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# PENSION TRENDS

Moderator: ERIC P. LOFGREN
Speaker: ANN L. COMBS*

MR. ERIC P. LOFGREN: One of our council members, Mike Mahoney, has worked closely with our speaker, and he will introduce her.

MR. MICHAEL W. MAHONEY: I think we're, indeed, fortunate to have Ann Combs here from the Department of Labor. Ann is the deputy assistant secretary of pension and welfare benefits at the Department. In that position she's responsible for assisting the secretary in the development and the execution of the regulations affecting all employee benefits, millions of individuals, and well over 800,000 pension plans, and better than 4 million health and welfare plans. I got the chance, in the early part of 1990, to work closely with Ann. We were both on Elizabeth Dole's Commission, which was responsible for looking into the health and welfare and pension benefits of the mine workers. It was during that time that I realized how extremely knowledgeable and capable she is.

MS. ANN L. COMBS: This went on for a number of years, and it really was an interesting, very political issue. We tried to figure out how to fund these benefits for the group of retired mine workers, and it ended up on Capitol Hill in the energy bill, which has still not been signed. I think it's sitting on the President's desk. Up until the last moment, it was touch and go. The House ended up taking the Senate version of the bill, but it was so annoyed at how things had been done that it said it was not changing one thing in the bill. It just declined to do any technical corrections, any legislative history, anything. It said it was going to have hearings early next year and it was going to reopen this issue. I thought some technical corrections would be made, and the deal that was struck would be settled so that the mine workers would have their benefits provided. But many people have spent many years trying to come up with the solution, and it's really quite a problem. Mike was terrific and having an actuary on the commission was invaluable. People were sitting around really puzzled as to how to possibly fund these benefits and how to get the costs under control. He tried to explain to the people how various options would work and he put some reality into the situation. Everybody felt that he was a key member of the commission, and without his advice and without the perspective of an actuary, we really would have been in trouble. It was not only fun, but it was really very beneficial to us to have Mike's input.

I'd like to talk to you about some of the things the Department has been doing in recent years. When I started in this field, my exposure to actuaries was primarily through working with the PBGC on their various funding proposals and in the more traditional defined-benefit-plan arena, funding of pension plans. In recent years that's really changed, as the pension system has evolved. Your role in it, or at least my very limited exposure to the actuarial profession, has certainly changed, and I've been

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involved with you much more on the defined-contribution-plan side and on risk management and investment issues. We've all benefited from your expertise, and I assume that your profession is evolving as the system evolves.

I'd like to talk about some of the trends that you're probably very aware of, and then some of the issues that have been in front of the Department in recent years that particularly affect the investment issues and plan assets, the 404(c) regulations that were recently issued, some of the annuity issues, and some of the guarantee investment contract (GIC) issues involved with Executive Life. Just to kind of put it in context, you're all aware of the statistics, I'm sure, on pension coverage, and how to expand pension coverage remains one of our biggest challenges.

Some studies show coverage has dropped slightly to about 48% of the full-time work force. Our studies show that it's been relatively stable at about 52%. It still isn't satisfactory; we have not done much to increase pension coverage, but it has kept pace with the growth in the work force. There's been a lot of movement within those kind of aggregate statistics. Coverage for women has increased significantly, but it's actually dropped off for men. What's really important is the shift from defined-benefit (DB) to defined-contribution (DC) plans. The total number of plans has increased significantly; there are now about 900,000 pension plans, up from about 500,000 when ERISA was passed. Most of that growth has been in defined-contribution plans, from 340,000 in 1980 to 584,000 in 1988. There has been a decline in defined-benefit plans, although they continue to cover about the same number of workers, because they tend to be the larger plans. The number of plans has dropped off very slightly, and there are about 146,000 defined-benefit plans. About 34 million people were covered by plans in 1988, many by defined-contribution plans. Many people have supplemental plans, but 14.5 million have defined-contribution plans as their primary source of retirement income. I think we really do need to focus on the issues that are unique to defined-contribution plans, in terms of how they are invested, what kind of return people are going to receive on their retirement income, and whether their savings are preserved for retirement.

