

ENRON, PENSION POLICY, AND SOCIAL SECURITY PRIVATIZATION

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I. INTRODUCTION

The collapse of Enron Corporation and the implosion of its stock's value are watershed events in the financial history of the United States.¹ Their legal implications have been and will continue to be fleshed out over many years in such diverse areas as auditor independence,² accounting industry regulation,³ corporate tax shelters,⁴ and stock options,⁵ to name just a few. This Article, however, uses

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1. See JOINT COMM. ON TAX'N, REPORT OF INVESTIGATION OF ENRON CORPORATION AND RELATED ENTITIES REGARDING FEDERAL TAX AND COMPENSATION ISSUES, AND POLICY RECOMMENDATIONS (JCS-3-03, 2003); see also PETER C. FUSARO & ROSS M. MILLER, WHAT WENT WRONG AT ENRON: EVERYONE'S GUIDE TO THE LARGEST BANKRUPTCY IN U.S. HISTORY (2002); CHERYL DE MESA GRAZIANO, ENRON AND THE POWERS REPORT: AN EXAMINATION OF BUSINESS AND ACCOUNTING FAILURES (2002); DIRK J. BARREVELD, THE ENRON COLLAPSE: CREATIVE ACCOUNTING, WRONG ECONOMICS OR CRIMINAL ACTS? (2002); ROBERT BRYCE, PIPE DREAMS: GREED, EGO, JEALOUSY AND THE DEATH OF ENRON (2002); ARTHUR L. BERKOWITZ, ENRON: A PROFESSIONAL'S GUIDE TO THE EVENTS, ETHICAL ISSUES, AND PROPOSED REFORMS (2002).

2. See Sarbanes-Oxley Act of 2002, Pub. L. No. 107-204, §§ 201–209, 116 Stat. 745, 771–75 (codified as amended in scattered sections of 11, 15, 18, 28, and 29 U.S.C.). See generally Richard L. Kaplan, *The Mother of All Conflicts: Auditors and Their Clients*, 29 J. CORP. L. (forthcoming 2004).

3. See Sarbanes-Oxley Act of 2002, Pub. L. No. 107-204, §§ 101–109, 116 Stat. at 750–71. See generally Larry E. Ribstein, *Market vs. Regulatory Responses to Corporate Fraud: A Critique of the Sarbanes-Oxley Act of 2002*, 28 J. CORP. L. 1 (2002).

4. See Abusive Tax Shelter Shutdown and Taxpayer Accountability Act of 2003, H.R. 1555, 108th Cong. (2003); Tax Shelter Transparency Act, S. 2498, 107th Cong. (2002).

5. See Ending the Double Standard for Stock Options Act, H.R. 626, 108th Cong. (2003); Prevention of Stock Option Abuse Act of 2003, S. 690, 108th Cong. (2003).

the Enron debacle to evaluate current pension practices and policies as well as emergent proposals for privatizing Social Security.

The Article begins in Part II by examining the two principal types of employer-based pension arrangements, defined benefit plans and defined contribution plans, and the present trends away from defined benefit plans. Part III then considers the emergence of 401(k) plans and their role in the pantheon of retirement financing mechanisms. Part IV then analyzes the single most contentious issue raised by the Enron disaster regarding 401(k) plans—namely, the overinvestment in employer stock by such plans. Finally, Part V examines the import of these developments on proposals to allow workers to manage some part of their Social Security contributions.

II. PENSION PLANS IN OVERVIEW

A system of employment-based pension plans has been part of the American workplace since the early 1920s.⁶ Even with the near-universal coverage of the federal government's Social Security program,⁷ employer-sponsored pension plans fulfill a vital role in supplementing that program's retirement benefits. These plans operate on a variety of different levels and are subject to numerous detailed and ever-changing rules.⁸ In fact, the Economic Growth and Tax Relief Reconciliation Act of 2001⁹ contained no fewer than 184 separate amendments to the tax rules affecting pension plans.¹⁰ These copious provisions are variations, for the most part, on the single theme of extraordinary tax subsidy for employment-based private pensions. This subsidy, in turn, represents the single largest revenue-losing provision in the U.S. tax code: \$83.5 billion in the most recent compendium.¹¹ Similar treatment is provided as well in most of the various state income tax systems.

The essence of this tax subsidy is fairly straightforward. The employer deducts its payments to the pension plan when these payments are made,¹² but the

6. 3 BORIS I. BITTKER & LAWRENCE LOKKEN, *FEDERAL TAXATION OF INCOME, ESTATES AND GIFTS* ¶ 61.1, at 61-4 (3d ed. 2001).

7. See LAWRENCE A. FROLIK & RICHARD L. KAPLAN, *ELDER LAW IN A NUTSHELL* 273 (3d ed. 2003) (nearly 91% of retirees receive Social Security benefits).

8. See *Pension Plan Guide* (CCH) (eleven-volume looseleaf service covering private pension plan rules and regulations); see also GARY I. BOREN & NORMAN P. STEIN, *QUALIFIED DEFERRED COMPENSATION PLANS* (2001) (two-volume treatise).

9. Pub. L. No. 107-16, 115 Stat. 38 (2001) (codified as amended in scattered sections of 26 U.S.C.).

10. Author's count derived from CCH INC., *2001 TAX LEGISLATION: LAW, EXPLANATION AND ANALYSIS* 589-622 (2001) (tabular compilation of all changes made by the 2001 tax legislation).

11. See JOINT COMM. ON TAX'N, *ESTIMATES OF FEDERAL TAX EXPENDITURES FOR FISCAL YEARS 2003-2007*, 26 (JCS-5-02, 2002).

12. I.R.C. § 404(a) (2003).

employees report no taxable income from the pension plan until they receive retirement income from it.¹³ The resulting mismatch of current deduction for employers and deferred income recognition by employees contrasts rather dramatically with the tax treatment of ordinary wages and salaries. For such payments, the employer gets a deduction in the current year,¹⁴ but the employee reports taxable income from the wage received during the same time period.¹⁵ Deferring recognition of income is an enormous financial benefit to workers covered by these arrangements: a tax payment of \$10,000 that is deferred for forty years is equivalent to a current tax liability of only \$668.¹⁶ In addition, investment gains obtained on this deferred income are also not taxed¹⁷ until they are distributed as part of the pension plan's payouts to its retirees.

Within these general parameters, however, lie two distinctly different types of pension plans with enormously significant consequences for the persons covered by these plans. These two general categories are "defined benefit" plans and "defined contribution" plans.¹⁸

A. Defined Benefit Plans

Defined benefit plans are the older of the two types and are often described as "traditional" or "standard" pension plans.¹⁹ Such plans are established in lengthy plan documents that define the "benefit" a covered employee will receive upon her retirement.²⁰ The focus on the benefit that a retiree will receive is the source of their name: defined benefit plans. The benefit itself is almost always a series of payments (usually monthly, but occasionally quarterly or even annually) received by the retired worker until that person dies.²¹ If that person leaves a

13. I.R.C. § 402(a) (2003).

14. I.R.C. § 162(a)(1) (2003).

15. I.R.C. § 61(a)(1) (2003).

16. See MICHAEL SHERMAN, COMPREHENSIVE COMPOUND INTEREST TABLES 177 (1986) (present value discounted at an annual rate of 7%).

17. I.R.C. §§ 401(a)(1), 501(a) (2003).

18. So-called "cash balance" plans are a hybrid with some characteristics of both defined benefit plans and defined contribution plans. See Treas. Reg. § 1.401(a)(4)-8(c)(3)(i) (as amended in 1993) ("A cash balance plan is a defined benefit plan that defines benefits for each employee by reference to the employee's hypothetical account . . . [which] is determined by reference to . . . allocations and interest adjustments that are analogous to . . . a defined contribution plan . . ."). See generally 1 BOREN & STEIN, *supra* note 8, § 1:07.50.

19. See 1 BOREN & STEIN, *supra* note 8, § 1:07; see also PETER J. STRAUSS, ET AL., AGING AND THE LAW 802 (1999).

20. See 3 BITTKER & LOKKEN, *supra* note 6, ¶ 61.1. 2, at 61-11.

21. 1 BOREN & STEIN, *supra* note 8, § 1:07, at 1-14. Benefits might also be paid in a single "lump sum" distribution if the plan so provides. See generally FROLIK & KAPLAN, *supra* note 7, at 374-84; DIANE BENNETT ET AL., TAXATION OF DISTRIBUTIONS FROM QUALIFIED PLANS ¶¶ 4.01-4.02 (2d ed. 1998).

surviving spouse, the survivor will receive a portion of the plan's regular payout—generally half—until that person passes on as well.²² For example, assume that Ellen retires with a monthly pension of \$4,000 per month. She will receive this amount every month until she dies, at which time, her husband will receive \$2,000 per month (half of Ellen's \$4,000 per month) for the rest of his life.

The amount of the benefit is determined by the specific plan, but typical plan provisions consider the employee's age at retirement, length of service with the employer, and recent salary history.²³ Average wages paid over a fairly short period—say three to five years—are usually the base computation,²⁴ though some plans include overtime pay, unused vacation time, and the like.²⁵ Different formulas might be employed to compensate for Social Security's retirement benefit calculus,²⁶ but at some point, a benefit level is determined. For example, assume that Kimberly retires after thirty years with her company. Under her pension plan, her benefit is based on the monthly average of her last three years' salary, and she receives 2% of that monthly average for each year of employment. If her average monthly salary for the last three years of her employment is, say \$5,000, her pension benefit is 60% (2% times thirty years) of that amount—\$3,000 per month.

From an employee's perspective, defined benefit plans have two extremely important features. First, the benefit amount is payable until death.²⁷ A retiree, therefore, cannot outlive his pension. A payment will arrive as long as the retiree—or his surviving spouse,²⁸ usually—is alive. This feature makes defined benefit plans similar to Social Security,²⁹ in that Social Security retirement benefits are paid as long as a covered retiree or her dependents (including the surviving

22. I.R.C. § 417(b) (2003). A retiree can elect to eliminate the survivor feature and receive a higher benefit as a result, but this election requires the consent of the retiree's spouse. *See generally* LAWRENCE A. FROLIK & MELISSA C. BROWN, *ADVISING THE ELDERLY OR DISABLED CLIENT* ¶ 11.02 [5] [b] (2000).

23. *See* MICHAEL J. CANAN & DAVID RHETT BAKER, *QUALIFIED RETIREMENT PLANS* 216–17 (2001).

24. *See* PENSION AND WELFARE BENEFITS ADMIN., U.S. DEP'T OF LABOR, *WHAT YOU SHOULD KNOW ABOUT YOUR PENSION RIGHTS* 9 (2001) [hereinafter cited as *YOU SHOULD KNOW*]; *cf.* I.R.C. § 415(b)(3) (2003) (three highest years are used in determining the maximum benefit allowable).

25. *See* I.R.C. § 415(c)(3)(A).

26. *See generally* 1 BOREN & STEIN, *supra* note 8, ch. 6; CANAN & BAKER, *supra* note 23, at 601–06; STEPHEN J. KRASS, *THE PENSION ANSWER BOOK* 7-1 to 7-14 (1999); Ellen E. Schultz, *How to Tell if Your Pension Is Right: Double Check Your Firm's Calculations*, *WALL ST. J.*, Mar. 12, 1997, at C1.

27. *See* 1 BOREN & STEIN, *supra* note 8, § 1:07, at 1-14.

28. *See supra* note 22.

29. *See* ROBERT B. FLEMING, *ELDER LAW ANSWER BOOK* 3-9 (2000).

spouse³⁰ or surviving divorced spouse³¹) are still living. It also addresses the single most important concern of retirees—namely, the certainty of lifetime income.³²

The second extremely important feature of defined benefit plans is that the employer sponsoring the plan assumes almost all of the investment risk associated with this arrangement. When the future retiree was working, she had no control over, or concern with, the investment activities of her employer's defined benefit plan.³³ Whether that plan scored great successes or suffered horrendous losses was of little concern to the prospective retiree. Her pension benefit would be paid on schedule in any case. If a defined benefit plan cannot meet its obligations, the sponsoring employer is customarily obligated to provide more financial resources to the plan.³⁴ If the employer cannot do so, a federal agency, the Pension Benefit Guaranty Corporation ("PBGC"), steps in and assures that the expected benefits are paid in full and on time.³⁵ Similar to the more familiar bank deposit insurance provided by the Federal Deposit Insurance Corporation, the PBGC stands behind the payment of a defined benefit plan, up to a maximum monthly benefit. This benefit level is adjusted annually, and was \$3,664.77 in 2003.³⁶ Payments above this level are not guaranteed by the PBGC, but that is the extent of a retiree's financial exposure. Up to this amount, payment is generally guaranteed.³⁷

30. 42 U.S.C. § 402(e) (widow), (f) (widower) (2003).

31. *Id.* To qualify, the divorced spouse must have been married to the covered worker for at least ten years. 42 U.S.C. § 416(d)(1), (4) (2003). *See generally* FROLIK & KAPLAN, *supra* note 7, at 294–304.

32. Lynn Miller, *The Ongoing Growth of Defined Contribution and Individual Account Plans: Issues and Implications*, EMP. BENEFITS RES. INST. BRIEF NO. 243 (2002), at 12.

33. *See* 3 BITTKER & LOKKEN, *supra* note 6, ¶ 61.1.2, at 61-12 (“[E]mployees and their beneficiaries are not affected by the trust’s earnings, mortality experience, or employee turnover.”).

34. *See* 1 BOREN & STEIN *supra* note 8, § 1:07, at 1-15 to 1-16 (describing the actuarial determination of an employer’s financial obligation to the pension plan); *see also* I.R.C. § 412(c)(3) (2003).

