Regulation of the Financial Services Industry: Whose Money is at Risk?

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By

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I. Introduction

In today’s financial geography, Wall Street intersects Main Street. When it comes to sound bites, politicians recognize that ordinary Americans feel the effects of plummeting financial markets in their retirement savings.1 But, when the discussion turns to reforming financial services regulation, the reformers forget that much of the money that greases the cogs of Wall Street comes from dedicated retirement savings accounts, such as 401(k) accounts.

The continuing turmoil in the financial services sector almost certainly will result in regulatory reform.2 Numerous commentators and policy makers have blamed deregulation, lack of federal oversight, or some similar regulatory failing for allowing the growth in subprime mortgages, credit default swaps, and other financial products that have contributed to the financial crisis. For the moment major regulatory reform appears to be on hold until the financial markets have stabilized and presidential administrations have changed but reform was on its way even prior to the crises of 2008.

In March 2008, Secretary of the Treasury Henry M. Paulson, Jr. set out an aggressive proposal, The Department of the Treasury Blueprint for a Modernized Financial Regulatory Structure3 (Blueprint), for the reorganization of regulatory authority over the financial services industry. The Blueprint’s publication date shortly followed the near bankruptcy of Bear Stearns, which was one of the early events to rattle US financial markets and challenge regulators to intervene aggressively.4 The proposal, though, was not a hastily compiled reaction to the Bear Stearns situation or to the later and more widespread financial instability in the US markets. In March 2007 Treasury had convened a conference on the competitiveness of US capital markets.5 Following the conference, Treasury

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1 John Harwood & Michael Cooper, McCain and Obama Urge Greater Oversight in Financial Bailout Plan, N.Y. TIMES, Sept. 22, 2008, at A18 (quoting Senator Barack Obama on the financial crisis: “Regardless of how we got there, we now have a situation where people’s jobs, people’s savings, people’s retirement accounts, their job security, all that is at risk.”); Carl Hurse, Faced With Financial Upset and an Election, Lawmakers Lash Out, N.Y.TIMES, Sept. 24, 2008, at A24. (quoting Representative John A. Boehner of Ohio: “But I am going to argue that if we do nothing, we are jeopardizing our economy, jobs, people’s retirement security. Congress has to act and we have to act quickly.”).


3 DEPT. OF THE TREASURY, BLUEPRINT FOR A MODERNIZED FINANCIAL REGULATORY STRUCTURE (2008) (hereinafter BLUEPRINT). Throughout this article I use the regulatory framework proposed by the Blueprint as a basis for discussing the implications for regulation of retirement-specific accounts. I do this not because I believe that framework is likely to be adopted exactly as proposed. In fact, reform of financial services legislation will be contentious and draw out many proposals. See, e.g. Arthur Levitt, Howe to Restore Confidence in Our Markets, WALL ST. J., Oct. 22, 2008, at A15. Rather the Blueprint is a widely accessible, detailed, and thoughtful starting point.


5 BLUEPRINT, supra note 3, at 1.
initiated a study on how other countries allocate authority over financial services and sought
comments on potential reform.6

As a result of that year-long effort, the Blueprint proposes major revision of the regulatory
structure used to oversee the institutions at the heart of the US financial system, such as investment
banks, commercial banks, and insurers as well as the operation of stock markets.7 Its approach
would in the long term, among other things, increase the authority of the Treasury Department,
decrease the authority of the Securities and Exchange Commission (SEC), and create new regulatory
agencies.8 Though primarily focused on the allocation of authority among regulators, the proposal
embeds significant substantive regulatory change by, for example, for the first time subjecting
investment vehicles such as hedge funds to federal oversight.9