I don't think there is a simple explanation for why there's been this shift from defined-benefit plans to defined-contribution plans. I think there are many different factors. People talk about shifts in the employment base, the administrative burden, the compliance burden on defined-benefit plans, and the preference for defined-contribution plans both by employers and employees. I think the shift in the employment base is particularly important. Most of the growth in the economy in the last decade has been in the small-business sector. As you know, this sector has had a strong preference for defined-contribution plans. Unionized manufacturing, which has been the stronghold of defined-benefit plans, has just not grown at all in the past decade but has actually shrunk. In terms of administrative cost, I think you are all aware of the number and frequency of changes in the law and the burden that's been placed on defined-benefit plans in the compliance sense. The PBGC did a study with Hay Huggins a few years ago about the administrative costs of maintaining a defined-benefit plan as opposed to a defined-contribution plan. The costs are rather startling, particularly for small employers. Maintaining a defined-benefit plan is really very costly, and it's not surprising that we're seeing no growth, and, in fact, many terminations in this small market.

Defined-contribution plans are very popular, as you know. The 401(k) plan really caused the explosion, but DC plans often result in higher benefits for mobile workers and for workers in smaller business. They have, as you know, faster vesting. They allow participants to invest their own assets, which I'll talk about, and to tailor their investment experience to their own particular circumstances. The large number of terminations of defined-benefit plans also led to some popularity of defined-contribution plans, with employees who like to see their account balance and know that they have that and that it will be there. DC plans also allow you to hedge a little bit against inflation. The account balance will grow commensurate with inflation, as opposed to a defined-benefit plan, if you separate from service. With all of those trends, I think it's not surprising that the Department, in recent years, has focused on regulatory issues that affect defined-contribution plans.

We have spent five or six years developing the regulations under Section 404(c) of ERISA, and they were finally published in final version in the *Federal Register* on October 13, 1992. This is the largest regulation project the Department's undertaken in recent years, and certainly since the plan-asset regulation. I thought I'd go through the final regulation and talk a little bit about how it will affect plan investments, how it's structured, and then maybe focus a little bit on the GIC issue, since I know many of you are with insurance companies. That was the major concern that the insurance industry had during the development of the regulation.

Under ERISA, a person who exercises control or authority over plan assets is a fiduciary. Section 404(c) provides a very limited exception to the general rule for plans that provide for participant direction. Under 404(c), a participant who, in fact, exercises control over the assets in his or her account is not considered a fiduciary, nor are the other fiduciaries of the plan liable for any loss that may result from the exercise of that control. It is a very limited exception. It's really a defense from a lawsuit for a participant who perhaps invested his or her account in the stock market before the crash in 1987, for instance. It would insulate the fiduciary from any liability for the results of that control. The 404(c) compliance is optional. You do not have to have a 404(c) plan, and, in fact, if you elect not to comply with the regulation, there is no implication that you have somehow breached ERISA.

The final regulation describes the elements that are necessary for a plan to comply with 404(c), and those circumstances under which a participant will be deemed to have exercised control over the assets. In general, the participant has to have the opportunity to choose from a broad range of investment options, to give investment instructions with the frequency that's appropriate in light of the market volatility of the investment, diversify the portfolio within and among investment alternatives, and obtain sufficient information to make an informed investment decision.

Like our proposed regulation in 1991, the final regulation provides that 404(c) has to have a broad range. A broad range under the regulation provides that participants have to be able to choose from at least three diversified alternatives that have materially different risk-and-return characteristics, and in the aggregate, the investments must allow the participant to achieve a portfolio with a risk-and-return characteristic that is appropriate to his or her circumstances. So, you have to put together an investment package that creates a spectrum among which the participants can place themselves for what's appropriate.

