies, oversee their financial health, and, when a company becomes insolvent, take charge of the liquidation process. When an insurance company fails, policyholders must turn to the relevant state guaranty associations for redress. These associations are neither state agencies nor funded by the states. Instead, they are an association of insurers in each state that have the power to assess member insurers when an insurance company becomes insolvent. Although these funds are called “guaranty” associations, they do not in fact provide a guarantee that they will have sufficient funds to cover the obligations of failed insurers. In addition, while these associations initially bear the cost of an insurance company insolvency, most states allow insurance companies to recover assessments through reductions in state premium taxes (American Council of Life Insurers 2004d) or rate increases. So ultimately the cost of an insurance company failure is borne by policyholders or taxpayers (Government Accountability Office 1992c).

The failure of Executive Life and the other companies gave employers and their employee benefits lawyers their first large-scale encounter with state guaranty associations and, for many it was a disturbing experience. There are no statistics available about the relief actually obtained from state guaranty associations, but contemporary accounts report a number of significant problems encountered by plans seeking to recoup losses:

• State guaranty funds generally did not provide coverage for guaranteed insurance contracts and similar products in DB plans, and only a few provided coverage for DC plans (Government Accountability Office 1991; Harrington 1992).
• "Variations in state rules cause gaps and significant differences in coverage," such as different rules for who is protected and the types of policies and annuities protected (Government Accountability Office 1995).
• Coverage was "generally limited to a maximum of $300,000 for individual claimants with no more than $100,000 for cash values of life insurance and annuity contracts" (Harrington 1992). (The same limits were still in effect in 2004 [American Council of Life Insurers 2004d].)
• Some states provide coverage to all if the insurance company is headquartered in that state, but others provide coverage only for state residents of companies doing business in that state (Government Accountability Office 1991).
Although the National Association of Life and Health Guaranty Associations exists to help coordinate guaranty association activities when an insurance company operating in several states fails (American Council of Life Insurers 2004a), there is no parallel coordinating mechanism for employee benefit plans. Employers found that dealing with multiple state guaranty funds was expensive and time-consuming. In addition, the patchwork of coverage available led to uneven outcomes among participants, and even no protection for large numbers of participants. In the end, many in the employee benefits community concluded that, whatever the merits of the state guaranty association system, it is not well suited to the needs of employer plans, particularly those with employees in a number of states.

The second regulatory weakness exposed was within the private pension system itself. Some employers as well as those frustrated by the state guaranty association system chose a different route. They proposed to make additional contributions to their plans to make participants whole. On the surface, this appeared to be a simple, reasonable solution to a difficult problem. But the private pension system, never having grappled with such a situation before, had no mechanism permitting this. In addition, these contributions actually raised a number of significant legal questions. For example, under tax law, there were issues about whether these contributions would violate the exclusive benefit rule of IRC § 401(a)(2), the nondiscrimination rules of IRC § 401(a)(4), the limits on deductions under IRC § 494, and the limits on benefits under IRC § 415, as well as various excise tax provisions. Under ERISA, there was a great deal of uncertainty about whether such contributions would be an admission of fiduciary liability, triggering the special 20% civil penalty for fiduciary breaches.

After some consideration by the Internal Revenue Service (IRS) and the DOL, and consultation with employer groups and benefits experts, the legal issues were resolved. Employers were given the ability to make such "reestoration" payments to their DC plans, but only after they had received regulatory approval. The IRS created a special program for this purpose. To participate in this program, employers also were required to obtain an exemption from the DOL for relief from fiduciary liability. This meant that employers had to provide information to the DOL about their plans, their failed contracts, and their affected plan participants. Employers who volunteered to make their participants whole found themselves involved in an expensive and time-consuming regulatory process.