Regulatory approaches, such as that of the Blueprint, which assume investor funds are
interchangeable amalgamations of assets, fail to recognize and react to the way in which current
regulation differs in its applicability based on the source of the funds. The terms are defined more
extensively below,10 but this article uses “retirement-specific accounts” to refer to dedicated, tax-
preferred retirement savings vehicles, which wrap around investor assets and enable the accounts to
receive favorable tax treatment. In benefits terminology, these are typically referred to as defined
benefit (DB) or defined contribution (DC) plans,11 and even more specifically as 401(k) plans,
employee stock ownership plans, and so forth. The specialized benefits terminology, however, may
be counterproductive where the focus should be, as it is here, on the assets held inside the benefits
plan accounts and how the regulation of those accounts compares to regulation of non-retirement
plan retail investment accounts such as brokerage accounts. To facilitate the discussion I use the
‘accounts’ terminology to refer to the various types of vehicles that hold investment assets. This
 terminology also eases the discussion of international approaches to the regulation of retirement
wealth accumulation since each country tends to use a unique terminology to refer to its retirement-
specific programs.12 In contrast to retirement-specific accounts, “generalized investment accounts,”
as used in this article, encompasses the broad universe of nonspecialized savings vehicles, such as
bank savings accounts, brokerage accounts, and other retail investment vehicles that do not receive
tax incentives intended to stimulate asset accumulation for retirement.

The Blueprint concludes that Australia’s regulatory structure for oversight of its financial
services industry and markets provides the closest model to what would be the optimal structure for
the US.13 Australia uses an objectives-based approach to financial services regulation. That
approach requires establishing a few key objectives and assigning a regulator to each objective.14
Another regulatory model, known as the single consolidated regulator approach, has been adopted by
the United Kingdom (UK)15 and praised by commentators on the basis of its efficiency, effectiveness,
and predictability.16

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6 Id.
7 Id.
8 See id. at 13-21.
9 See id. at 19.
10 See infra Part II
11 For a discussion of the definition of defined benefit (DB) as compared to defined contribution (DC)
plans, see infra text accompanying note 52.
12 In the US, the holding vehicles and their governing terms are called plans. In the UK the equivalent
reference typically is to schemes. Australia does not even typically refer to retirements or pensions,
instead preferring the term superannuation.
13 See Blueprint, supra note 3, at 143.
14 Id. at 142.
15 Id. at 141.
16 Elizabeth F. Brown, The Tyranny of the Multitude is a Multiplied Tyranny: Is the United States
369, 372-73 (2008); Elizabeth F. Brown, E Pluribus Unum – Out of Many, One: Why the United
Australia and the UK each made significant changes in their retirement income systems within a few years of undertaking reform of regulation over their financial services sectors. Both countries resolved the interdependency of stable financial markets and healthy private-sector mechanisms that provide retirement income by giving financial services industry regulators some authority over aspects of retirement-specific accounts. This is not to say that the path chosen by either Australia or the UK is the appropriate model for US regulation. Their approaches, however, help to show how the seemingly different worlds of financial services and retirement savings are now intrinsically linked and provide possible principles to guide US reform.

Even before the most recent instability in the financial markets, the overlapping nature of retirement-related investment accounts and other retail investment accounts in the US had increasingly blurred the boundaries between the authority of the SEC and Department of Labor (DOL). For example, after the Enron and other corporate scandals in the early part of the century, courts struggled to rationalize a DOL supervised disclosure regime for retirement-specific accounts, which arguably required earlier and more extensive disclosure to employee-shareholders than to non-employee shareholders, with the SEC’s insider trading provisions, which would seem to prohibit the more extensive disclosures. Not only did the colliding regulations potentially put fiduciaries in a position where they would be forced to violate one of the requirements, the DOL’s resolution of the conflict essentially gave it power to nullify the long tradition of securities law enabling companies to remain silent between required disclosure periods. In another example of overlap, recently the SEC and DOL each issued separate regulatory proposals detailing requirements for disclosure of investment account fees and costs. The DOL’s regime applies to retirement-specific accounts while the SEC’s regime applies to some, but not all, types of generalized investment accounts. Not surprisingly, the financial services industry has called for coordination between the two forms of disclosure requirements. From an overall perspective, the regulatory overlaps have become so extensive that in July 2008, the SEC and DOL entered into a formal Memorandum of Understanding (2008 MOU) in order to clarify the division of authority over retirement specific accounts.

To date the reform proposals and literature have focused on either the financial system and securities side of regulatory reform or on the pensions side. In this article I argue that the two perspectives should be merged. Although the complexity of each of the areas has no doubt contributed to the paucity of literature merging the two, US reform of regulation over the financial services industry must take into account that Americans hold almost $18 trillion in retirement-specific accounts. A financial oversight structure that fails to recognize that some assets are held in retirement-specific accounts would create negative externalities on disclosures and other information flows. It would fall short of maximizing application of the insights of researchers in the fields of behavioral finance and behavioral economics. And it would create inefficiencies as entities could exploit regulatory differences between the formal retirement savings regime and the regulation of other investment vehicles to the detriment of investors.