We really tried to incorporate a modern portfolio theory in the regulation and leave a lot of flexibility for plan sponsors. We did not specify specific investment alternatives. We started down that road with our first proposal on the regulation, and that was one of the real issues with GICs. Everybody wanted to have their investment alternatives described as being one of the designated ones. The problem with GICs was that GIC writers didn't want any competing funds because of the disintermediation problem. The issuing insurers didn't want people to be able to move into a competing fund when interest rates rose or fell. We really have backed out of that problem by being very flexible and just describing the type of portfolio you have to create, and working with the actuaries, the investment professionals, and the insurance companies.

For instance, if the plan sponsor wants to offer a GIC, the portfolio can be designed to insulate the insurer from any problems like that and, at the same time, still comply with the broad-range requirement. Section 404(c) never relieves fiduciaries, however, from their liability in selecting the investment alternatives. You will always remain on the hook for choosing an investment alternative for the participants. This is really more of an issue for the plan sponsors and the lawyers than for the actuaries, but it's important to remember that all the investment selections have to be prudent, and you can't just walk away from the plan. You have to monitor your investment alternatives and make sure that they remain prudent.

In 1991, we said that in-house managed funds had to have an independent fiduciary select the in-house fund as one of the investment alternatives, and that was highly controversial. We dropped that requirement from the final regulation because you retain your fiduciary liability. If an in-house plan selects its own investment alternative, it is acting as a fiduciary when it makes that selection. Also, participants must have a reasonable opportunity to give investment instructions. To exercise control, we have this general rule on volatility; you have to be able to move or transfer assets with a frequency that's reasonable, in light of the market volatility of the investment. There's also another separate rule. For the investments that constitute the broad range that make up the core of the fund, you have to let participants move at least as frequently as once in any three-month period. You have to have quarterly transfers for the core.

We had a rule at one point in 1991 that caused a great deal of confusion. For plans that had more volatile investments, the participant had to be able to move the money out of the highly-volatile investment into the least-volatile investment. The idea was really to allow people to be able to pull the money out of a very volatile investment, if they felt it was going south quickly, and move into the least volatile. That created some problems. We've modified that rule, and now there are two different alternatives. It's up to the plan sponsor to pick one when designing the plan.

Under the first, the plan can pick any investment alternative on the core that it wants the volatile investment to go into. If there is a commodities fund out there that's not one of your core options, but it's a high-risk fund and you have daily trading in it, you can designate one of the three core options to receive that money on a daily basis. In the alternative, you could create a subfund, or an account within the volatile fund, and park the money there until the next quarterly option opens up so the people could then move the money into the core. The policy goal is to have people be able to get

out of a volatile fund, if they perceive the need to do that, at a time that's appropriate.

We are not, by the way, ruling on or describing how volatile investments are. We've had many questions about that. How volatile is my employer's stock? How volatile is an equity fund? That depends on the facts and circumstances, and that's a judgment that the fiduciary's going to have to make. The Department's not getting in the business of looking at specific investments and opining. I think plan sponsors and their advisors are in a much better position to do that than we are at the Department.

There's another major change from the 1991 proposal on employer securities. The proposed regulation had required an independent fiduciary to be appointed to deal with all decisions involving employer security; decisions on buying, holding, selling, and voting stock. That was very controversial because it interfered with plan administration. Many employers manage their 401(k) plan in-house and will have an employer securities fund. There was concern that they would not be able to manage the fund with this independent fiduciary requirement. So, we did modify that, and now we've said that as long as you have a procedure in place that ensures the confidentiality of participants' decisions about voting or selling the stock, that is sufficient, and you have to identify a plan fiduciary. You have to designate a plan fiduciary to be responsible for maintaining and monitoring the confidentiality procedures. The fiduciary will also have the responsibility, if a situation presents itself where he or she believes there's a potential for undue influence on the participants, in that circumstance, to name an independent to handle that vote or that tender, or that board election.