35. 29 U.S.C. § 1305 (2003). *See generally* CANAN & BAKER, *supra* note 23, § 19.3; Jill L. Uylaki, *Promises Made, Promises Broken: Securing Defined Benefit Pension Plan Income in the Wake of Employer Bankruptcy: Should We Rethink Priority Status for the Pension Benefit Guaranty Corporation?*, 6 ELDER L.J. 77, 83–91 (1998).

36. Disclosure to Participants; Benefits Payable in Terminated Single-Employer Plans, 67 Fed. Reg. 71,470 (Dec. 2, 2002).

37. *See* Vanessa O’Connell, *Salvaging Your Troubled Pension Plan*, WALL ST. J., Aug. 13, 1996, at A5 (most pension recipients lose no benefits due to PBGC coverage). The PBGC’s coverage applies, however, only to participants whose benefits have “vested.” *See* YOU SHOULD KNOW, *supra* note 24, at 52. Employees who leave their jobs before their pension benefits “vest” lose any right to those benefits, regardless of PBGC coverage of the plan in question. *See also* Ellen E. Schultz, *Young and Vestless: Many Mobile Workers Fail to Reap Promise of New-Style Pensions*, WALL ST. J., Dec. 16, 1999, at A1. Benefits vest

Certain defined benefit plans are exempted from PBGC coverage,³⁸ however, and their retirees accordingly bear some financial risk. But most of these exempt plans are sponsored by governmental units³⁹ or by church-based employers that have chosen not to pay the premiums that PBGC coverage requires.⁴⁰ Employees of the federal government face little real risk, of course, since their employer has the means to literally print its way out of any shortfalls. Most state and local governments are also extremely reliable credit risks, since they are not going out of business in any real sense of the phrase. Nevertheless, to the extent that a defined benefit pension plan is not protected by the PBGC, the covered employees risk the loss of their retirement benefits.

B. Defined Contribution Plans

The other major type of pension is the defined contribution plan. This type of pension derives its name from the plan document, which sets forth, or “defines,” the amount, or “contribution,” that an employer pays into an employee’s separate account.⁴¹ Indeed, defined contribution plans are often described as “individual account” plans for this very reason.⁴² The “contribution” itself is usually a function of the employee’s salary and perhaps her length of service with the employer,⁴³ but once that amount has been determined, the employee chooses how those contributions will be invested, subject to certain conditions set forth in the specific plan.⁴⁴

For example, a typical defined contribution plan might offer a “guaranteed investment contract” (“GIC”) that provides for a fixed rate of interest

after an employee completes five years of service to the employer, or 20% per year over a five-year period starting after an employee’s third year of service. See I.R.C. § 411(a)(2) (2003). See generally 3 BITTKER & LOKKEN, *supra* note 6, ¶ 61.5; 1 BOREN & STEIN, *supra* note 8, §§ 3:09–3:19; CANAN & BAKER, *supra* note 23, §§ 9.6–9.9.

38. See 29 U.S.C. § 1321(b)(13), (c)(2) (2003) (exempting plans maintained by a “professional service employer,” including physicians, lawyers, dentists, architects, engineers and accountants, who have no more than twenty-five employees at any time); see also CANAN & BAKER, *supra* note 23, § 19.2 [B] (other exceptions).

39. 29 U.S.C. § 1321(b)(2). See generally 2 LOUIS A. MEZZULLO & MARK WOOLPERT, *ADVISING THE ELDERLY CLIENT* §§ 20:1–20:49 (1992).

40. 29 U.S.C. § 1321(b)(3). A church plan may elect to have PBGC coverage pursuant to I.R.C. §§ 410(d)(1), 414(e) (2003).

41. YOU SHOULD KNOW, *supra* note 24, at 9. For a one-page table succinctly setting out the major differences between defined benefit plans and defined contribution plans, see Jonathan Barry Forman, *Public Pensions: Choosing Between Defined Benefit and Defined Contribution Plans*, 1999 L. REV. M.S.U.-D.C.L. 187, 205.

42. 1 BOREN & STEIN, *supra* note 8, § 1:16, at 1-45; see also I.R.C. § 414(i) (2000).

43. See CANAN & BAKER, *supra* note 23, § 3.12. Many plans limit the employer’s contribution to the amount of profits realized during the year or the maximum tax deduction allowable.

44. See FROLIK & KAPLAN, *supra* note 7, at 358.

over a specified term.⁴⁵ This GIC is usually issued by a prominent insurance company and operates much like a bank certificate of deposit. The defined contribution plan might also offer a money market account, a bond fund, and two or more stock portfolios that essentially mimic mutual funds.⁴⁶ These portfolios might concentrate in so-called “growth” stocks, which are companies that are expected to have above-average rates of growth,⁴⁷ or in so-called “value” stocks, which are companies whose assets are worth more than their stock’s current value implies.⁴⁸ Alternative options may concentrate on large companies, small companies, domestic corporations, or multinational operations.⁴⁹ Some portfolios include stocks from several different categories or seek diversification according to other specified criteria. The number of different portfolios and the frequency with which an employee can change her allocations varies with the particular defined contribution plan,⁵⁰ but the bottom line is that it is the employee who makes the relevant investment decisions during her working life. Moreover, once the employee retires, the balance accumulated represents her pension plan.⁵¹ There are no guarantees of income adequacy or assurances of any specified amounts. Indeed, an employee might end up with less than the amount invested in her plan.

This feature underscores the most salient feature of defined contribution plans: the employee reaps the success or failure of her own investment decisions. If the investments selected by an employee prosper, that employee’s account “balance” rises accordingly. If those investments do poorly, the retiree will have less to live on when her working life concludes. There is no minimum benefit level, and the PBGC plays no role in defined contribution plans whatsoever.

These plans are comparatively new,⁵² and employees covered by defined contribution plans are only now beginning to retire. Whether they will take their account balance in a single lump sum,⁵³ withdraw it over their lifetime at some

45. See BUCK CONSULTANTS, 401(K) PLANS SURVEY REPORT ON PLAN DESIGN 23 (1999).

46. *Id.*

47. See ELLIE WILLIAMS, THE MCGRAW-HILL INVESTOR’S DESK REFERENCE 389–90 (2001).

48. *See id.* at 384–85.

49. *See* BUCK CONSULTANTS, *supra* note 45.

50. *See id.* at 22.

51. *See* FROLIK & BROWN, *supra* note 22, ¶ 11.02 [2].

52. *See* Susan J. Stabile, *Freedom to Choose Unwisely: Congress’ Misguided Decision to Leave 401(k) Participants to Their Own Devices*, 11 CORNELL J.L. & PUB. POL’Y 361, 361 (2002) (“As recently as twenty years ago, the primary means of providing retirement income to employees was the traditional defined benefit pension plan . . .”).

53. *See* Ellen E. Schultz, *Frittered Away: Offered a Lump-Sum, Many Retirees Blow It and Risk Their Future*, WALL ST. J., July 31, 1995, at A1. *See generally* BENNETT, *supra* note 21, ¶¶ 4.02–4.05.

predetermined rate, or use it to purchase a commercial annuity⁵⁴ that mimics a defined benefit plan's payout schedule remains to be seen. The point is that the investment risk in a defined contribution plan—during both the accumulation and the payout phases—rests with the employee. As a result, two employees at the same company, with identical work records and salary histories, may have radically different pension benefits when they retire—a circumstance that is unlikely in a defined benefit plan.⁵⁵

To be sure, most employees have a source of retirement income apart from their defined contribution plan—namely, Social Security.⁵⁶ Retirement benefits under that program, however, are limited by that program's benefit calculation methodology, which is intentionally down-weighted.⁵⁷ As a result, the average retirement benefit is fairly low—less than \$900 per month, according to current statistics.⁵⁸ Any retirement income above this amount must come from an employee's pension plan, and if that pension plan is a defined contribution plan, the individual employee's investment skill and/or luck will be critical determinants of that person's retirement income.

C. Participation Data

The most comprehensive data available show that only 56% of full-time private sector employees participate in any sort of pension plan.⁵⁹ In contrast, the

54. See Thomas D. Begley, Jr., *The Suitability of Annuities for Sale to Seniors*, ELDERLAW REP., July/Aug. 2002, at 1.

55. Major differences can arise, however, in a defined benefit plan's payout depending upon whether the retiree has a spouse and whether that spouse has waived survivor benefits. See FROLIK & KAPLAN, *supra* note 7, at 360–61. See generally Camilla E. Watson, *Broken Promises Revisited: The Window of Vulnerability for Surviving Spouses Under ERISA*, 76 IOWA L. REV. 431 (1991).

56. 42 U.S.C. §§ 401–434 (2003).

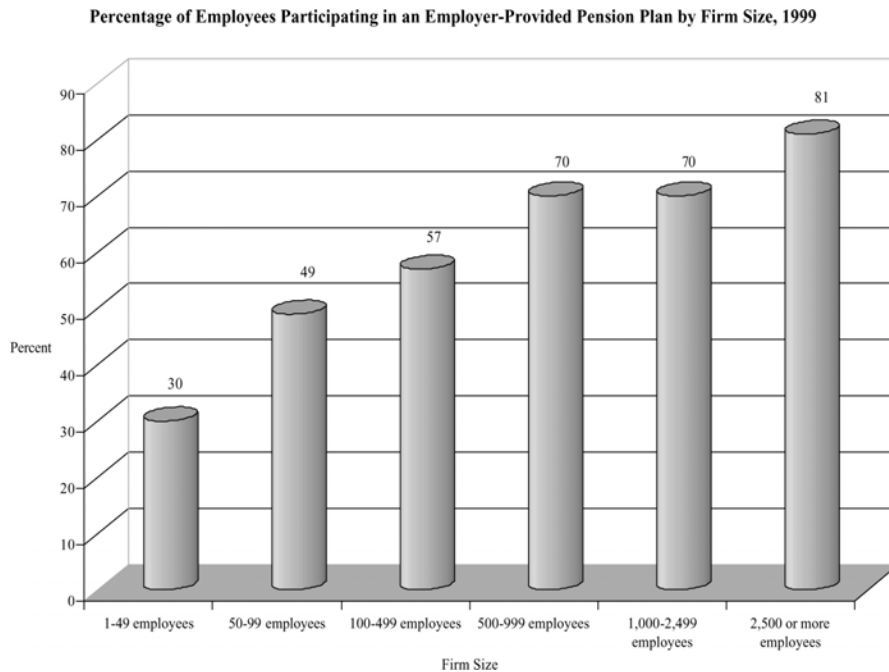
57. See FROLIK & KAPLAN, *supra* note 7, at 286–91 (explaining the Social Security retirement benefit calculation). In addition, only wages subject to Social Security's payroll tax are considered in calculating this benefit. *Id.* at 289. In 2003, the annual earnings limit on which that tax applied was \$87,000. See Social Security Administration, *2003 Social Security Changes*, at <http://www.ssa.gov/cola/colafacts2003.htm> (last visited July 16, 2003).

58. See Social Security Administration, *Monthly Statistical Snapshot, March 2003*, at http://www.ssa.gov/policy/docs/quickfacts/stat_snapshot/index.html#table2 (last visited July 16, 2003) (average monthly benefit paid in March 2003 was \$897.10).

59. JOINT COMM. ON TAX'N, PRESENT LAW AND BACKGROUND RELATING TO EMPLOYER-SPONSORED DEFINED BENEFIT PLANS 28 (JCX-71-02, 2002). There are significant variations in pension plan coverage among racial groups. See Yung-Ping Chen & Thomas D. Leavitt, *The Widening Gap Between White and Minority Pension Coverage*, PUB. POL. & AGING REP., Winter 1997, at 10. Gender differences, in contrast, are virtually nonexistent. See Craig Copeland, *Pension Coverage: Examining CPS Data*, EBRI NOTES, Sept. 2000, at 1.

participation rate for public sector employees is much higher: 87% for state and local government workers, and 88% for federal government employees.⁶⁰ In any case, the private sector data reveal significant variances by type of pension plan. For example, of the private sector employees who participate in a pension plan, 56% have a defined contribution plan exclusively, 14% have only a defined benefit plan, and the remaining 30% have both types of plans.⁶¹ Industry variations are also significant. For example, the pension plan participation rate is 68% in manufacturing but only 30% in retail trade, with the services sector falling roughly in the middle, at 45%.⁶² Employer size is a major factor as well. As Figure A shows, there is a direct correlation between the number of employees and the pension plan's participation rate.⁶³

Figure A



60. JOINT COMM. ON TAX'N, *supra* note 59, at 28.

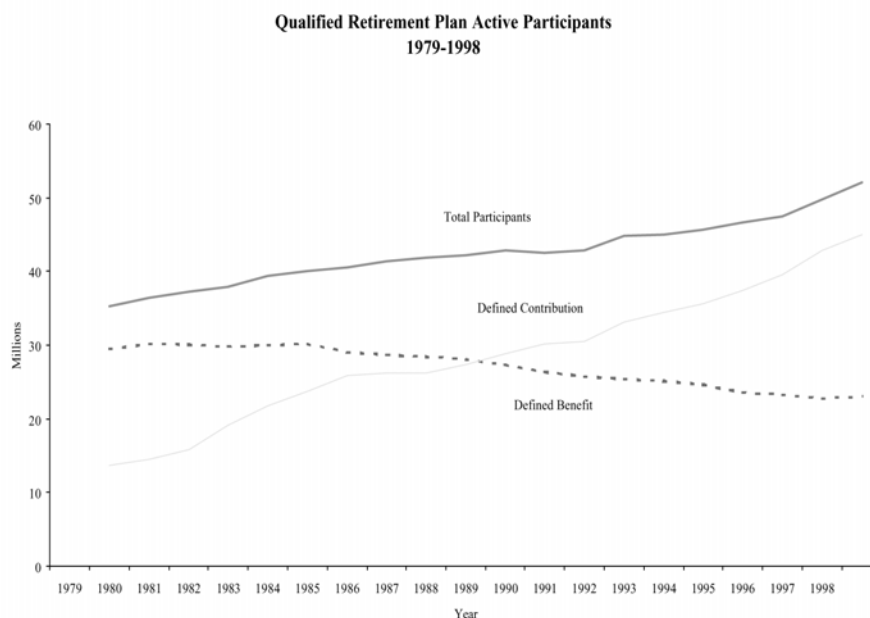
61. *Id.* at 30.