Part II begins by examining the importance to the US financial system of assets held in retirement-specific accounts. It also analyzes the role of those assets in contributing to retirement

17 See infra text accompanying note 143.
18 See infra text accompanying note 143.
19 See infra text accompanying notes 195-99
income security. The Part concludes by explaining the fragmented approach taken by the US to regulating the relationship between the financial services industry and retail investors. It shows how that approach depends on the nature of the account used to facilitate investment. Part III explains the paradigm shift that has taken place in the basic nature of retirement-specific accounts. That shift changed the nature of the risks associated with the assets held in retirement-specific accounts. The current legislative approach was targeted at mitigating the risks of the prior paradigm.

Part IV considers the allocation of regulatory responsibility over retirement-specific accounts and compares it to the regulation of generalized investment accounts. Although changes in the basic structure of retirement-specific accounts have decreased many of the differences between those accounts and generalized investment accounts, neither the substantive regulation nor the assignment of regulatory authority has changed. The Part undertakes an operational analysis of the risk in retirement-specific accounts, which reveals specific types of problems that have arisen in these accounts. The analysis shows that regulatory strategies to address those issues can be categorized as disclosure-oriented or as substantive regulation of conduct.

Part V argues that reform of financial services industry oversight must recognize the attributes and regulation of retirement-specific accounts. To ignore this sector of investment would further entrench overlapping regulation, disregard the substantive risks to individual investors, and endanger the use of tools intended to maximize the accumulation of wealth for retirement support. Throughout the article, the approaches used by the UK and Australia are used to inform the discussion and analysis.

II. The Role and Regulation of Retirement-Specific Accounts in the US Financial System

This Part considers the importance of retirement-specific assets to the US financial system and to the individuals who rely on those assets for retirement security. The Part ends by describing how the current regulation of the relationships between financial services firms and investors differentiates based on whether assets are held in retirement-specific accounts or in generalized-investment accounts.

A. Deployment of Assets

In the US, assets designated as formal retirement savings exceeded $17.6 trillion in 2007. Seventy-one percent of households in the US reported in 2007 that they had an IRA, an employer-sponsored retirement plan or both. Almost two-thirds of those assets are held in accounts that are formatted as workplace (employer-sponsored) employee benefit plans. Significant portions of assets held in IRAs, which are not considered to be a workplace employee benefit plan, originated in a workplace plan. As individuals change employers, retire, or otherwise leave an employer-sponsored plan, they often will roll over their workplace plan assets into an IRA.

An important indicator of the importance of retirement assets to a national economy is the size of those assets compared to the size of the economy. As of year-end 2006, OECD data indicates that the percentage of US pension fund assets relative to the size of the US economy was 73.7 percent. Another indicator of the importance of retirement savings is the comparison of retirement-specific assets to market capitalization of US companies. The $17.6 trillion held as formal retirement savings compares to $25.1 trillion, which was the worldwide market capitalization of operating companies listed on the New York Stock Exchange (NYSE) as of 2006 year end.

23 Id. at 86.
24 Id.
25 Id. at 2.
26 Id. at 15, n.19.
27 OECD Pension Markets in Focus, Nov. 2007, available at http://www.oecd.org/dataoecd/46/57/395090002.pdf, at Figure 4A.
28 2006 Annual Report, NYSE Group, Inc. 4 (2007). The NYSE did not break out the market capitalization of its listed operating companies for year-end 2007. The combined market capitalization
The $17.6 trillion held as formal retirement savings in the US can also be compared to the division of assets among various financial sectors. At year end 2006 the assets held by US insurers totaled $6 trillion.\textsuperscript{29} The US securities sector and banking sectors each held assets of approximately $12.5 trillion.\textsuperscript{30}