Employer securities continue to have to be publicly traded on a national exchange and traded with sufficient frequency and volume so the participants can actually buy and sell promptly when they determine that that's what they want to do. In addition, employer securities cannot be one of the core alternatives, because it's not a diversified account. Employer securities could be added as a fourth option, for instance. You'd also be able to have an employer security account that didn't meet the 404(c) requirements. We require that a participant be able to sell. Many employers that have a 401(k) plan with a match in employer securities don't permit participants to sell the employer's stock. That wouldn't comply with 404(c). You could either change that and get into compliance and have the relief from the fiduciary liability, or you could have an employer securities account that didn't comply with 404(c). But you would remain responsible for the results of those investment decisions. You retain your fiduciary liability over that account.

We changed the regulation the most in the disclosure area. Unlike in 1991, we've identified specific information that must be made available to all participants, and specific information that actually has to be provided as well. There's a range of information that must be furnished. You have to tell people that it's a 404(c) plan and explain what that means. You have to describe the investment alternatives under the plan, including a general description of the risk-and-return objectives, identify any designated investment managers, and give an explanation of how you give investment instructions and what restrictions are on those instructions. You have to describe any fees or transaction expenses that are charged to people's account. If you invest in an investment alternative that's subject to the Securities Act of 1933,

you have to give them the copy of the most recent prospectus immediately following the purchase of the investment. You have to pass through voting rights, tender rights, and other rights, to the extent they're passed through to participants. You have to give them all the material on that, and you have to give them a description of information that's available upon request and the name of the person that they can get that from. Upon request, you have to reveal operating expenses that are borne by the plan as a whole, any prospectuses or financial statements that are furnished to the plan, and a listing of the portfolio assets of any investment alternative that is holding plan assets as they're defined under Department regulations. Also, for instance, in the case of a GIC or a bank investment contract (BIC), you'd have to give the name of the insurance company, the maturity of the contract, and the interest rate, the rate of return on the contract. You have to give information concerning the values of shares or units in any investment alternative and past and present investment performance. You also have to give the participant the value of the shares in their account, their account balance, basically.

The regulation is not effective until the second plan year beginning after publication. For a calendar-year plan, that would be January 1, 1994; collectively bargained plans have additional time. It's the later of the second plan year or the date on which the last collective bargaining agreement expires. As I said, we believe that we've been very responsive to the public in this regulation in trying to put out a proposal there that's protective of participants, that gives them sufficient control, and at the same time recognizes that the marketplace is constantly changing, and this will accommodate new investment vehicles. It will accommodate, we believe, changes in the market and it is a good framework to work from.

The GIC issues were really very difficult, as I said earlier, when we had a construct that was more specific with certain types of funds. You had to have some kind of a bond fund and some kind of an equity fund, and we got all tied up in ourselves in trying to put things in various categories. GICs had, as I said, problems with competing funds. GICs historically have had equity washes. Six-month equity washes were very typical. Because of the transfer rule, a GIC with a six-month equity wash could not be one of the three core options. A GIC could serve potentially as one of the core options, if it didn't have those features, if you were allowed to move the money in and out, and you could negotiate with the plan sponsor so that a competing fund wasn't offered, for instance. There's no reason why a GIC couldn't be structured to fit within the core, but if you want to have a six-month equity wash, it's going to be outside the core. It's going to have to be a fourth fund or a fifth fund, because if you're going to have the equity wash and hold it there for six months, that's going to have to be outside the core, too.

Frankly, given the recent changes in the GIC market, plan sponsors feel that they're going to have a little bit more negotiating strength with the insurance companies, and they're going to be able to either eliminate the equity wash or cut it down from six to three months, so that it fits more easily into their portfolio. I think the regulation accommodates those kind of changes, and I think that's its strength, frankly. The insurance industry in the end was very supportive of the regulation. I think it felt that we were responsive to its concerns and, at the same time, that this was something that it could deal with on a client-relationship basis and structure a product that it could sell for these plans.