62. *Id.* at 28.

63. *Id.* at 29.

Trend data are especially revealing. As Figure B shows, the number of active participants in defined benefit plans has declined over the past two decades, while the number of participants in defined contribution plans has increased steadily.⁶⁴

Figure B

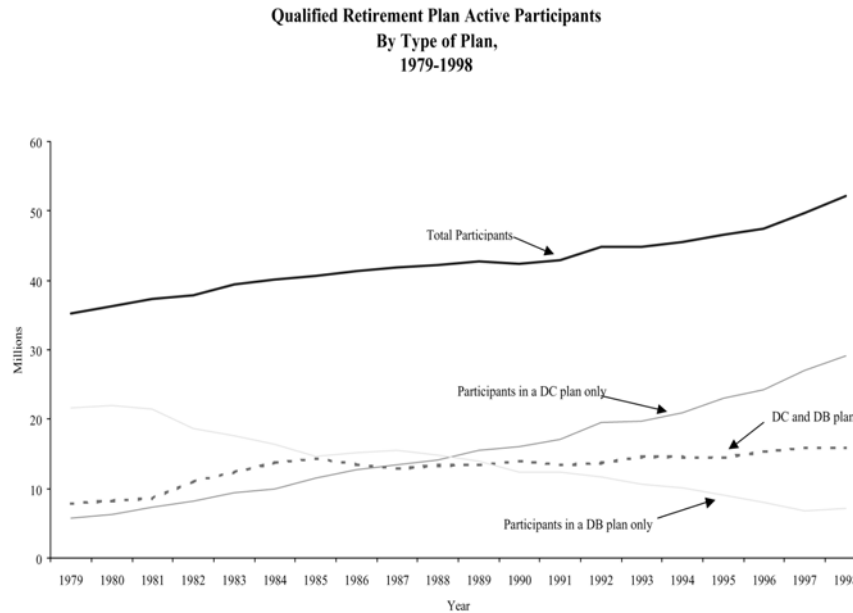


Most importantly, the number of participants in a defined benefit plan exclusively has declined precipitously, while the number of participants in a defined contribution plan exclusively has risen steadily.⁶⁵

64. *Id.* at 31; see also Craig Copland & Jack VanDerhei, *Personal Account Retirement Plans: An Analysis of the Survey of Consumer Finances*, EMP. BENEFITS RES. INST. BRIEF NO. 223 (2000), at 7–8.

65. JOINT COMM. ON TAX'N, *supra* note 59, at 32; see also Jonathan Barry Forman, *How Federal Pension Laws Influence Individual Work and Retirement Decisions*, 54 TAX LAW. 143, 162 (2000).

Figure C



There are several reasons for this shift from defined benefit plans to defined contribution plans, including (1) absence of PBGC premiums, (2) no actuarial expenses, (3) fewer compliance costs due to less burdensome regulations,⁶⁶ and (4) the structural transformation of the American economy from unionized manufacturing companies to service sector operations and high technology enterprises.⁶⁷ The combined effect of these varied factors is unmistakable: more pension risk being borne by employees.

III. 401(K) PLANS

Since the early 1980's, some employers began offering salary reduction arrangements sanctioned under Section 401(k) of the Internal Revenue Code.⁶⁸ This

66. David Rajnes, *An Evolving Pension System: Trends in Defined Benefit and Defined Contribution Plans*, EMP. BENEFITS RES. INST. BRIEF NO. 249 (2002), at 22-24.

67. Regina T. Jefferson, *Rethinking the Risk of Defined Contribution Plans*, 4 FLA. TAX REV. 607, 683 (2000).

68. See Karen W. Ferguson, *Assessing ERISA from a Participants' Perspective*, 85 TAX NOTES 951, 953 (1999).

subsection, one of the longest and most complicated in the entire tax code,⁶⁹ is entitled “cash or deferred arrangements.”⁷⁰ This phrase expresses succinctly what these plans offer: an employee can choose to take cash wages currently or can direct these funds into an account designated for that employee’s retirement.⁷¹ In the latter circumstance, no income tax is owed currently; the tax, in other words, is deferred until the funds in question are withdrawn, presumably after the worker retires.⁷² This feature is of genuine value because the funds thus saved for retirement are “pre-tax” savings; i.e., they are taken from an employee’s earnings *before* any income tax is calculated. Accordingly, more money can be invested for that person’s retirement.

To illustrate the applicable mechanics, assume that Ann’s salary is \$50,000 per year. If she directs \$10,000 into her 401(k) plan, she will pay income tax only on the difference—\$40,000 on these facts. Her W-2 report of earnings for the year will similarly show a salary of \$40,000, rather than \$50,000. If, instead of using the 401(k) plan, Ann took her entire salary, the \$10,000 she wants to save for her retirement would first be reduced by current income taxes. Assuming that she faces a combined federal and state income tax rate of 30%, Ann will pay \$3,000 in taxes and will be able to save only \$7,000 (\$10,000 earned less \$3,000 paid in taxes). Her use of the 401(k) plan, in other words, enables her to invest an additional \$3,000 towards her retirement.

This \$3,000 is not some gift from the government, however. The income taxes that the \$3,000 represents will eventually be payable, but not until Ann withdraws money from her 401(k) plan in the form of a taxable “distribution.”⁷³ That time may be many years or even decades away, and until then, Ann’s \$3,000 is invested in her retirement account. Moreover, when Ann receives the distribution, the applicable tax rate will be the rate that is then in effect.⁷⁴ That rate may well be lower than the 30% tax rate that she would owe today, because income in retirement is typically less than pre-retirement earnings, and a lower tax bracket should therefore apply.⁷⁵ In that circumstance, Ann will receive the double bonus of additional investment gains earned on the deferred taxes (\$3,000 in this example), and reduced taxes when those gains are withdrawn from her 401(k)

69. In the Commerce Clearing House edition of the complete tax code, this single subsection runs over four pages.

70. I.R.C. § 401(k) (2003).

71. I.R.C. § 401(k)(2); see 3 BITTKER & LOKKEN, *supra* note 6, ¶ 62.1. See generally EMJAY CORP., 401(K) ANSWER BOOK (2000).

72. I.R.C. § 402(e)(3) (2003); Treas. Reg. §§ 1.401(k)-1(a)(4)(iii) (as amended in 1994), 1.402(a)-1(d)(2)(i) (as amended in 1994).

73. I.R.C. § 402(e)(3); Treas. Reg. §§ 1.401(k)-1(a)(4)(iii), 1.402(a)-1(d)(2)(i).

74. I.R.C. § 402(a).

75. See ROBERT W. HAMILTON, MONEY MANAGEMENT FOR LAWYERS AND CLIENTS 201 (1993); see also I.R.C. § 1(a)-(c) (2003) (multiple income tax brackets).

plan. And if future income tax rates are generally lower than current rates,⁷⁶ a further bonus may result.

As attractive as 401(k) plans are, they are not true pension plans for one key reason: they involve only the employees' money. That is, a pension plan—be it defined benefit or defined contribution—generally involves the investment of employer resources over and *above* an employee's wages.⁷⁷ Here, the employee is investing her funds alone, not her employer's.

This feature highlights another distinction between real pension plans and 401(k) plans. In a real pension plan, all employees who meet certain criteria are covered.⁷⁸ Some plans impose minimum age or length-of-service requirements.⁷⁹ But once an employee satisfies the stipulated conditions, pension plan coverage generally applies.⁸⁰

That is not the case with 401(k) plans, most of which provide for *voluntary* participation by employees.⁸¹ Many employees, in fact, choose not to participate in these plans at all. An analysis⁸² of actual tax return data found that participation in 401(k)-type plans⁸³ varied by age: individuals who were twenty-one to twenty-five years old had the lowest rate of plan participation,⁸⁴ while those age fifty to fifty-five had the highest.⁸⁵ Income was also a determining factor: persons earning less than \$50,000 per year had the lowest rate of participation,

76. See, e.g., Economic Growth and Tax Relief Reconciliation Act of 2001, Pub. L. No. 107-16, § 101(a), 115 Stat. 38, 41–42 (adding I.R.C. § 1(i)(2)) (lowering income tax rates from 2001 through 2006); Jobs and Growth Tax Relief Reconciliation Act of 2003, Pub. L. No. 108-27, § 105, 117 Stat. 752, 755 (making the previously enacted tax rate reductions effective immediately).

77. See WALTER FELDESMAN, *DICTIONARY OF ELDERCARE TERMINOLOGY* 46 (1997); see also I.R.C. § 404(a)(1) (2003) (deduction of employer's payment).

78. I.R.C. §§ 401(a)(3), 410 (2003).

79. An employee may be excluded if he or she is under age twenty-one or has worked for the employer less than one year. I.R.C. § 410(a)(1)(A); see 3 BITTKER & LOKKEN, *supra* note 6, ¶ 61.3.2.

80. Plans may exclude certain employees, as long as the "minimum coverage" rules of I.R.C. § 410(b) are satisfied. These rules set forth three separate tests, any one of which may be met. See generally 3 BITTKER & LOKKEN, *supra* note 6, ¶ 61.3.3; 1 BOREN & STEIN, *supra* note 8, § 3:03.30; CANAN & BAKER, *supra* note 23, § 8.5.

81. See I.R.C. § 401(k)(2)(A) ("under which a covered employee may *elect* to have the employer make payments . . . on behalf of the employee . . .") (emphasis added).

82. David Joulfaian & David Richardson, *Who Takes Advantage of Tax-Deferred Saving Programs? Evidence from Federal Income Tax Data*, 54 NAT'L TAX J. 669 (2001).

83. The participation data included plans under I.R.C. §§ 403(b), 457 (2003). Joulfaian & Richardson, *supra* note 82, at 670.

84. Joulfaian & Richardson, *supra* note 82, at 675.

85. *Id.* at 674.

while those earning between \$50,000 and \$90,000 annually had the highest.⁸⁶ Moreover, those employees who participate in these plans typically defer much less than the applicable law allows.⁸⁷ In many instances, to be sure, the extent of participation is limited by the sponsoring employer,⁸⁸ but the bottom line is that 401(k) plan participation is less than universal, especially among younger and lower-earning workers.

The reasons for this phenomenon are quite varied, beginning with simple inertia.⁸⁹ Most 401(k) plans require affirmative enrollment by employees; indeed, a 1999 survey of 401(k) plan sponsors found that only 7% of these plans provided automatic enrollment, with employees having a right to opt out.⁹⁰ In addition, the decision to participate in a 401(k) plan requires the employee to make other financial decisions, such as the level of participation (i.e., how much income to defer) and specific investment selection, for which many employees feel unprepared.⁹¹

86. *Id.* at 678.

87. See U.S. GEN. ACCOUNTING OFF., 401(K) PENSION PLANS: LOAN PROVISIONS ENHANCE PARTICIPATION BUT MAY AFFECT INCOME SECURITY FOR SOME 3 (GAO/HEHS-98-5, 1997) (finding an average contribution rate of 7% of salary). During the survey period, the maximum contribution rate was 20%. EMJAY CORP., *supra* note 71, at 8-14; see also Sarah Holden & Jack VanDerhei, *Contribution Behavior of 401(k) Plan Participants*, EMP. BENEFITS RES. INST. BRIEF NO. 238 (2001) (finding a 6.8% contribution rate using 1999 data); David Cay Johnston, *401(k) Changes Go Unheeded*, N.Y. TIMES, Dec. 19, 2001 at C18 (reporting that only 11% of 401(k) participants made the maximum allowable contribution in 1999).

88. See Joulfaian & Richardson, *supra* note 82, at 671 (only one out of seven participating employees were in plans that allowed the statutory maximum to be deferred).

89. See Susan J. Stabile, *The Behavior of Defined Contribution Plan Participants*, 77 N.Y.U. L. REV. 71, 80 (2002). See generally Brigitte C. Madrian & Dennis F. Shea, *The Power of Suggestion: Inertia in 401(k) Participation and Savings Behavior*, 116 Q.J. ECON. 1149 (2001).

90. Stabile, *supra* note 89, at 81 n.31.

91. See George Loewenstein, *Is More Choice Always Better?*, NAT'L ACAD. OF SOC. INS. SOC. SEC. BRIEF NO. 7 (1999), at 2 (discussing the tendency to procrastinate when facing difficult decisions); see also Miller, *supra* note 32, at 10-11 (discussing psychographic determinants of 401(k) plan participation). A similar situation is presented by retirement plan balances that employees receive when they leave an employer. Many employees spend these balances on current consumption, rather than undertake the process of transferring them to an individual retirement account or some other retirement savings plan. See Stabile, *supra* note 89, at 96; Craig Copland, *Lump-Sum Distributions: An Update*, EBRI NOTES, July 2002, at 1; see also Schultz, *Frittered Away*, *supra* note 53. More than three-quarters of defined benefit plans, however, do not offer lump-sum distributions, thereby avoiding the potential dissipation of these retirement assets. See BUREAU OF LABOR STATISTICS, U.S. DEP'T OF LABOR, BULL. 2517, EMPLOYEE BENEFITS IN MEDIUM AND LARGE PRIVATE ESTABLISHMENTS, 1997 107 (1999), available at <http://www.bls.gov/ncs/ebs/sp/ebbl0017.pdf> (last visited Aug. 8, 2002).