By themselves, these regulatory issues would probably not have been significant enough to turn savings plan sponsors against annuities. But litigation surrounding the collapse of the Executive Life Insurance Company of California led to a major change in law with just that effect. The leading case was Keyes v. Pacific Lumber.7 The Maxam Group obtained control of the Pacific Lumber Company through a hostile takeover, then terminated its overfunded DB plan. It selected Executive Life, an insurance company whose bid was $2.7 million less than other companies, to provide annuities to participants and received $62 million in surplus plan assets that were then used to pay off debt from the leveraged buyout. When this insurance company subsequently failed, litigation on behalf of annuitants, seeking to impose liability on plan fiduciaries for their self-interested selection of Executive Life, ran into a legal Catch-22. Because their annuities were fully guaranteed by an insurance company, they no longer satisfied the definition of plan "participant" under ERISA and therefore had no standing to sue.

To many, Keyes v. Pacific Lumber signaled a problem with ERISA's fiduciary rules that needed to be fixed. Its holding, although legally correct, suggested that plan fiduciaries could violate with impunity ERISA's requirement that they act solely in the best interests of plan participants when purchasing annuities. Congress concurred and swiftly enacted the Pension Amendments Protection Act of 1994 (PAPA). PAPA amended ERISA to grant annuities standing to bring suit against plan fiduciaries for breaches of duty in connection with the purchase of insurance contracts and annuities. This not only gave annuitants the right to sue, it also greatly expanded the period of time during which fiduciaries could be at risk for a claim of breach of fiduciary duty. In addition, it authorized courts to award appropriate relief and money damages, including the purchase of backup annuities, remedies that are generally not available under ERISA.

In interpreting the new rules under PAPA, the DOL issued regulatons about annuity purchases that were highly controversial. As the GAO (Government Accountability Office 1993) noted during the height of the Executive Life crisis, fiduciaries had no guidance from the DOL about the process they should follow or the criteria they should observe when selecting annuity providers for participants to comply with ERISA's requirements. In 1995, however, the DOL issued an interpretive bulletin for that purpose. Its central holding was that ERISA required plan fiduciaries to select the " safest possible annuity." To do this, in the DOL's view, fiduciaries are required to conduct an objective and thorough search for potential providers, generally with the assistance of an independent expert. In particular, they should analyze each provider's creditworthiness and claims-paying ability. They should conduct their own evaluation of the safety of possible providers and not just
rely on a rating from a commercial rating service. Factors to be consid-
ered include the quality and diversification of each company's investment
portfolio, its capital level and surplus, and its lines of business and exposure
to liability as well as the structure of the proposed annuity contract and its
Guarantors. To the DOL's view, a proper review should include analysis of
the adequacy of state guaranty fund protection. In 2002, the DOL ampli-
fied that guidance by advising plan fiduciaries to examine "whether the
provider and the annuity provider are covered by state guarantors and the
extent of those guarantors, in terms of amounts (e.g., percentage limits on
guarantees) and individuals covered (e.g., residents, as opposed to non-
residents, of a state)." (Department of Labor 2002)