The insurance industry's not as pleased with our activity in the annuities area. It began before the failure of Executive Life, but that's really the crystallizing event. We had ongoing investigations of Executive Life annuities before that time, but we filed our first lawsuit in the aftermath of Executive Life. We set out the ERISA requirements for purchasing and selecting annuity providers, and I think it clearly was very controversial with the insurance industry, but again I think the market has moved to accommodate the ERISA standard. ERISA, as you know, requires that fiduciaries exchange their duties prudently and solely in the interest of the participants and the beneficiaries. In choosing to purchase an annuity, the fiduciary must obtain the safest annuity available for the participants, and, at a minimum, ERISA requires fiduciaries to conduct an objective process to select an insurer from whom to purchase the annuity.

Fiduciaries should use a consultant or an advisor to assist them, if they lack the expertise in selecting an insurer. They should use a bidding process to attract competing bids and determine what options are available to the plan. They should study the companies that are bidding; look at their financial stability, their track record, their claims-paying ability, and the administrative capabilities of the plan to service the contract. These are the kinds of things where your obvious expertise comes into play. Actuaries play a big role in providing this kind of advice to insurance companies and to plan fiduciaries.

The reason we're so concerned about the selection of an annuity provider is because it's such an important event to the participant. When an annuity is purchased and distributed to the participants, they cease to have any recourse against the plan or the PBGC; their only recourse is to the insurer, obviously. So, we want to make sure that decision-making process isn't tainted. Any fiduciary who has a conflict of interest as a practical matter is going to need to obtain independent, expert advice that's designed to identify insurers with the best claims-paying ability that are willing to write the business. The issue is particularly sensitive when there's a termination of a plan and excess assets are recaptured. There the conflict is rather clear. The cheaper, riskier annuity results in a larger reversion to the plan sponsor.

In other circumstances when annuities are purchased, the interest may be balanced. You may have participants remaining in the ongoing plan, and you're purchasing annuities for retirees. There you're going to have to balance the interest of both sets of participants, and you may want to take an annuity that has a slightly lower price, if it has sufficient security. As long as you're making that decision in the interest of the plan participants, and not in the interest of the corporation, you've met your fiduciary duty.

We have expended a considerable amount of investigative resources in the annuities area. It was the hot news last year, and many people have forgotten about it, or it's faded away a little bit. Since March 1990, we've had 500 referrals from the PBGC. We have the names of 1,100 companies that bought Executive Life from the California Insurance Commission. I think we've sent out about 1,000 letters to plan sponsors asking for more information, and we've been conducting 85 full-blown, fiduciary investigations where people from our field offices go out to a company and really do a thorough investigation.

We filed another lawsuit on October 22, 1992. The issue's not gone away. It's our eighth lawsuit against companies that purchased Executive Life. This was Raymark. One lawsuit that was filed involves Presidential Life Insurance Company, the Strouse Adler case. We still have a number of demand letters out asking people to come in and make participants whole to avoid a lawsuit. We will continue to work through these cases. I think, frankly, what happened is that there were tolling agreements (agreements by both parties to extend the statute of limitations), as there are in any litigation when you're doing this number of investigations. You enter into tolling agreements with potential defendants to get more time to develop the investigation, and many of these tolling agreements were entered into in the past year, and they're now starting to expire. I think you're going to see more cases coming out of the pipeline, but the issue isn't over. I do think, however, the market has reacted to the lawsuits and has reacted to the pressure from participants, plan sponsors, and other insurance companies, in the wake of Executive Life. People are paying much closer attention to the selection of an annuity provider, and the market has improved. I think the ratings of the companies that we see filing with the PBGC have gone up. We were getting hundreds of referrals from the PBGC in the beginning of this, and now we're getting only a couple a month. There really has been a flight to quality in the marketplace, and we think that's a real positive development in this area.