But there can be little doubt that a major impediment is affordability. That is, many employees believe that their present earning level does not permit them to forego current income, even for an objective as important as saving for their retirement. Returning to the previous example, Ann elected to defer \$10,000 and saved \$3,000 in taxes that would otherwise be due. She also gave up, however, the ability to use the \$7,000 difference for current needs—be they orthodontia for her son, college expenses for her daughter, or home care costs for her mother. The prospect of tax reductions may be insufficient to overcome this fundamental concern. After all, someone in the 15% tax bracket saves only \$150 in taxes for every \$1,000 of income placed in a 401(k) plan, in contrast to the \$350 saved by someone in the 35% tax bracket.

In response to the realities, many employers with 401(k) plans provide “matching” funds; i.e., they supplement the employee’s 401(k) deferral with employer funds. If an employee chooses not to participate in the 401(k) plan, these “matching” funds are simply forfeited, a powerful inducement indeed. The practice of matching employees’ 401(k) contributions, however, is not universal,⁹² and the match rate varies from employer to employer, and often among employees working for the same employer.⁹³ A common “match” rate is 50% of the amount that the employee defers,⁹⁴ but other percentages are used as well, and the matching contribution may itself be subject to caps or other limitations.⁹⁵

To the extent that an employer provides matching funds, a 401(k) plan functions much like a conventional defined contribution plan. The employee invests her funds, plus the employer funds that have been allocated to her, among the various investment options that her plan provides. The balance accumulated in the plan at retirement is determined entirely by the investment success or failure of the options the employee selected. There is no minimum benefit guaranteed; in fact, the retiree might end up with less than her actual contributions to the plan.

92. See CINDY HOUNSELL ET AL., WOMEN’S INST. FOR A SECURE RETIREMENT, YOUR FUTURE PAYCHECK: WHAT WOMEN NEED TO KNOW ABOUT PAY, SOCIAL SECURITY, PENSIONS, SAVINGS AND INVESTMENTS 26 (2002); EMJAY CORP., *supra* note 71, at 2-7. Employers that match employees’ 401(k) plan contributions may discontinue that practice, as some major companies have demonstrated recently. See ALICIA H. MUNNELL & ANNIKA SUNDEN, CTR. FOR RETIREMENT RESEARCH, SUSPENDING THE EMPLOYER 401(K) MATCH 4 (2003) (listing Textron, Prudential Securities, Charles Schwab & Co., Goodyear Tire & Rubber, Ford Motor Co., and General Motors, among others).

93. See Ellen E. Schultz, *Many Workers Are Missing Out on 401(k) Plans*, WALL ST. J., Dec. 16, 1999, at C1 (“matching contribution formulas that take salary, age or tenure into account”). Matching contribution formulas are subject, however, to certain numerical guidelines known collectively as the nondiscrimination requirement. See I.R.C. § 401(a)(4), (m) (2003). See generally 3 BITTKER & LOKKEN, *supra* note 6, ¶ 62.1.5.

94. See Miller, *supra* note 32, at 11 (describing a 50% match as “optimal”).

95. See, e.g., CANAN & BAKER, *supra* note 23, § 3.92 [D], at 238 (providing an example of 100% match for the first 2% of salary deferred, then 75% or 50% match on the next 3% of salary deferred).

If an employer does not provide matching funds, however, the 401(k) plan is simply a salary reduction arrangement, much like the plans created under Internal Revenue Code Section 403(b) or Section 457. Those arrangements allow employees of nonprofit organizations⁹⁶ (i.e., colleges, universities, hospitals, churches) or state and local governments,⁹⁷ respectively, to set aside part of their salaries in a dedicated retirement savings vehicle. Many of the rules pertaining to so-called 403(b) and 457 plans apply to 401(k) plans as well⁹⁸—including maximum amounts that can be deferred⁹⁹ and applicable “rollover” or account transfer privileges.¹⁰⁰ But employees covered by 403(b) and 457 plans are usually covered by their employer’s regular pension plan, often a defined benefit plan.¹⁰¹ As a consequence, employees in 403(b) and 457 plans typically have fairly significant pension coverage without considering the income deferrals that these plans permit.¹⁰²

That is not necessarily the case with 401(k) plans. In fact, of all employees enrolled in 401(k) plans, fully half work at companies that have only those plans, a proportion that has increased in recent years.¹⁰³ Clearly, increasing numbers of employers are setting up 401(k) plans *instead of* traditional pension plans,¹⁰⁴ rather than as supplements to such plans. The prevalence of these 401(k) plans has undoubtedly lulled some employees into thinking that they have an employment-based pension plan, when they in fact do not.

The tax provisions enacted in 2001 regarding 401(k) plans, moreover, may have exacerbated this situation by highlighting the role of individual opportunity for retirement savings. These amendments increased the maximum amount that a employee can contribute into a 401(k) plan from \$10,500 in 2001 to

96. I.R.C. § 403(b)(1)(A)(i), (ii) (2003).

97. I.R.C. § 457(e)(1)(A) (2003).

98. *See generally* CANAN & BAKER, *supra* note 23, §§ 22.2 (403(b) plans), 22.3 (457 plans).

99. I.R.C. §§ 403(b)(1)(E), 457(b)(2)(A).

100. I.R.C. §§ 403(b)(8), 457(e)(16).

101. *See* DONALD R. LEVY ET AL., 403(B) ANSWER BOOK 1-3 (5th ed. 2000).

102. Some employers, however, utilize a 403(b) plan as their main pension plan and provide employer contributions to the employee’s account, much like a conventional defined contribution plan. *See id.*

103. JOINT COMM. ON TAX’N, PRESENT LAW AND BACKGROUND RELATING TO EMPLOYER-SPONSORED DEFINED CONTRIBUTION PLANS AND OTHER RETIREMENT ARRANGEMENTS 31 (JCX-9-02, 2002) (the applicable percentage was 44% in 1995 and 46% in 1996).

104. *See* Leslie E. Papke et al., *Do 401(k) Plans Replace Other Employer-Provided Pensions?*, in ADVANCES IN THE ECONOMICS OF AGING 219, 235 (David A. Wise ed., 1996); *see also* John Hechinger, *Changing Fortunes: Market’s Swoon Boosts Pensions Over 401(k) Plans*, WALL ST. J., Aug. 16, 2002, at A1 (six out of ten workers with retirement coverage “rely primarily on 401(k)s and similar plans”).

\$15,000 per year by the year 2006.¹⁰⁵ Furthermore, employees who are at least fifty years old by the end of the year could contribute an additional \$1,000 in 2002, and this additional amount rises to \$5,000 by 2006.¹⁰⁶ These changes have been the source of extensive media reporting and advertising by the financial services firms that administer 401(k) plans.¹⁰⁷ The resulting onslaught of publicity indicates that 401(k) plans are more attractive than ever, and encourages employees to take the responsibility for funding their retirement into their own hands and contribute the legal maximum to their accounts.

But an individually funded savings account does not substitute for an employer-based pension plan. To prevent employees from confusing these different arrangements, an employer should be required to establish a separate

105. The maximum amount that can be contributed per year increases according to the following schedule:

Year	Amount
2002	\$11,000
2003	\$12,000
2004	\$13,000
2005	\$14,000
2006	\$15,000

I.R.C. § 402(g)(1)(B) (2003) (amended by Economic Growth and Tax Relief Reconciliation Act of 2001, Pub. L. 107-16, § 611(d)(1), 115 Stat. 38, 97-98 (2001)). After 2006, the \$15,000 limit is to be indexed annually for inflation. I.R.C. § 402(g)(4).

106. The extra contribution amount for persons age fifty and over increases according to the following schedule:

Year	Amount
2003	\$2,000
2004	\$3,000
2005	\$4,000
2006	\$5,000

I.R.C. § 414(v)(2)(B)(i) (2003) (amended by Economic Growth and Tax Relief Reconciliation Act of 2001, Pub. L. 107-16, § 631(a), 115 Stat. 38, 111-13 (2001)). After 2006, the \$5,000 limit is to be indexed annually for inflation. I.R.C. § 414(v)(2)(C).

107. See, e.g., David Cay Johnston, *The Tax Bill Up Close: Some Facts, Some Tips*, N.Y. TIMES, June 3, 2001, § 3, at 1; Sue Kirchhoff, *Congress Strikes Deal on Tax Cut; House, Senate Conferees Set Quick Rebates*, BOSTON GLOBE, May 26, 2001, at A1; Kathy M. Kristof, *Some Relief Comes This Year, Most Much Later*, L.A. TIMES, May 27, 2001, at A1; David Nicklaus, *To Boost Savings, Should We Make Consumption Less Satisfying?*, ST. LOUIS POST-DISPATCH, Aug. 15, 2001, at C1; *Passage of New Tax Law Provides a Second Chance for the 50-Plus*, IN THE VANGUARD (Summer 2001), available at <http://www.vanguard.com/educ/newsstnd/ITV/2001Summer/passage.html> (last visited Aug. 5, 2003).

pension plan—be it defined benefit or defined contribution—before it may sponsor a 401(k) plan.¹⁰⁸ This proposal would align the role of 401(k) plans with many employers' 403(b) and 457 plans,¹⁰⁹ which are roughly equivalent to 401(k) plans in this regard.

Alternatively, employers should be required to provide some level of matching contribution to their 401(k) plans. Most employers already do so,¹¹⁰ especially larger companies.¹¹¹ Accordingly, this proposal should not unduly burden present circumstances. The point, in any case, is that employees should receive some employer contribution toward their retirement beyond simple encouragement.

Would employers respond to these new requirements by curtailing their 401(k) plans entirely? Some might, perhaps. After all, no law requires employers to offer any pension plan at all. But employers generally establish pension benefits for a variety of compelling business reasons, in particular staff retention.¹¹² Those business reasons should continue to apply and would likely militate against the wholesale termination of 401(k) plans. And if an employee did lose her 401(k) plan, she would then realize very clearly that she has no pension coverage at work. So informed, she might encourage her employer to provide some pension plan or she might respond by seeking employment elsewhere. But at least she would know precisely where she stands regarding pension coverage, a distinct improvement over the current situation.

IV. EMPLOYER STOCK IN 401(K) PLANS

As this Article has shown thus far, defined contribution plans shift the investment risk for retirement assets from employers to employees, an ominous development when such plans are offered in lieu of defined benefit plans, rather than as supplements to such plans. When 401(k) plans are substituted for

108. Even Enron Corporation provided a conventional pension plan in addition to its now-notorious 401(k) plan. See Ellen E. Schultz, *Enron Workers Face Losses on Pensions, Not Just 401(k)s*, WALL ST. J., Dec. 19, 2001, at C1; see also Daniel Halperin, *Employer-Based Retirement Income—the Ideal, the Possible, and the Reality*, 11 ELDER L.J. 37, 47–49 (2003).

109. See *supra* note 101.

110. See EMJAY CORP., *supra* note 71, at 2-7 (reporting that 71% of 401(k) plans in one survey included matching contributions).

111. A survey in 2002 of 280 companies, of which 95% had at least 1,000 employees, found that 89% of employers provided a matching contribution to their 401(k) plan. HEWITT ASSOC., SURVEY FINDINGS: HOT TOPICS IN 401(K) PLANS 2002 8 (2002). Within this group, 37% of employers had at least 15,000 employees. *Id.* at 23; see also BUCK CONSULTANTS, *supra* note 45, at 5-6 (survey in 1998 of 646 companies, of which 58% had at least 1,000 employees, also found a 401(k) match rate of 89%).

112. See KRASS, *supra* note 26, at 1-1; CANAN & BAKER, *supra* note 23, § 1.1, at 2-4.

conventional pension plans, the investment risks for employees are compounded because they are risking mainly their own money, rather than employer-provided funds, especially when the employer's matching contribution is small or nonexistent. This Article now considers the central issue dramatized by the Enron debacle—namely, the role of employer stock in 401(k) plans and related investment restrictions.

A. Employer Stock and Nondiversification

Many 401(k) plans have several very different options from which an employee can choose, including mutual funds, guaranteed investment contracts, and stable value or money market accounts.¹¹³ But many 401(k) plans have only one option—namely, stock of the corporate employer.¹¹⁴ A variation is the 401(k) plan with several investment options, but the employer's matching funds are invested exclusively in corporate stock.¹¹⁵ Other plans utilize purchase discounts and other financial incentives to encourage investment in the employer's stock. Oftentimes, subtle workplace pressures encourage employees to purchase employer stock with their 401(k) funds.¹¹⁶ The result of these various realities is that some 30% of 401(k) assets are invested in the sponsoring corporation's stock.¹¹⁷

This level of asset concentration did not occur by chance. Employees in companies that use corporate stock for their matching contributions put 50% more of their own money in such stock.¹¹⁸ As one observer noted, “[e]mployees tend to view the match as an endorsement of [their] investment strategy.”¹¹⁹ Indeed, in one recent survey of large employers, 77% of companies include employer stock as an

113. EMJAY CORP., *supra* note 71, at 6-6.

114. *Id.* at 6-28 (describing a 401(k) plan that is invested primarily in employer stock as a KSOP).

115. See Employee Benefit Research Inst., *Facts from EBRI*, Jan. 2002, at 1.

116. See, e.g., SUSAN J. STABILE, 401(K) ANSWER BOOK 5-9 to 5-10 (Spec. Supp. 2002) (describing pressure at Enron to buy employer stock).

117. See Aaron Lucchetti & Theo Francis, *Dangers of Not Diversifying Hit Investors*, WALL ST. J., Feb. 15, 2002, at C1.

118. Sarah Holden & Jack VanDerhei, *401(k) Plan Asset Allocation, Account Balances, and Loan Activity in 2000*, EMP. BENEFIT RES. INST. ISSUE BRIEF NO. 239 (2001), at 10.