The percentages of retirement assets to the size of the national economy were slightly higher in the UK and much higher in Australia, with 77.1 percent and 94.3 percent respectively.\textsuperscript{31} Estimates indicate that, among all of the major Asia-Pacific countries, Australia will continue to have the largest value of pension assets under management at least through 2015.\textsuperscript{32} Almost fifty percent of total Australian pension account assets are invested in equity securities of Australian companies.\textsuperscript{33}

While the amounts invested are important because of the proportion and volume of the assets, investments made through retirement accounts also have an effect on the financial products offered by the financial services industry. Assets invested through participant-directed retirement-specific accounts have changed the market, and marketing, for retail investment products. In 1990 only eight percent of long-term mutual fund holdings were held in the type of retirement-specific accounts known as defined contribution (DC) plans.\textsuperscript{34} By 2007 that percentage tripled, to 24 percent.\textsuperscript{35} Decision-making on investments in those accounts is typically the responsibility of the individual account holders. Thus, pension trends mean that mutual funds increasingly must recognize and target the individual investor market. As a comparison, institutions, including financial institutions, not-for-profit companies and other institutional investors, held 14 percent of mutual fund assets in 2007.\textsuperscript{36}

Acknowledgement of the scope of overall retirement assets invested in mutual funds would require knowing the extent to which those institutional investors were investing other types of plan assets, most specifically defined benefit plan assets.

Less quantitative measures of the importance of retirement savings to the US economy and the financial services industry were evidenced in legislation passed as the Pension Protection Act (PPA) of 2006.\textsuperscript{37} PPA amended prior law to permit hedge funds to receive more investments from pension plans without causing the hedge funds to become subject to complex and limiting rules that apply to pension plan fiduciaries.\textsuperscript{38} And, although for a number of years there has been significant demand from employees for investment advice connected with their DC plans, until 2006 significant hurdles discouraged employers and others from directly or indirectly providing advice.\textsuperscript{39} PPA provisions addressed those issues by reducing barriers to the provision of information on DC plan investments by employers and professional investment advisors.\textsuperscript{40} The PPA provisions had been

for listed operating companies on NYSE Euronext was $30.4 trillion. 2007 Annual Report, NYSE Euronext, 2 (2008).

\cite{fnref:29} BLUEPRINT, supra note 3, at 165.
\cite{fnref:30} Id.
\cite{fnref:31} OECD Pension Markets in Focus, Nov. 2007. available at http://www.oecd.org/dataoecd/46/57/39509002.pdf, at Figure 4A.
\cite{fnref:33} Id. at 5.
\cite{fnref:35} Id.
\cite{fnref:36} Id. at 83.
heavily lobbied for by hedge funds and investment advisors who wanted easier access to the business opportunities in retirement-specific accounts. In addition, to signaling the importance of the retirement assets to the financial services market, the enactment of those PPA provisions illustrates that as recently as 2006 legislation effectively reduced the regulatory effect on the relationship between investors in retirement-specific accounts and the financial services industry.

From the investor-side of the equation, retirement-specific accounts play an important role in providing some level of financial security in a system where the governmental Social Security system of retirement benefits is fragile. More than a third of Americans receive pensions or annuities from retirement-specific accounts attributable to employer-sponsored benefit plans.41 Those pensions and annuities contribute more than 19 percent of the income received by the population age 65 and over.42

The receipt of pension and annuity income is not, however, distributed evenly across income groups. Those in the highest income quartile are most likely to receive income from pensions and annuities.43 In contrast, experts estimate that individuals born between 1929 and 1935 and who are in the median ten percent of income derive 25 percent of their income from employer-sponsored pension plans.44 As discussed below,45 increasingly employers are establishing retirement-specific accounts that pass on a variety of risks, such as investment risk to the individuals who accumulate assets in those accounts. But, individuals in the lower income quartiles frequently do not receive any benefits from retirement-specific accounts.

In sum, in the current retirement regime, many individuals rely on the capital markets for the stability and integrity of their retirement income. In turn, the capital markets rely on retirement assets as both a source of assets to be invested and of fees to support the financial services industry.