On the regulatory side, about a year ago, we issued an advanced notice of proposed rule-making, asking the public whether it was appropriate for the Department to issue regulations detailing when a participant was considered to be covered under the plan. It's not rule-making on the fiduciary standard, and we weren't asking whether we should modify the standard that the fiduciary act solely in the interest of plan participants and beneficiaries. We're not going to do that. That isn't the issue here. The issue is, when does a participant lose his or her status as a participant in the plan and lose his or her connection to the employer and to the PBGC? We received a number of comments. I think the insurance industry's biggest concern is that we not establish a minimum standard that would create a bright line that was ratings-based, where someone could open up *The Wall Street Journal* and say, "Gee, so-and-so doesn't meet the test for providing annuities to pension plans." Many companies aren't even in the business, but it was afraid that it would spill over and have collateral damage on their other products. Companies wouldn't be able to write life insurance or they wouldn't be able to sell a health product, if someone thought that the government believed they weren't stable enough for the government's purposes.

That's been the insurance industry's biggest concern. We've been very sympathetic to that, frankly, and have been looking at the issue. It's taken so long because there's been so much change in the marketplace. We're trying to consider whether we need to go forward or whether we need additional information about what's happened. The NAIC, as you know, has developed model regulations for the states to deal with solvency issues. One NAIC proposal is that an insurance company has to be certified, which would be another role for an actuary, and unless it was certified by the NAIC, the plan would have to go out and get an actuarial certification on the solvency of the insurer. Every state, Puerto Rico, everyone except the District of Columbia, where I live, has a guaranty fund at this point. So, there's been a lot of change in the marketplace, and we may need additional information before we decide whether to go forward at this point.

Just in closing, on the GIC side, other issues that came up with Executive Life are related to what happens with GICs? People have defined-contribution plans, Executive Life or Mutual Benefit GICs, or plans at other companies. They're frozen in the plans. We have expedited consideration of transaction-exemption requests. Without a transaction exemption, assets cannot be transferred among accounts, because such transfers are considered a loan to a plan.

Many sponsors want to buy back the GIC and put cash into the account so that they can make distributions. They need an exemption to do that. We have expedited those requests. We've done dozens. We've gotten to the point where they're standardized now. I think you could probably find one that was developed that met your criteria and model your exemption after that. It's not taking too long to get those processed. So, we're trying to help the marketplace in that sense, accommodate the problems that have come forward from Executive Life. Many plan sponsors are concerned about what to do in wake of California's rehabilitation efforts. They're trying to now go with the guarantee funds to get the difference made up in the GIC amount that the International Life Insurance Council (ILIC) is not making up. They're going against individual state guarantee funds to try to make up the difference. Some guarantee funds are paying off, some are not. We still have to wait and see how that's all going to work out, but we're monitoring this situation.

In closing, the Department's been very active in recent years. We've been spending more and more time on health, which I know is not a major issue for this particular section of the Society. I think it is an area, however, that the profession is certainly going to be increasingly involved in the incoming years. We continue to have a number of challenges. We've really got to work together to deal with the small-plan market. I think it is where the growth needs to occur. It's where the challenges are. We need to work on portability, on preservation of assets, and I think we really need to resist attempts, which I'm afraid are going to come in the coming years, to look at pension plans as a source of investment capital, subsidized investment, and social investing.

I think we're going to see a renewed push for that type of activity, given the size of the capital that pensions represent. I think plans do play a critical role in the capital markets, and we've always encouraged their full participation in the markets, but I think the Department has a very good record of not interfering with participation unrealistically. Within the confines of the statute, obviously, there are always prohibited transaction problems and things like that, but we really have never gone down the road of saying that these are good investments and these are not good investments. We've resisted those attempts, and I think it's been the wise course. I think that there will be continuing pressure, however, to encourage plans. It'll start out by encouraging plans to invest in certain types of projects. If it's not at a market rate and plans aren't interested, I think we'll see continuing pressure to have subsidized investment, and then I think it's going to be a real challenge because we have to preserve the retirement income. It needs to be there to supplement Social Security in the future, and I hope that we can work with you to make sure that we have adequate funding, that we have the security there, and that the investments are appropriate, are prudent, and make sense from an economic standpoint. We cannot succumb to the social investing temptation.