119. Daniel Kadlec, *Time Bomb: 401(k)s Stuffed With Employer Stock Are a National Calamity. Here's How to Fix It*, TIME, Mar. 5, 2001, at 84; see also Nellie Lang & Scott Weisbenner, *Investor Behavior and the Purchase of Company Stock in 401(k) Plans—The Importance of Plan Design* 30 (2002) (unpublished manuscript, on file with the *Arizona Law Review*).

option in their 401(k) plan,¹²⁰ and fully 88% of those companies allow their employees to put *all* of their money into that stock.¹²¹

Enron demonstrated the folly of this concentration. Many employees had invested most or all of their 401(k) plan assets in Enron stock,¹²² and when that stock's value evaporated, so did their 401(k) plan. Moreover, Enron employees were subject to restrictions on when they could sell their stock. Quite apart from the "blackout periods" that caught the attention of Congressional reformers,¹²³ the real problem was that Enron employees could not sell their stock until they reached a designated age (fifty years) or left the company.¹²⁴ Thus, even if the employees had wanted to reduce some of their 401(k) plan's exposure to Enron, they could not do so.

In both the concentration of 401(k) assets in employer stock and the limits on its disposition, Enron was not unique. The following table¹²⁵ lists only some of the more prominent corporations and the percentage of assets in their 401(k) plans that are invested in their own stock:

COMPANY	PERCENTAGE
Proctor & Gamble	96
Abbott Laboratories	90
Dell Computer	88
Pfizer	86
Anheuser-Busch	82
Coca-Cola	81
McDonald's	74

120. HEWITT ASSOC., *supra* note 111, at 4 (surveyed companies had an average of 22,000 employees).

121. *Id.* at 5.

122. Patrick J. Purcell, *The Enron Bankruptcy and Employer Stock in Retirement Plans*, CONG. RES. SERV. REP., Jan. 23, 2002, at 1; *Enron Debacle Will Force Clean Up of Company Stock Use in DC Plans*, DC PLAN INVESTING, Dec. 11, 2001, at 1.

123. See Sarbanes-Oxley Act of 2002, Pub. L. No. 107-204, § 306(b)(1), 116 Stat. 745, 780-84 (adding 29 U.S.C. § 1021(i)) (requiring thirty days advance notice of a "blackout period"); see also Ellen E. Schultz, 'Lockdowns' of 401(k) Plans Draw Scrutiny, WALL ST. J., Jan. 16, 2002, at C1. A "blackout" or "lockdown" is a period of a few weeks during which employees are not allowed to change any investments in their 401(k) plans. These events "occur when a plan is being transferred to a new recordkeeper, or is implementing some structural change, such as a shift to daily valuation from monthly valuation." *Id.*

124. Schultz, *supra* note 123, at C1.

125. Compiled by Author from Kadlec, *supra* note 119, at 84, and Ellen E. Schultz, *Employers Fight Limits on Firm's Stock in 401(k)s*, WALL ST. J., Dec. 21, 2001, at C1.

COMPANY	PERCENTAGE
Gillette	66
Campbell Soup	63
International Paper	60
Norfolk Southern	58
Cooper Tire	56
Sprint	52

As this table shows, extraordinarily high levels of 401(k) plan investment in company stock is a phenomenon that crosses industry lines and is a feature common to both “high tech” and more traditional corporations.

Age restrictions on the disposition of company stock are similarly not uncommon. Age fifty-five is often the earliest time when an employee can diversify his or her 401(k) holdings by selling employer stock in a 401(k) plan.¹²⁶

1. Employer's Perspective

Encouraging employees to purchase stock with their 401(k) funds makes sense from an employer's perspective. All other things being equal, additional purchases of the corporate employer's stock support that stock's market price.¹²⁷ This enhanced market value, in turn, benefits those corporate officials who hold significant stock options, because these options typically acquire real value only when the stock exceeds a specified market price.¹²⁸ Hence, higher stock values effectively improve the compensation package of corporate managers.

Higher stock values can also help finance corporate mergers in certain circumstances. If a potential target company will accept corporate stock of the acquiring company, the acquisition is far less costly from the acquiring company's standpoint. Rather than raise cash by selling assets or increasing its borrowings, a corporation can finance its acquisition activities by using its own stock as a

126. See Kadlec, *supra* note 119, at 84; see also Ellen E. Schultz, *Workers Put Too Much In Their Employer's Stock*, WALL ST. J., Sept. 13, 1996, at C1. Participants in “employee stock ownership plans” must be allowed to diversify their holdings after reaching age fifty-five and participating in the plan at least ten years. JOINT COMM. ON TAX'N, BACKGROUND INFORMATION RELATING TO THE INVESTMENT OF RETIREMENT PLAN ASSETS IN EMPLOYER STOCK 11 (JCX-1-02, 2002). Company executives often participate in supplemental savings plans that contain employer stock without any restrictions on when this stock may be sold. See Ellen E. Schultz & Theo Francis, *Why Company Stock Is a Burden for Many—And Less So for a Few*, WALL ST. J., Nov. 27, 2001, at A1.

127. See N. GREGORY MANKIW, PRINCIPLES OF ECONOMICS 544 (1998).

128. See generally 3 BITTKER & LOKKEN, *supra* note 6, ¶ 60.6.2.

currency surrogate.¹²⁹ Such a company, therefore, has a powerful incentive to maintain the market value of its stock, and additional stock purchases by 401(k) plan participants constitute one mechanism for doing so.

Using corporate stock can also reduce a company's operating costs if the stock can be used in lieu of cash expenditures.¹³⁰ For example, a company might need to expend or even borrow cash to make a required contribution to a defined benefit pension plan. But if this company can use its own stock to satisfy the pension expectations of its employees, its cash outlays are significantly lower, consisting of small registration fees and similar compliance expenses.

In addition, an employer can reap important tax benefits by funding its 401(k) plan with corporate stock. A corporation is allowed to deduct the full market value of stock that it contributes to the employees' 401(k) plan,¹³¹ even though the corporation's out-of-pocket cost is trivial or nonexistent.¹³² Furthermore, dividends paid on such stock are usually not deductible,¹³³ but when these shares are held in a 401(k) plan, the dividends become a deductible expense.¹³⁴ As a result, a cash outlay that would otherwise provide no tax benefits is transformed into a tax-lowering expenditure. In fact, some companies maximize the available tax deduction by issuing a special class of stock exclusively for their 401(k) plans, with these shares paying higher dividends than their regular corporate stock.¹³⁵

Finally, having employees hold portions of a company's stock provides a source of stockholder stability should some other company try to acquire it.¹³⁶

129. See generally PATRICK A. GAUGHAN, *MERGERS, ACQUISITIONS, AND CORPORATE RESTRUCTURINGS* (1996).

130. See ALICIA H. MUNNELL & ANNIKA SUNDEN, *CTR. FOR RETIREMENT RESEARCH, 401(K)S AND COMPANY STOCK: HOW DO WE ENCOURAGE DIVERSIFICATION?* 6 (2002).

131. I.R.C. § 404(a) (2003).

132. See Norma M. Sharara, *Employer Stock as a Matching Contribution in § 401(k) Plans: A Case Study of Current Law and the Impact of Enron*, 43 *TAX MGMT MEMORANDUM* 283, 285 (2002).

133. BORIS I. BITTKER & JAMES S. EUSTICE, *FEDERAL INCOME TAXATION OF CORPORATIONS AND SHAREHOLDERS* ¶ 4.01[2], at 4-6 (7th ed. 2000).

134. I.R.C. § 404(k).

135. See Ellen E. Schultz & Theo Francis, *Companies' Hot Tax Break: 401(k)s*, *WALL ST. J.*, Jan. 31, 2002, at C1. Additional tax benefits may apply if the plan borrows money; in that case, the corporation can deduct interest and principal payments on the loan. *Id.*

136. See *id.*; MUNNELL & SUNDEN, *supra* note 130, at 6. This issue is examined in careful detail in Susan J. Stabile, *Pension Plan Investments in Employer Securities: More Is Not Always Better*, 15 *YALE J. ON REG.* 61, 90-115 (1998).

Giving employees a direct stake in the ownership of a business may align the interests of employees and company stockholders in other ways as well.¹³⁷

2. *Employee's Perspective*

Employees are often only too happy to receive corporate stock in their 401(k) plan. This phenomenon has two sources. First, there is the timeless investment maxim, "Invest in What You Know."¹³⁸ That is, the company most employees know best and understand is their employer. By this logic, it makes sense to put one's money in that corporation's stock. In fact, even when employees have options beyond their employer's stock, an unusually large proportion of 401(k) plan assets is invested in that stock.¹³⁹ As one observer has noted, "most people think their company is safer than a stock mutual fund, when the data show that the opposite is true."¹⁴⁰

Second, there is what might be called the "Microsoft Syndrome." Recalling the incredible success of employees at Microsoft Corporation,¹⁴¹ many employees apparently hope to ride a similar price escalator to untold wealth. It is a type of lottery without the frivolous connotations that lotteries sometimes invoke. And when stocks are rising generally, this strategy may seem prudent.

Enron revealed the potential downside, however, when it filed for bankruptcy and wiped out the retirement accounts of many current and former employees.¹⁴² But the downside risk is enormous even if one's employer does not go bankrupt. Stock price declines are often precipitous even when companies remain solvent.¹⁴³ That is why most investment advisors invoke another familiar

137. Schultz & Francis, *supra* note 135; MUNNELL & SUNDEN, *supra* note 130, at 6 ("The notion is that tying employee income and wealth to company performance will increase productivity . . . by decreasing labor management conflicts and encouraging employee effort.")

138. See Lucchetti & Francis, *supra* note 117, at C15 (quoting famed mutual fund manager, Peter Lynch).

139. See *id.* at C1 (average of 30% in employer stock); see also Holden & VanDerhei, *supra* note 118, at 10–11 (average of 33.2% of the employee's own contributions in employer stock).

140. Lucchetti & Francis, *supra* note 117, at C1.

141. See JAMES WALLACE & JIM ERICKSON, *HARD DRIVE: BILL GATES AND THE MAKING OF THE MICROSOFT EMPIRE* 410 (1992) (reporting that more than 2,000 Microsoft employees were millionaires by 1992).

142. See Lucchetti & Francis, *supra* note 117, at C1.

143. See, e.g., E.S. Browning, *Nasdaq Tumbles to a 5-Year Low*, WALL ST. J., July 2, 2002, at C1; E.S. Browning, *S&P 500 Follows Nasdaq to Multi-Year Low*, WALL ST. J., July 3, 2002, at C1.

maxim of investment strategy, “Diversify your holdings.”¹⁴⁴ Concentrations of employer stock in a 401(k) plan violate this maxim.¹⁴⁵

Actually, far more is at stake than violating the injunction to diversify one’s retirement investments. When a stock declines in value, it often reflects negative economic conditions at the company, conditions that may lead to employee layoffs, as recent events have shown.¹⁴⁶ Employment terminations imperil the employee’s biggest asset, that person’s job. The resulting loss of a dependable income stream inflicts much more immediate harm to an employee’s lifestyle than does a decline in the value of her 401(k) plan. Everyday expenditures, such as rent, food, school costs for children, and home repairs, become problematic. And if the employment termination occurs when replacement jobs are difficult to find, the loss of one’s livelihood is compounded further.

Add to this tragedy the concomitant loss of health insurance. Most employees and their families receive health insurance as part of their employment compensation.¹⁴⁷ Lose the job, lose the health insurance. In this situation, continuation coverage is statutorily mandated,¹⁴⁸ but with some significant drawbacks. The cost of continuation coverage is generally paid entirely by the former employee,¹⁴⁹ without the subsidy that most employers provide. As a result, the monthly cost to the former employee can increase by a factor of ten or

144. See U.S. DEP’T OF THE TREASURY, REPORT OF THE DEPARTMENT OF THE TREASURY ON EMPLOYER STOCK IN 401(K) PLANS 4 (2002), available at [http://www.treas.gov/press/releases/reports/401\(k\).pdf](http://www.treas.gov/press/releases/reports/401(k).pdf) (last visited July 17, 2002) [hereinafter EMPLOYER STOCK REPORT] (“Asset diversification is a bedrock principle of prudent long-term investing.”); see also James K. Glassman, *Diversify, Diversify, Diversify*, WALL ST. J., Jan. 18, 2002, at A10.

145. Some commentators contend that overconcentration in employer stock risks tax-disqualification of the 401(k) plan for failure to meet the statutory requirement that a plan be for the “exclusive benefit” of employees. See D. Larry Crumbley & William M. VanDenburgh, *Enforce the Exclusive Benefit Provision for Pension Plans*, 95 TAX NOTES 1256 (2002).

146. See, e.g., Don Clark, *Intel CEO’s Planned Speech Fuels Talk of Imminent Cuts*, WALL ST. J., July 16, 2002, at B8; Shawn Young, *WorldCom Will Pay Out Severance on an Installment Plan*, WALL ST. J., July 16, 2002, at B1; Jesse Drucker, *Motorola to Cut 7,000 More Jobs and Take \$3.5 Billion in Charges*, WALL ST. J., June 28, 2002, at B6; Mitchell Benson, *Dynegy Announces Layoffs, Halts Energy Trading Online*, WALL ST. J., June 21, 2002, at B3; Donna Fuscaldo, *H-P to Furlough Contract Workers While it Ponders Additional Lay-offs*, WALL ST. J., June 20, 2002, at B7; Suzanne Craig, *Wall Street Firms’ Earnings Will Provide Job-Cut Clues*, WALL ST. J., June 18, 2002, at C5.