The DOL's attempt to add clarity was not well received. Some courts
refused to apply the interpretive bulletin's guidance when evaluating the
conduct of fiduciaries, even in cases related to Executive Life.20 More-
over, Congress added "the safest possible annuity" standard. In the Pension
Protection Act, passed in mid-2006, Congress noted that it was not its intention that there "be a single safest annuity available contract" (Joint Committee on Taxation 2006:149).21 Congress directed the DOL to issue new regulations within 12 months setting standards more closely tied to ERISA's general standard of prudence for fiduciaries. It also strongly indicated that the DOL's interpretive bullet-
In the Executive Life crisis and the regulatory struggle over appropriate fiduciary standards for annuity purchases largely explains why savings plan sponsors shun annuities. This is an ironic outcome. As suggested by PAPA, make sense only for DB plans. Given the volume of annuities that DB plans typically
purchase, it seems reasonable to require a formal evaluation process of
providers to satisfy fiduciary standards. In addition, the price paid for
annuities inevitably affects the funded status of DB plans, so plan fiduci-
aries have an inherent conflict of interest regarding the cost of the annu-
ity provider they choose. It seems reasonable to ensure that plan
participants have redress against fiduciaries that put the costs of annuities
first and the safety of the annuities they purchase for participants second.
It also seems reasonable to believe that annuities, given their long-term
and irrevocable nature, deserve extended protection against fiduciary
misconduct in ways lump sum and installment distributions do not.
But it is hard to understand why fiduciaries of savings plans should
be held to the same standards as their counterparts in DB plans. Savings
plan purchase annuities infrequently and usually once at a time. Many
plans are sponsored by small employers who lack the staff, the expertise,
and the funds to follow the procedures the DOL recommends. There is
no conflict of interest when a savings plan buys an annuity because it can
to only use a participant's own account assets for that purpose.
In the end, savings plan participants lost more than they gained by the
post-Executive Life reforms. These reforms prevented what was a
small risk to plan participants by imposing a big risk on plan fiduciaries.
Savings plan sponsors responded by concluding the fiduciary liability
attached to annuities should be avoided wherever possible. They also
observed that state guaranty associations do not provide adequate or
even protection when an insurance company fails. Even volunteering to
make their participants whole would be complicated, requiring cumbersome
some regulatory approvals. But, primarily, they decided they did not
want to be the potential guarantors of private annuity providers under
PAPA. They looked at their increased fiduciary liability and concluded that
offering annuities was just not worth the risk when participants could
always buy annuities on their own. The law offers savings plan
sponsors an out, and many take it by deciding not to offer annuities.
That leaves savings plan participants without the assistance of an impor-
tant intermediary, their employer, and a valuable product, a life annuity,
as they make the transition to retirement.

How Proposed Insurance Reforms Could Help
Proposals for Changing Pension Law
The absence of annuities from savings plans has not gone unnoticed,
and various options have been proposed to reimagine them (Government
Accountability Office 2003). Among the most prominent are proposals for
some form of mandatory annuitization. These would change existing
law to compel plans to provide and/or participants to receive annuities as
distribution options. The most extreme proposal would eliminate partici-
pants' choice and require all benefits, regardless of the type of plan, to be
paid in the form of annuities. Under a more moderate proposal, the cur-
rent exemption for savings plans under IRC § 401(a)(11) would be
repealed. Savings plan participants would be required to receive their
benefits as an annuity unless they, with spousal consent, chose an alter-
native. Another proposal would merely require savings plans to offer
annuities.
These proposals are appealing in their simplicity; just amend pension
law and the problem will be solved. The trend in the law, however, is
moving strongly in the opposite direction, that is, to give savings plan
sponsors more flexibility, not less, with respect to annuities. For example,
the IRS has recently revised long-standing regulations and now permits savings plans to eliminate all forms of annuity distributions. In addition, it is likely that these proposals would exacerbate the coverage problem currently facing the private pension system. Plan sponsors would be likely to respond to this mandatory plan that would expand their fiduciary liability by refusing to sponsor new plans or terminating their existing plans.

Plan sponsors' negative response to PAPA suggests that these proposals will not achieve what they intend. First, it is unrealistic to assume that plan sponsors will willingly assume responsibility for what they cannot control, namely the financial health of the insurance companies from which they purchase annuities. Plan sponsors are not eager to become potential guarantors for annuity providers, especially given the extended period under ERISA's statute of limitations during which they could be at risk for litigation. Second, as with pension law, by itself, cannot make annuities a safer or more appealing product to either plan sponsors or plan participants. These are issues that lie primarily within the control of the life insurance industry, not pension law.