FROM THE FLOOR: You mentioned social investing. What about a union-sponsored plan, where maybe the head of the union wants to invest in something that may put some of the pension funds at risk?

MS. COMBS: The construction industry, particularly, has been interested in investing in mortgages, with the theory being that will employ more of its members in the construction industry. There's nothing wrong with investing in mortgages or any other investment if it's at a market rate. In many instances, there's some subsidy involved. We have taken the position that a reasonable rate of interest means a market rate of interest. We have brought a number of cases to that effect; there are many enforcement initiatives in that area. We just had a case down in Florida where there was a local that had put 90% of the plan assets in shopping malls in one area, in one county in Florida. It lost all its money, and we had the head of the local union removed as a fiduciary. We tried to restore as much of the assets as we could. We put the plan in receivership, basically, and tried to work it out, but people did lose some of their benefits in that case. The Department has been consistent in that position since 1974. It has not changed with various political regimes. I think everyone believes that as long as it's economically prudent, it's prudent under ERISA. We've been very clear. You cannot subsidize the investment. You can't take more risk than would be appropriate in light of the return, or vice versa, take less return for the risk to achieve some social goal. If two investments are economically equivalent, you are allowed at that point to then consider other factors in choosing an election, but they have to be economically prudent, which means you basically have to maximize the investment return for the plan with the appropriate risk.

FROM THE FLOOR: What about giving investment advice to your participants?

MS. COMBS: Mike said I have this broad range of knowledge. I'm not the lawyer who makes those determinations. I'm really not the right one to ask. I do think you want to stay away from creating the situation where you're giving investment advice, however, because at that point, you're going to become a fiduciary, and you've taken on a lot of responsibility.

There's always been a dilemma for employers. At some point, if you start to give investment advice to your participants, you're going to be a fiduciary and assume a lot of responsibility. Employers have really tried to stay away from that. I think they've probably erred on the side of being too conservative, and in recent years, we've seen a lot of interest among employers in doing a better job of educating their work force, because I think they've looked at the statistics that are real troubling. We've all looked. You've seen it. No offense to the insurance industry, but 40%, or 50%, or 60% -- I don't know the number -- of defined-contribution-plan assets are in GICs. That's just astounding, particularly for younger employees, that they would all be in a relatively conservative fixed-rate investment fund. Many employers are troubled by that, and they're trying to set up programs where they do better jobs of educating their work force generically. Don't say "Put in the Magellan Fund," but say, "Here's how stock markets perform, and here's how bond markets perform, and here's what the difference will be over a 20-year period." This is all computerized, as you know, and employers are doing runs and showing the various rates of return under different options, bringing people in to talk about diversification, to talk about vesting for the long term. We don't have specific regulations on it, but we do

encourage people to do a better job. In 404(c), we've tried to lay out a number of disclosure items that will help participants in making their choices and in making investment decisions on historical rates of return, on various risk-and-return options. That's designed to help participants make better choices and to educate them, but I do think it's really the role of the plan sponsor and its advisors to develop programs to encourage people.

People were maybe too cautious, and they've come a long way. I've heard plan sponsors say they worry about their plan administrators or the people in their benefits office sitting down with an individual and telling him or her to put 30% of their fund in the stock market and the rest in the bond fund. At that point, they're probably over the line. They've given specific investment advice to an individual. The individual has relied on it. What you want to do is make it more generic. Many employers are having employee meetings, where they're bringing in professionals to describe it generically. But they're worried about the old retiree health cases, with the benefits administrator telling the retirees not to worry, it will be there for the rest of their lives. The courts will then find that they had a contractual obligation to make those payments, even though the plan document may have said they could terminate at anytime. They're worried about what's going on between the plan administration, the benefits person up on the fourth floor, and the individual participant. People are getting more aggressive in that area, though, and there is concern that more and more of their employees are relying on defined-contribution plans for their retirement income, and employers don't want to see them coming up short when they retire, through poor investment performance.