147. PAUL FRONSTEIN, EMPLOYEE BENEFIT RESEARCH INST., SOURCES OF HEALTH INSURANCE AND CHARACTERISTICS OF THE UNINSURED: ANALYSIS OF THE MARCH 2001 CURRENT POPULATION SURVEY 4 (2001) (four out of five nonelderly persons with health insurance have employment-based coverage).

148. 29 U.S.C. §§ 1161(a), 1162(1) (2003).

149. 29 U.S.C. §§ 1162(3)(A), 1164(1) (2003).

more¹⁵⁰—at a time, one should recall, when that person is usually not receiving a paycheck.¹⁵¹ Moreover, even these limited benefits generally expire eighteen months after an employee loses her job.¹⁵² A person can try to obtain health insurance in the individual market, of course, but such policies are often very expensive and are subject to whatever medical underwriting standards the insurer cares to apply.¹⁵³ Thus, pre-existing medical conditions—including any stress-related maladies attributable to losing one's job—may be excluded from the policy's coverage.

Given these realities, employees may need to tap their retirement plan's assets to pay for living costs, health care expenses, and the like.¹⁵⁴ What a terrible time to discover that those assets are substantially lower than expected because the company's stock has declined in value.

B. Reform Proposals

The Enron disaster has inspired various proposals regarding employer stock in 401(k) plans. Most of these proposals create a stipulated limit of 20% of 401(k) plan assets that can be invested in an employer's stock.¹⁵⁵ Other proposals require that employees be able to sell such stock after some specified period of time—typically ninety days.¹⁵⁶

150. See INSURE.COM, KNOW YOUR COBRA RIGHTS, available at <http://www.insure.com/health/cobra.html> (last modified Nov. 29, 2001).

151. Only one in five COBRA-eligible individuals obtains such insurance. KAISER COMM'N ON MEDICAID & THE UNINSURED: COBRA COVERAGE FOR LOW-INCOME UNEMPLOYED WORKERS 1 (2001), available at <http://www.kff.org/content/2001/10252001/4021.pdf> (last visited Feb. 11, 2002).

152. 29 U.S.C. §§ 1162(2)(A)(i), 1163(2) (2003). This eighteen-month limitation does not apply, however, if the employee loses her health insurance because the employer filed for bankruptcy. 29 U.S.C. §§ 1162(2)(A)(iii), 1163(6).

153. See COUNCIL OF ECON. ADVISORS, REACHING THE UNINSURED: ALTERNATIVE APPROACHES TO EXPANDING HEALTH INSURANCE ACCESS 2-3 (2000).

154. So-called "hardship" withdrawals are allowed from 401(k) plans to meet these sorts of expenses. See Treas. Reg. § 1.401(k)-1(d)(2)(iv)(A) (as amended in 1994). See generally EMJAY CORP., *supra* note 71, at 14-13 to 14-18. Such withdrawals are subject to income taxes, however, and to a 10% penalty if the former employee is under age 59½. *Id.* at 14-10 to 14-11; see also 3 BITTKER & LOKKEN, *supra* note 6, ¶ 62.1.2, at 62-10 n. 47.

155. See, e.g., Pension Protection and Diversification Act of 2002, H.R. 3640, 107th Cong. (2002); Safeguarding America's Retirement Act of 2002, H.R. 3677, 107th Cong. (2002); Retirement Security Protection Act of 2002, S. 1919, 107th Cong. (2002). *But see* Pension Protection Act, H.R. 3463, 107th Cong. (2001) (10% limit).

156. See, e.g., Pension Protection and Diversification Act of 2001, S. 1838, 107th Cong. (2001); Pension Plan Protection Act, S. 1921, 107th Cong. (2002). *But see* Pension Protection Act, H.R. 3463, 107th Cong. (2001) (requiring three-year holding period).

Considering the concentration of risks described above,¹⁵⁷ the better solution would be to ban all 401(k) investment in employer stock. The employee already has her livelihood and health insurance tied to the employer's economic well-being. Any further alignment of the employee's and the employer's financial interests can only be described as reckless. If employees want to use nonretirement funds for such recreational investing, that is certainly their prerogative. But retirement-oriented assets are too important to an employee's future economic security to be burdened with such investment exposure.

Furthermore, a complete ban presents fewer compliance difficulties than does a concentration level limit. Limits require constant monitoring as the market value of a plan's various securities fluctuate. As explained in a recent Treasury Department analysis of this issue, percentage limits must be monitored "on a participant-by-participant basis," which would "necessitate tens of thousands of individual computations."¹⁵⁸ Similarly, if the limits were exceeded, divestment of employer stock would be required "on a participant-by-participant basis, with each participant then needing to give the plan administrator instructions on how to reinvest those proceeds."¹⁵⁹ A complete ban would eliminate this problem and would also make the holding period issue moot. That is, if employer stock is banned from 401(k) plans, the particular duration of an individual employee's investment in such stock need not be monitored. Consequently, in terms of administrative convenience as well as in terms of sound financial management, 401(k) plans should not contain *any* employer stock.

To be sure, an outright ban presents its own set of difficulties. For example, what should be done with existing 401(k) plans that contain employer stock? They could be grandfathered in, of course, but the employees in such plans then face the same risk of financial calamity that Enron's employees have learned the hard way. A better approach would require a phased elimination of employer stock over a long enough period to avoid significant market disruption. In fact, legislation has already been introduced along these lines, using three to five years as the prescribed period for investment adjustment.¹⁶⁰ Plan accounts of older

157. See *supra* notes 144–53 and accompanying text.

158. EMPLOYER STOCK REPORT, *supra* note 144, at 6. In contrast, the 10%-of-assets restriction on investment in employer stock by defined benefit plans presents few compliance difficulties, because defined benefit plans do not utilize separate accounts for every employee. See JOINT COMM. ON TAX'N, *supra* note 59, at 8. Accordingly, the required investment level monitoring can be done for the plan as a whole. The individualized nature of 401(k) plans, in contrast, precludes this approach.

159. EMPLOYER STOCK REPORT, *supra* note 144, at 6.

160. See Employee Retirement Savings Bill of Rights, H.R. 3669, 107th Cong. § 4(a) (2002) (phasing in the diversification requirement over a five-year period, 20% each year); Retirement Security Protection Act of 2002, S. 1919, 107th Cong. § 201(a) (2002) (providing a four-year period during which 401(k) investments could be reallocated to meet

employees might even be given some preference during this phase-down period, since their financial exposure is greatest in the immediate term.

Employers, of course, can be expected to resist these proposals. In 1996, for example, Senator Barbara Boxer introduced legislation that would have limited the share of employer stock in 401(k) plans to 10%.¹⁶¹ Employer opposition at the time was intense.¹⁶² The legislation was eventually incorporated into the Taxpayer Relief Act of 1997,¹⁶³ but not before being essentially eviscerated¹⁶⁴—as the current situation demonstrates so clearly.¹⁶⁵ But the investment world today looks very different than it did in 1996, and investors' unalloyed faith in financial markets has dimmed somewhat during the intervening years.¹⁶⁶ Moreover, the prospect of a corporate collapse is no longer hypothetical; its name is Enron. In other words, the Microsoft Syndrome is less compelling now,¹⁶⁷ though some employees may be unwilling to give up their dreams of easy 401(k) riches.

Faced with restrictions on corporate stock in 401(k) plans, would employers reduce or even eliminate their matching contributions? This possibility certainly exists, but most experts believe that such a reaction is unlikely.¹⁶⁸ Companies use 401(k) matching contributions for a number of reasons, including

the applicable percentage limitation); National Employee Savings and Trust Equity Guarantee Act, S. 1971, 107th Cong. § 101(a) (2002) (three-year period).

161. See 401(k) Pension Protection Act of 1996, S. 1837, 104th Cong., § 2(a) (1996).

162. See Schultz, *Workers*, *supra* note 126 (“Employers vigorously oppose any changes in law that would limit the amount of employer stock in 401(k) and profit-sharing plans.”) (emphasis added).

163. Pub. L. No. 105-34, 111 Stat. 788 (1997) (amending various sections of 26 U.S.C.).

164. *Id.* § 1524(a) (amending 29 U.S.C. § 1107(b)(2) (2000)); see Stabile, *supra* note 89, at 94 (describing the 1997 change as “of little significance”).

165. See *supra* text accompanying note 125.

166. See Rebecca Buckman & David Bank, *For Silicon Valley, Stocks' Fall Upsets Culture of Options*, WALL ST. J., July 18, 2002, at A1; see also Ellen E. Schultz & Theo Francis, *Business Lobby Guts Legislation to Curb Employer Stock in 401(k)s*, WALL ST. J., July 23, 2002, at A4 (describing the practice of referring to 401(k) plans as “201(k)s and 101(k)s because they have been battered so much by the plunging stock market”).

167. Buckman & Bank, *supra* note 166 (describing the disappointment among more recently hired employees at various companies, including Microsoft Corporation).

168. See Ellen E. Schultz & Theo Francis, *Employers Say They May Cut 401(k) Rations*, WALL ST. J., Mar. 5, 2002, at C1. A January 2002 survey of employee benefit specialists asked “what would be the most likely response to a legislative change limiting to 20% the investment employees can have in any one stock” in their 401(k) plans. Only 1% of respondents predicted that the 401(k) plan would be discontinued, and only 16% expected a decrease in employer matching contributions. In fact, 47% predicted that nothing would change, although 24% indicated that they “do not know.” JACK VANDERHEI, EMPLOYEE BENEFIT RESEARCH INST., COMPANY STOCK IN 401(K) PLANS: RESULTS OF A SURVEY OF ISCEBS MEMBERS 21 (2002).

to broaden employee participation.¹⁶⁹ Such broadened employee participation, in turn, enables higher income corporate officials to maximize their personal 401(k) plan deferrals.¹⁷⁰ In any case, the level of 401(k) matching contributions already fluctuates from year to year due to economic conditions,¹⁷¹ quite apart from the application of any restrictive legislation.

A more fundamental concern is whether employees' choices should be restricted at all. That is, should employees be allowed to "put all their eggs in one basket," as it were, if they so choose? As the U.S. Treasury Department stated in its report on this issue, "[a]rbitrary caps on employees 401(k) investment choices challenge fundamental notions of private property rights."¹⁷² Many 401(k) plan sponsors seem to agree: a recent survey found that 88% of responding plan sponsors allow employees to invest *all* of their 401(k) contributions in company stock.¹⁷³ In fact, only 5% of these plan sponsors reported even considering a limit on such investments.¹⁷⁴

This notion of individual choice ignores certain realities, however. First, it disregards the substantial tax subsidies that tax-favored retirement savings vehicles, such as 401(k) plans, receive.¹⁷⁵ The public, therefore, has a major investment in the financial soundness of these arrangements. Second, 401(k) disasters have consequences for society as a whole. As Professor Susan Stabile has explained, employees with insufficient retirement assets may choose not to retire, thereby reducing the number of jobs that are available to new employees.¹⁷⁶ Alternatively, workers who retire with inadequate retirement resources may require government assistance,¹⁷⁷ such as Supplemental Security Income¹⁷⁸ or other means-tested payments. In any case, certain aspects of corporate culture¹⁷⁹

169. Schultz & Francis, *supra* note 168.

170. *Id.*

171. See Steven T. Goldberg, *Earn It Back*, KIPLINGER'S PERS. FIN. MAG., Mar. 2002, at 87, 88 (reporting that "the average employer match dropped from 3.3% of pay in 1999 to 2.5% in 2000").

172. EMPLOYER STOCK REPORT, *supra* note 144, at 7.

173. HEWITT ASSOC., *supra* note 111, at 5.

174. *Id.*

175. See *supra* note 11 (annual cost of employer-based pension plans in terms of tax revenue foregone is \$84 billion).

176. See Stabile, *supra* note 52, at 395.

177. *Id.* at 394.

178. See generally FROLIK & KAPLAN, *supra* note 7, at 320-33 (explaining the Supplemental Security Income program).

179. Stabile, *supra* note 52, at 378-86 (showing how employers can manipulate investment decisions by plan participants).

and financial incentives¹⁸⁰ beyond the tax system make this vision of individual employee choice chimerical in many cases.

Enron and others have shown that the risks of nondiversification in 401(k) plans are real and carry the potential for enormous financial pain. These risks should be avoided in the future, and an outright ban on employer stock in such plans is the simplest and most effective way of doing so.

V. SOCIAL SECURITY PRIVATIZATION

Beyond the need to reform 401(k) plans as set forth above, what does the Enron meltdown and the experience of employees in defined contribution plans generally suggest about Social Security privatization? This section considers that question.

Social Security privatization is, of course, a gigantic subject, one that has spawned numerous articles and books,¹⁸¹ computer simulations,¹⁸² and lengthy

180. See, e.g., EMPLOYER STOCK REPORT, *supra* note 144, at 2 (some companies that provide matching 401(k) contributions “provide a higher match if the employee chooses his or her employer’s stock”).

181. See, e.g., SOCIAL SECURITY REFORM: BEYOND THE BASICS (Richard C. Leone & Greg Anrig, Jr. eds., 1999); Patricia E. Dilley, *Taking Public Rights Private: The Rhetoric and Reality of Social Security Privatization*, 41 B.C. L. REV. 975 (2000); Kathryn L. Moore, *Privatization of Social Security: Misguided Reform*, 71 TEMP. L. REV. 131 (1998); Rebecca E. Perrine Wade, Note, *The Face of Social Security in the Twenty-First Century: An Analysis of the Reform Proposals Offered by the Social Security Advisory Council*, 6 ELDER L.J. 115 (1998). See generally HENRY J. AARON & ROBERT D. REISCHAUER, COUNTDOWN TO REFORM: THE GREAT SOCIAL SECURITY DEBATE (1998); FRAMING THE SOCIAL SECURITY DEBATE: VALUES, POLITICS AND ECONOMICS (R. Douglas Arnold et al. eds., 1998); JOSEPH J. CORDES & C. EUGENE STEUERLE, THE RETIREMENT PROJECT, A PRIMER ON PRIVATIZATION (1999); PROSPECTS FOR SOCIAL SECURITY REFORM (Olivia S. Mitchell et al. eds., 1999); DANIEL SHAVIRO, MAKING SENSE OF SOCIAL SECURITY REFORM (2000); C. EUGENE STEUERLE & JON M. BAKIJA, RETOOLING SOCIAL SECURITY FOR THE 21ST CENTURY (1994); RESECURING SOCIAL SECURITY AND MEDICARE: UNDERSTANDING PRIVATIZATION AND RISK (Judith G. Gonyea ed., 1998).