A Proposal for Changing Insurance Law

The life insurance industry itself has recently proposed reforms with the potential to make annuities again an attractive option for savings plan sponsors. It has asked Congress to create a new model for insurance company organization and regulation: an optional federal charter for life insurance companies. This initiative for change comes at a time when the traditional lines between the insurance, banking, and securities industries have been blurring. In addition, recent legislation, notably the Gramm-Leach-Bliley Act of 1999, has modernized federal regulation over most of the financial services industry. Similar reform has not yet been attempted on a broad scale within the life insurance industry, which remains a creature of state law.

As one industry spokesperson has noted, however, for the insurance business to remain viable and serve the needs of the American public, a system of life insurance regulation must become far more efficient and responsive to the needs and circumstances of a 21st century global business. Life insurers today operate under a patchwork system of state laws and regulations that lack uniformity and is applied and interpreted differently from state to state. The result is a system characterized by delays and unnecessary expenses that hinder companies and disadvantage their customers. (American Council of Life Insurers 2004d)
From the perspective of plan sponsors, it would be preferable to have a single guaranty fund under the jurisdiction of a single regulator and federal law. How significant this omission is, given the benefits of the proposal, is open to question. There are, however, some improvements, short of a single guaranty fund, that could be made to the proposal that plan sponsors might find helpful. For example, perhaps the proposal could include some sort of explicit coordination mechanism for employee benefit plans in the event of a multi-jurisdiction insolvency. Alternatively, a single jurisdiction, perhaps that of the employer, could be designated for annuities purchased through an employee benefit plan. Changes like these could improve the efficiency of the guaranty system for plan sponsors without adversely affecting the protection available for plan annuitants.

Conclusion

At a minimum, the federal charter proposal would enable plan fiduciaries to minimize their fiduciary exposure when helping participants purchase annuities. That, by itself, might be sufficient to persuade more plan sponsors to offer annuities. From the perspective of pension law, this would be a practical and welcome solution to a problem largely created by pension law. But the federal charter proposal holds the potential for some positive changes to pension law as well. With a strong federal regulator, the risks of insolvency by national insurers would presumably be greatly reduced, and the need to give plan participants additional protection under ERISA would correspondingly decrease as well.

If so, why not make annuities more attractive to savings plan sponsors by reducing their exposure to fiduciary liability proportionately? One possible way to do that is to amend pension law so that the purchase of an annuity from a federally chartered insurance company by savings plan fiduciaries automatically satisfies ERISA’s fiduciary provisions. If the federal charter proposal fulfills its promise, such a change would undo the damage that PAPA has inflicted on savings plans. It would give savings plan sponsors a more appropriate role as facilitators, not guarantors, of annuities. It would be a helpful step toward making annuities once again a standard feature of savings plans and making workers more receptive to annuities.

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Chapter 9


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This chapter examines how U.S. federal pension policy has evolved since the enactment of the country’s major pension law: the Employee Retirement Income Security Act of 1974 (ERISA, P.L. 93-406). Pension policy has had to balance the need for a reliable pension supplement to Social Security within a voluntary system of employer-provided employee benefits. Although experts have long known that tax incentive-based systems do little to promote extra savings for retirement, such incentives remain the most popular and attractive public policy tool. As individual-based retirement plans, such as 401(k) plans, have become the dominant form of retirement savings, it is becoming clearer that individuals are unreliable managers of long-term savings and that employers have an inconsistent history in managing 401(k) plans and large incentives to extend them to the lowest earners. This chapter outlines the predictable issues that arise in federal pension policy and suggests directions future policy might take. One of the current challenges is to encourage individual saving plans to adopt more traditional guaranteed benefit features to ensure needed minimum long-term retirement security.

Pension policy was largely unregulated until the enactment of ERISA, which has been described as the triumph of Congress over the affected special interest groups: employers and unions (Wooten 2004). For much of the past 30 years, congressional amendments to ERISA have tested this unusual policy dynamic, sometimes balancing and sometimes failing to find a balance between the interests of public policy, organized labor, and business.

Participant Activism to Perfect ERISA

Throughout the 1980s, participant advocates sought and fought to close the gaps in the private pension system that ERISA failed to