We don't say that you can't give people investment advice. If you do, however, you're taking on a lot of responsibility. It goes without saying that if you're going to give investment advice, then you have to be responsible for the outcomes of that.

FROM THE FLOOR: Who is developing regulations with specific solvency standards?

MS. COMBS: My understanding is that the NAIC is developing model regulations, which will be adopted by the states, that would deal with specific solvency standards. It also has a proposal that a company either be licensed in the state that has been certified by the NAIC, that has complied with these model regulations (the states adopted them, and the company is licensed there), so they've met these standards. Or if a company happens to be domiciled in a state that did not adopt the standards, then the plan sponsor or the insurance company can go out and hire an actuary to certify individually that the company meets the solvency standards that the NAIC has laid out.

But this is an NAIC proposal. This isn't something that the Department has adopted. We're looking at it and waiting to see the effect that that has in the marketplace. If a number of states adopt that kind of thing, there may be less concern about some of the solvency requirements in various states. If not many states do, we may have additional concerns.

FROM THE FLOOR: Sound investment decisions require access to timely and accurate information. Plan participants may not always have access to this type of information. How have you addressed this?

MS. COMBS: We have met with the SEC during the development of the regulation, and I've had informal discussions with them, as it came out. We haven't heard from them since the final was published, actually. For those of you who may not follow it as closely, the SEC issued a study six months ago. It is concerned that individuals' pension plans are now, in many instances, the primary interface that the individuals may have with the markets, and they're not getting the kind of market information that Congress determined was necessary under the securities law for individual investors in the marketplace, in pension funds. People in defined-contribution plans, particularly, need more information.

That was a lot of the impetus behind our beefed-up disclosure in the 404(c) regulation. I think I mentioned that in the proposal in 1991, we just had a kind of generic statement saying you had to give people sufficient information to allow them to make informed decisions, and that's all it said. It's now really quite extensive, and much of that is in response to the kinds of concerns the SEC raised. We share their views that people do need better market information to invest wisely. I would hope that 404(c) really satisfies many of their concerns. They commented on the regulation extensively. We took many of their suggestions and met with them and listened to what they had to say. We're concerned that if you have SEC-type disclosure, you're going to end up with many prospectuses and mutual-fund-type disclosures, which are boilerplate in kind of legal jargon and are passed onto participants, which really may not be meaningful or helpful to them.

I think the plan sponsors have done a terrific job in communicating these plans, particularly 401(k) plans. The way the nondiscrimination rules work, you have every incentive in the world to make sure people participate, and employers have really beefed up their employee communication and have done a good job of making it understandable, legible, and helpful. I'd hate to see us go away from that to a dense, kind of prospectus-type disclosure, and the SEC doesn't really disagree with that. All mutual fund prospectuses don't have to be so dense either. We've said people can do much more clear, plain-language things, but they don't do it. So, I hope the SEC will look at 404(c) and believe that we've satisfied some of its goals. The SEC's changes needed legislation. We were able to go forward in a regulatory fashion. It has to actually go to Congress and get changes in the law. The SEC was only going to affect common and collective trusts, banks, pooled accounts, and insurance companies, which really doesn't cover all the pension plan investments. The 404(c) regulation covers every investment in the pension plan.

We believe we have a broader impact than the SEC in that we'll work with it. I hope the SEC will think we've made great strides and at least wait and see how things play out in the market before we add another layer of regulation and another competing agency. We do coordinate with the SEC on many issues, corporate governance issues in particular, and we work real well with it, but I don't think plan sponsors are interested in another government agency having another slightly different compliance burden placed on plans. I hope 404(c) will satisfy it.