For analyses of how privatization might affect women and minorities, see Dorothy A. Brown et al., *Social Security Reform: Risks, Returns, and Race*, 9 CORNELL J.L. & PUB. POL’Y 633 (2000); Karen C. Burke & Grayson M.P. McCouch, *The Impact of Social Security Reform on Women’s Economic Security*, 16 N.Y.L. SCH. J. HUM. RTS. 375 (1999); Jonathan Barry Forman, *Making Social Security Work for Women and Men*, 16 N.Y.L. SCH. J. HUM. RTS. 359 (1999); Heidi Hartmann et al., *Strengthening Social Security for Women* (July 1999), available at Institute for Women’s Policy Research, <http://www.iwpr.org/pdf/AIRLIE.PDF> (last visited Aug. 4, 2003); Kathryn L. Moore, *Partial Privatization of Social Security: Assessing Its Effect on Women, Minorities, and Lower-Income Workers*, 65 MO. L. REV. 341 (2000); John D. McKinnon & Jacob M. Schlesinger, *Bush Hopes to Sell Social Security Plan to Minorities and Women—a Tall Order*, WALL ST. J., July 19, 2001, at A24. But see Alvin Williams, *Reforming Our Ailing Social Security System: The State of the*

government reports.¹⁸³ At base, however, the issue comes down to the investment by ordinary Americans of some portion of their “contributions” to the Social Security program.¹⁸⁴ Therefore, Social Security privatization proposals parallel to some extent the movement to defined contribution plans, including 401(k) plans, in assigning the risk of investment management to individual employees.¹⁸⁵

There is much in the record of these plans, however, that should give pause to would-be Social Security privatizers. The enormous concentration of 401(k) assets in employer stock¹⁸⁶ demonstrates an almost reckless indifference to investment risk, even when one’s own funds are involved and when a goal as important as retirement security is at stake. Although employers have played a major role in fostering these concentration levels, they are not solely responsible. Employees have found it easier to simply follow management’s recommendations rather than do independent research.

But employer stock is not the only problem. One analysis showed that a staggering 97.5% of all 401(k) assets were invested in a single asset category, large-capitalization growth stocks.¹⁸⁷ So much for asset allocation! Actually, only half of 401(k) participants have any sort of asset allocation plan, and only one-

Current System, and Its Impact on African Americans, 8 ELDER L.J. 221 (2000) (contending that Social Security privatization would especially benefit African-Americans).

182. See, e.g., JOHN MUELLER, WINNERS AND LOSERS FROM “PRIVATIZING” SOCIAL SECURITY (1999); Peter A. Diamond & Peter R. Orszag, *Assessing the Plans Proposed by the President’s Commission to Strengthen Social Security*, 96 TAX NOTES 703 (2002); Martin Feldstein & Andrew Samwick, *Potential Effects of Two Percent Personal Retirement Accounts*, 79 TAX NOTES 615 (1998); Phil Gramm, *Investment-Based Social Security*, 89 TAX NOTES 923 (2000); Pierre Pestieau & Uri M. Possen, *Investing Social Security in the Equity Market: Does It Make a Difference?*, 53 NAT’L TAX J. 41 (2000).

183. See REPORT OF THE PRESIDENT’S COMM’N, STRENGTHENING SOCIAL SECURITY AND CREATING PERSONAL WEALTH FOR ALL AMERICANS (2001), available at http://csss.gov/reports/Final_report.pdf (last visited Jan. 11, 2002); U.S. GEN. ACCOUNTING OFF., SOCIAL SECURITY REFORM: ANALYSIS OF REFORM MODELS DEVELOPED BY THE PRESIDENT’S COMMISSION TO STRENGTHEN SOCIAL SECURITY (GAO-03-310, 2003); see also PETER A. DIAMOND & PETER R. ORSZAG, CTR. ON BUDGET & POLICY PRIORITIES & THE CENTURY FOUND., REDUCING BENEFITS AND SUBSIDIZING INDIVIDUAL ACCOUNTS: AN ANALYSIS OF THE PLANS PROPOSED BY THE PRESIDENT’S COMMISSION TO STRENGTHEN SOCIAL SECURITY (2002).

184. DIAMOND & ORSZAG, *supra* note 183, at 11–13; see also Martin Feldstein & Andrew Samwick, *Allocating Payroll Tax Revenue to Personal Retirement Accounts*, 87 TAX NOTES 1645 (2000).

185. See Colleen E. Medill, *Challenging the Four “Truths” of Personal Social Security Accounts: Evidence from the World of 401(k) Plans*, 81 N.C. L. REV. 901, 917–22 (2003). Indeed, proponents of Social Security privatization often point to the prevalence of self-directed retirement plans as evidence that Americans can handle their proposals. See, e.g., PETER J. FERRARA & MICHAEL D. TANNER, A NEW DEAL FOR SOCIAL SECURITY 211 (1998).

186. See *supra* text accompanying notes 117–25.

187. Ellen Graham, *The Nest-Egg Blues*, WALL ST. J., June 24, 2002, at R10.

third of *that* group do anything to maintain this mix, according to studies by John Hancock Financial Services, Fidelity Investments, Putnam Investments, and AARP.¹⁸⁸

A. Accumulating Assets for Retirement

These results bring into serious question the fundamental premise of defined contribution plans generally—namely, that ordinary employees are the best managers of their retirement assets. Despite jingoistic appeals to individual initiative and paeans to the glories of personal choice, the fact is that most employees have neither the training, the interest, nor the desire to become competent money managers. As Professor Stabile has explained, “[s]tudy findings reveal that substantial numbers of plan participants are financially illiterate, including a lack of knowledge and understanding of financial concepts and common financial instruments.”¹⁸⁹ A further reality check is provided by the National Center on Education Statistics, which reports that one in five adult Americans has reading skills at or below the fifth-grade level.¹⁹⁰

It is hardly surprising, therefore, that individually managed retirement accounts perform more poorly than professionally managed accounts, often by significant margins.¹⁹¹ Professional managers devote their working hours to investing retirement assets for long-term growth. This is their only job. By dint of academic training and/or experience, they attain a level of proficiency and competence that part-timers with little inclination in matters financial¹⁹² cannot

188. *Know-Nothings*, TIME, June 4, 2001, at 79.

189. Stabile, *supra* note 89, at 88; *see also* Joseph Bankman, *Tax Policy and Retirement Income: Are Pension Plan Anti-Discrimination Provisions Desirable?*, 55 U. CHI. L. REV. 790, 816–17 (1988).

190. *See* U.S. GEN. ACCOUNTING OFF., SOCIAL SECURITY: CAPITAL MARKETS AND EDUCATIONAL ISSUES ASSOCIATED WITH INDIVIDUAL ACCOUNTS 56 n.8 (GAO/GGD-99-115, 1999).

191. *See* AM. ACAD. OF ACTUARIES, ISSUES REGARDING SOCIAL SECURITY INDIVIDUAL ACCOUNTS 2 (Winter 1998); M. Barton Waring et al., *Mind the Gap! Why DC Plans Underperform DB Plans, and How to Fix Them*, BARCLAYS GLOBAL INVESTORS INV. INSIGHTS, Apr. 2000, at 1 (finding a 43% difference over thirty years); *see also* Jeff D. Opdyke, *Should the Pros Run Your 401(k)?*, WALL ST. J., Apr. 30, 2002, at D1 [hereinafter Opdyke, *Pros*] (describing an employee-controlled plan that earned 4.9% per year while the employer’s pension plan earned 8%—more than 63% better); Jeff D. Opdyke, *State Workers’ Pension Plans Spark Debate*, WALL ST. J., May 5, 2000, at C1 (employees in Nebraska’s government pension plan receive 50% more than average 401(k)-style plan participants after thirty years). *See generally* Ken Gregory & Steve Savage, *Why We Prefer Funds*, KIPLINGER’S PERS. FIN. MAG., Aug. 2002, at 59 (“Behavioral finance demonstrates that all investors are hard-wired in certain ways that greatly increase the probability they will make poor investment decisions.”).

192. *See* James A. Fanto, *Comparative Investor Education*, 64 BROOK. L. REV. 1083, 1100 (1998) (“In light of U.S. ideology, it is not surprising that much investor

expect to achieve. Indeed, were the results otherwise, the question would be why have professional pension managers at all? Money management may not be brain surgery, but it is not beanbag either.

This phenomenon is best summarized by one pension director whose company has followed 401(k) investors for a decade: “For most people, self-directed retirement plans are a bad idea.”¹⁹³ The essence of the “problem is that people with no experience on Wall Street are expected to make the same investment decisions as highly trained portfolio managers.”¹⁹⁴ Nevertheless, the popular media advise ordinary Americans to play this game with real money, their retirement money in fact:

What can an individual investor do? Watch for independent analysis from agencies like Moody’s, Standard & Poor’s and Value Line. Look skeptically on any stock for which accounting issues have been raised.¹⁹⁵

You should use research as a supplement to, rather than a substitute for, your own digging. Examine a company’s quarterly and annual reports and read up on recent news, then use brokerage reports to flesh out the picture.¹⁹⁶

To be colloquial, get real! Receptionists, factory workers, sales assistants at department stores, office workers, literature professors, dare I say even tax lawyers should “examine a company’s quarterly and annual reports” and “look skeptically . . . [when] accounting issues have been raised”? Is this prescription realistic or almost criminal in its reckless disregard for people’s interests, talents, and aptitudes?

On the other hand, why do we presume that everyone wants to be an investment planner and money manager? Most people have better things to do. An

education involves essentially self-education that allows individuals to teach themselves about saving and investing when managing their own portfolios.”). For an examination of the special difficulties that women and minorities face in defined contribution plans, see Jayne Elizabeth Zanglein, *Investment Without Education: The Disparate Impact on Women and Minorities in Self-Directed Defined Contribution Plans*, 5 EMPLOYEE RTS. AND EMP. POL’Y J. 223 (2001). *But see* HOUNSELL ET AL., *supra* note 92, at 39–41 (suggesting that women’s investing patterns are similar to men’s, after accounting for marital status, earnings level, and experience); Martha Priddy Patterson, *Pension Envy: Why Retirement Planning for Women Is More Challenging*, J. RETIREMENT PLAN., July/Aug. 2000, at 16, 24–25 (similar findings).

193. *Know-Nothings*, *supra* note 188.

194. Opdyke, *Pros*, *supra* note 191; *see also* Larry E. Ribstein, *Bubble Laws*, 40 Hous. L. Rev. 77, 97 (2003) (“Ordinary investors . . . should rely on fund managers and other advisors rather than their own imperfect judgment and stale information.”).

195. Daniel Kadlec, *Your Money: Old Safety Nets Are Gone. Here’s What to Do*, TIME, Jan. 28, 2002, at 26, 28.

196. Robert Frick, *Analysts You Can Trust*, KIPLINGER’S PERS. FIN. MAG., Aug. 2002, at 50, 51.

occasional exercise I use in class asks law students several fairly straightforward questions about financial matters. In the style of the popular television show, *Who Wants to Be a Millionaire?*, I ask questions such as “What measure of stock prices is commonly described as ‘the market?’” and “How many stocks are in the Dow Jones Industrial Average?” The point is not to humiliate anyone. Students are even allowed to “phone a friend” (by calling on another student) or to “poll the audience.” The results suggest that even highly educated law students have other matters on their minds. Little wonder, then, that in a survey of 401(k) participants, 47% thought that a “money-market fund” contained stocks,¹⁹⁷ or that “over half of all Americans do not know the difference between a stock and a bond,”¹⁹⁸ according to the Securities and Exchange Commission.

Recognizing this reality, some defined contribution plans have begun offering a professional management option.¹⁹⁹ This development responds to many employees’ desire for ongoing expertise in the investment of their retirement assets.²⁰⁰ This option enables the employee to shift the responsibility for accumulating retirement funds to financial professionals. In so doing, the employee transforms her defined contribution plan into the rough equivalent of a defined benefit plan, which is what an increasing percentage of working Americans say that they prefer.²⁰¹

B. Withdrawing Assets During Retirement

This transformation can be extended to the distribution of one’s retirement funds as well. Rather than risk the vicissitudes of market fluctuations, retirees can purchase commercial annuities from insurance companies and other financial institutions.²⁰² Here again, the peace of mind that retirees crave²⁰³ can be obtained by intentionally replicating the features that defined benefit plans typically provide.

In any case, retirees with defined contribution plans must search out annuity providers on their own and decide which of several intricate offers they prefer. Defined benefit plans, in contrast, include this feature without burdening

197. U.S. GEN. ACCOUNTING OFF., *supra* note 190, at 59.

198. *Know-Nothings*, *supra* note 188.

199. Opdyke, *Pros*, *supra* note 191.

200. See Scott Burns, *A Better 401(k)*, WORTH, April 2000, at 75, 76 (reporting that 94% of eligible employees at one company elected the “professionally directed investment” option for their 401(k) plans).

201. See Jane T. Kim, *Smaller Firms Augment Benefits, Survey Shows*, WALL ST. J., June 6, 2002, at D2.

202. See generally JEFFREY R. BROWN ET AL., THE ROLE OF ANNUITY MARKETS IN FINANCING RETIREMENT (2001).

203. See Daniel Kadlec, *Everyone, Back in the Labor Pool*, TIME, July 29, 2002, at 23, 30 (reporting that retirees are more financially satisfied if their fixed costs are covered by “guaranteed income,” regardless of income level).

the prospective retiree. Moreover, defined benefit plans accomplish the goal of providing annuitized payments on the “wholesale” rather than the “retail” level, thereby avoiding onerous sales charges²⁰⁴ and other transactional inefficiencies.²⁰⁵ It is hardly surprising, therefore, “that defined benefit plans provide more dollars of income per unit of cost than do defined contribution plans.”²⁰⁶

Furthermore, the process of researching annuity options is not for the faint-hearted or the financially inexperienced. The *Wall Street Journal* recently published an insider’s account of how annuities are marketed to older people, in particular to retirees.²⁰⁷ The picture was not pretty. The article described some suggested approaches for selling annuities:

- “Treat them like they’re blind 12-year olds.”²⁰⁸
- “Toss hand grenades into the advice to disturb the seniors.”²⁰⁹
- “Show them their finances are all screwed up so they think, ‘Oh no, I’ve done it all wrong.’”²¹⁰
- “Tell them you can protect their life savings from nursing-home and Medicaid seizure of assets. They don’t know what that is, but it sounds scary... It’s about putting a pitchfork in their chest.”²¹¹

These techniques were offered at what the article described as a major training enterprise, one that has involved 7,000 agents over the past thirteen years.²¹² The point here is not to smear the annuities industry. Rather, it is to suggest that the paternalism embodied in defined benefit plans looks less belittling when one considers the alternative of individual investigation in the context just described.

204. See JOHN T. ADNEY ET AL., ANNUITIES ANSWER BOOK 1-22 (3d ed. 2000) (commissions of 7% are common).

205. Surrender charges, for example, are “ubiquitous in the industry [and] can be as high as 20% and can spread over 17 years or more.” Jeff D. Opdyke, *Should You Drop Your Insurer?*, WALL ST. J., Nov. 20, 2002, at D1.

206. Miller, *supra* note 32, at 13.

207. Ellen E. Schultz & Jeff D. Opdyke, *Annuities 101: How to Sell to Senior Citizens*, WALL ST. J., July 2, 2002, at C1.

208. *Id.*

209. *Id.*

210. *Id.*

211. *Id.*

212. *Id.*

C. *The Illusory Appeal of Privatization*

Given the realities set forth above, why do polls show significant interest in Social Security privatization, especially among younger employees?²¹³ That is, employees claim that they prefer defined benefit plans.²¹⁴ When confronted with defined contribution plans, they often opt for professional management of their funds.²¹⁵ And when those accumulated funds must provide retirement income, employees endure the annuity sales experience in order to secure a dependable income stream.²¹⁶ But when presented with Social Security, which is a defined benefit plan of sorts, with no imposition of investment management responsibilities during either the accumulation or the withdrawal phase, many workers find privatization appealing. Do these poll respondents not realize that they already have in Social Security what they are trying to create in their 401(k) plans?

There are no clear answers, since the Social Security polls do not ask *why* a person favors privatization. There can be little doubt, however, that the constant drumbeat about Social Security's impending bankruptcy is having an effect.²¹⁷ Indeed, a higher percentage of young Americans believe in unidentified flying objects than in the long-term viability of Social Security.²¹⁸ However erroneous the alarms about Social Security's solvency may be,²¹⁹ they apparently make privatization seem attractive. After all, anything is better than nothing.

213. See Benjamin I. Page, *Is Social Security Reform Ready for the American Public?*, in SOCIAL SECURITY AND MEDICARE: INDIVIDUAL VS. COLLECTIVE RISK AND RESPONSIBILITY 183, 198 (Sheila Burke et al. eds., 2000) (discussing surveys reporting support for Social Security privatization among 67–71% of respondents). *But see* Greg Hitt, *Social Security Plan Stalls*, WALL ST. J., July 23, 2002, at A4 (showing support for Social Security privatization dropping to 41% of those polled).

214. See *supra* note 201.

215. See *supra* note 200.

216. See *supra* text accompanying notes 207–11.

217. See, e.g., Jackie Calmes, *Social Security Debate Begins Amid Misunderstandings*, WALL ST. J., Apr. 7, 1998, at A20.

218. See Melynda Dovel Wilcox, *Saving Social Security*, KIPLINGER'S PERS. FIN. MAG., April 1997, at 61, 66 (reporting that in a survey of persons eighteen to thirty-four years old, 46% believe in unidentified flying objects but only 28% expect Social Security to survive).

219. See Richard L. Kaplan, *Top Ten Myths of Social Security*, 3 ELDER L.J. 191, 198–99 (1995); see also DEAN BAKER & MARK WEISBROT, SOCIAL SECURITY: THE PHONY CRISIS (1999); JOSEPH WHITE, FALSE ALARM: WHY THE GREATEST THREAT TO SOCIAL SECURITY AND MEDICARE IS THE CAMPAIGN TO "SAVE" THEM (2001); Robert Eisner, *Don't Sock the Elderly, Help Them: Old Age Is Hard Enough*, 5 ELDER L.J. 181 (1997); Charles J. Zwick & Peter A. Lewis, *Apocalypse Not: Social Security Crisis Is Overblown*, WALL ST. J., Apr. 11, 2001, at A18. See generally MAX J. SKIDMORE, SOCIAL SECURITY AND ITS ENEMIES: THE CASE FOR AMERICA'S MOST EFFICIENT INSURANCE PROGRAM (1999); Alan D.

Similarly, various purported calculations of Social Security's low "rate of return" undoubtedly cast privatization in a favorable light.²²⁰ But the problem with this approach is that Social Security is an enormously complex program, only one part of which is the provision of retirement benefits to covered workers.²²¹ Social Security also provides benefits to the current spouse of a retired worker²²² as well as to a divorced spouse,²²³ if their marriage lasted at least ten years.²²⁴ When the worker dies, the benefits paid to the surviving spouse²²⁵ and to the surviving divorced spouse²²⁶ increase.²²⁷ Other benefits are paid to dependent children²²⁸ of retired workers and to workers who are unable to work because of disabilities.²²⁹ All these benefits are adjusted annually for inflation²³⁰ and secured—ultimately²³¹—by the strongest government on earth.

These nonretirement aspects of Social Security are not trivial features. For example, the value of Social Security's payments to a deceased worker's family is comparable to a life insurance policy of \$350,000 to \$500,000,

Viard, *The Social Security Surplus, The Trust Fund, and the Federal Budget*, 94 TAX NOTES 891 (2002).

220. See, e.g., GARETH G. DAVIS & PHILIPPE J. LACOUE, WHAT SOCIAL SECURITY WILL PAY: RATES OF RETURN BY CONGRESSIONAL DISTRICT (1999); FERRARA & TANNER, *supra* note 185, at 69–70 (rates of return of 2% or less); U.S. GEN. ACCOUNTING OFF., SOCIAL SECURITY: ISSUES IN COMPARING RATES OF RETURN WITH MARKET INVESTMENTS 6 (1999) (2% implicit rate of return for baby boomers); Wilcox, *supra* note 218, at 63 (reporting projections of 1% rate of return after inflation).

221. See Kaplan, *supra* note 219, at 205–08; see also DEAN BAKER, THE FULL RETURNS FROM SOCIAL SECURITY (1998).

222. 42 U.S.C. § 402(b)(1), (c)(1) (2003).

223. *Id.*

224. 42 U.S.C. § 416(d)(1), (4) (2003).

225. 42 U.S.C. § 402(e)(1), (f)(1).

226. *Id.*

227. Upon the death of a retired worker, the benefit paid to that person's spouse or former spouse usually increases from half to all of the retired worker's benefit. See 42 U.S.C. § 402(b)(2), (c)(2), (e)(2), (f)(2). See generally FROLIK & KAPLAN, *supra* note 7, at 294–97, 302.

228. 42 U.S.C. § 402(d)(1). These benefits are subject, however, to a family maximum that is determined by the amount of the retired worker's Social Security benefit. 42 U.S.C. § 403(a)(1) (2003); see FROLIK & KAPLAN, *supra* note 7, at 301.

229. 42 U.S.C. § 423(a)(1) (2003). A person is disabled for this purpose if he or she cannot "engage in any substantial gainful activity by reason of any medically determinable physical or mental impairment which can be expected to result in death or which has lasted or can be expected to last for a continuous period of not less than 12 months." *Id.* § 423(d)(1)(A).

230. See 42 U.S.C. § 415(i)(1)(D) (2003) (consumer price index escalator); see also AVRAM SACKS, 2003 SOCIAL SECURITY EXPLAINED 344–46 (2003).

231. See Kaplan, *supra* note 219, at 199.

depending on the composition of the worker's family.²³² Similarly, the value of Social Security's disability payments is equivalent to a \$233,000 disability policy obtained from private sources.²³³ Of course, private sources often impose underwriting restrictions that limit the amount of disability insurance that one can purchase, or even preclude the issuance of a policy at all.²³⁴ Not so with Social Security, which takes all comers, regardless of work environment or medical history. Despite the obvious significance of these nonretirement aspects of Social Security, the studies that purport to calculate that program's "rate of return" generally ignore these considerations and focus exclusively on the retirement benefits it provides.²³⁵

Not only are these studies fundamentally flawed, therefore, they also misunderstand the nature of the Social Security program itself. The key is in the program's official name, "Old-Age, Survivors, and Disability *Insurance*."²³⁶ Rates of return for insurance programs are always higher the sooner the insured event occurs. So, if Herman buys a life insurance policy at age twenty-five and dies soon thereafter, his "rate of return" on the premium paid is much higher than if he lives until age ninety and pays premiums until that time. Most people would prefer the lower rate of return in these circumstances. Be that as it may, when confronted with an alleged "rate of return" of less than 2%,²³⁷ Americans may think they can do better themselves and accordingly support Social Security privatization.

The Enron episode, however, has brought these issues into clear focus. The purpose of Social Security, and defined benefit pension plans as well, is not to accumulate vast wealth or to achieve impressive "rates of return." Rather, these programs provide a source of income when regular employment ceases—whether due to retirement, disability, or death. In the final analysis, as Enron's former employees have learned, this important objective is best met by Social Security and professionally managed defined benefit plans, rather than by 401(k) plans.

232. Diane Harris, *The Good News: What Every Baby Boomer Should Know*, MY GENERATION, May–June 2002, at 33, 34 (using the average surviving spouse benefit of \$841 per month).

233. *Id.* (using the average disability benefit of \$815 per month).

234. See JONATHAN D. POND, PERSONAL FINANCIAL PLANNING HANDBOOK 4-60 (2d ed. 1999) ("Disability insurance is especially difficult to obtain for those persons with a dangerous job or hobby or with a previous medical problem. . . . Persons in these groups, if they can get disability insurance at all, face premiums as much as three times higher than those for lower-risk individuals.").

235. See, e.g., U.S. GEN. ACCOUNTING OFF., *supra* note 220, at 6; see also BAKER, *supra* note 221, at 28 ("[W]hen all the benefits of the Social Security program are included, and assessed at their insurance value, the rate of return provided by the program to most workers appears comparable to returns that might otherwise be available in the private sector.").

236. 42 U.S.C. § 401(a), (b) (2003) (emphasis added).

237. See *supra* note 220.

VI. CONCLUSION

Developments in employment-based retirement plans have generally pushed more financial responsibility and risk onto employees and away from employers. The movement away from defined benefit plans to defined contribution plans, then to 401(k) plans instead of either pension arrangement, then to 401(k) plans loaded with employer stock and weighed down by disposition restrictions, has jeopardized the future economic well-being of millions of Americans. In colloquial terms, this progression has shifted the focus of decision-making from professionally trained investment managers to the retirement equivalent of Amateur Hour. Some employees have done well, to be sure, but many have not.

In this context, privatizing Social Security would only exacerbate these disturbing trends. The fixed annuity represented by Social Security's retirement benefits provides a safe and dependable retirement income floor. Exposing this program to the same sorts of financial risks that now characterize employment-based pension plans would *augment* the precariousness of future retirees' financial security. Survey data suggest that Americans increasingly prefer the dependability and predictability of a defined benefit plan at work,²³⁸ comparable in this respect to Social Security. Even the Bush Administration indicated at the recent National Summit on Retirement Savings²³⁹ that more should be done to encourage defined benefit plans.²⁴⁰

Privatizing Social Security, in contrast, moves in the opposite direction—toward more risk and more uncertainty for employees. In light of recent events, typified by but not limited to the Enron disaster, a very different agenda seems appropriate: encourage defined benefit plans, require that employers either establish such plans before setting up 401(k) plans or match contributions to their 401(k) plans, keep corporate stock out of 401(k) plans entirely, and avoid Social Security privatization. Otherwise, the retirement security of ordinary Americans will be jeopardized still further.

238. See *supra* note 201.

239. This gathering of experts on retirement savings was convened pursuant to 29 U.S.C. § 1147 (2003).

240. See Michael W. Wyand, *Administration Pro-Active in Response to Enron Collapse, Official Tells Conference*, DAILY TAX REP. (BNA), May 21, 2002, at G-2; see also JOINT COMM. ON TAX'N, DESCRIPTION OF CHAIRMAN'S MODIFICATIONS TO THE "NATIONAL EMPLOYEE SAVINGS AND TRUST EQUITY GUARANTEE ACT" 32 (JCX-74-02, 2002) (authorizing a study of ways to "encourage the establishment . . . [and] continued maintenance of defined benefit plans").