Regulatory reform proposals such as Treasury’s Blueprint recognize that the framework for regulation of the financial markets including futures exchanges, securities offerings, and depository institutions, and futures exchanges is now more than 70 years old and increasingly archaic.46 The regulatory framework has not kept up with evolution of the capital markets, which has developed sophisticated products and faces increased competition from foreign capital markets.47 What is rarely recognized though is the extent to which that framework also has departed from the current paradigm in retirement asset accumulation. Given the importance of retirement-specific accounts to the economy, the financial services industry, and individuals, regulatory reform will be inadequate unless it addresses the way in which retirement plan regulation intertwines with financial services regulation.

B. Regulation of Interactions between Financial Services Firms and Investors

Much of the actual regulation that is of relevance in reform proposals such as the Blueprint is focused on the operation and governance of the capital markets, the relationships between financial services firms, and the connections between the government, including government guarantees, and the financial firms. Another important set of relationships covered by the reform proposals though is the interactions between the financial services industry and retail investors. It is in this latter set of relationships that the Blueprint appears to assume, without discussion or a plan for transition, that the new regulatory regime will apply to retail investments as undifferentiated amalgamations of assets.

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42 Id. at 3, chart 7.1b.
43 Id. at 1.
45 See infra Section III.A.
46 BLUEPRINT, supra note 3, at 2.
47 Id.
But, that ignores the current regulatory approach, which differentiates depending on the type of account in which assets are held.

Figure 1 shows a simplistic model\(^\text{48}\) of the relationships between the financial services industry and retail investors. Those retail investors all purchase financial products hoping for a positive return on their assets. But, the current regulatory regime splinters authority for regulation of investment-related matters among a variety of agencies depending on the type of account that holds the investor’s assets. Without considering all the possible retail investment alternatives, a few examples can make the point. Some investors may put after-tax money in retail brokerage accounts and invest in products such as mutual funds or securities of individual companies (A$). Others may decide to hold after-tax money in what have historically been viewed as more conservative products such as bank savings accounts, certificates of deposits, or US Treasuries (B$). In either case, this article refers to the investments as generalized investment accounts.

Still other investors save pre-tax in dedicated retirement-specific accounts that generally provide an array of investment product choices (R$). US tax rules permit investment of pre-tax dollars so long as the assets are held in a plan or account that meets detailed requirements intended to achieve specific policy goals such as ensuring the fairness of any employer contributions and controlling the foregone tax revenue. It is the accounts or plans that meet these requirements that this article refers to as retirement-specific accounts. Within R$, the assets may be held in accounts created through plans sponsored by private-sector employers (referred to here as employer retirement dollars (“ER$”)) or be in accounts established by individuals, not employers (individual retirement dollars (“IR$”).\(^\text{49}\)

Currently federal regulation differentiates R$ not just by establishing minimum tax policy requirements for retirement-specific accounts but also by sometimes setting different standards for the relationship between the investors of R$ and the financial services industry. The differentiation is observable in both the substantive requirements that govern that relationship and in the regulatory entities that develop, administer, and enforce those substantive requirements. More specifics of the differentiation are explored below in Part IV, which also considers the resulting inefficiencies. First, however, the next Part explains how this regulatory differentiation came to exist and why it is becoming a historical anachronism.

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\(^{48}\) The model ignores the layers of financial services firms involved in a retail investment transaction because the critical point for this article is the relationship between the retail investors and the financial services industry writ large, not the relationship among the various firms in the financial services industry.

\(^{49}\) A third possibility is that assets are held in retirement-specific accounts established by governmental employers. Because neither the tax nor the labor provisions of ERISA reach those plans, this article treats them as beyond its scope.
Figure 1

Financial Services Firms

A$

B$

ER$

IR$

SEC, FINRA, states, etc.

DOL, IRS, etc.

Banking & Insurance

IRS, SEC, FINRA, etc.

Individual Investors
III. Paradigm Shifts in Asset Accumulation for Retirement

The US, UK, and Australia now share an individual savings oriented approach to the accumulation of retirement assets. Over the past thirty years, workers in the US and the UK have taken on more individual responsibility in planning for their financial security in retirement.\(^5\) Australia's history is a bit different. Its success in generating retirement savings is traceable to 1992 when it began requiring employers to contribute to retirement asset accumulation programs.\(^5\) This Part examines those trends and discusses the import for retirement adequacy.

A. The Transition from Receiving Monthly Checks to Writing Your Own Checks

For most of the twentieth century one of the many traditions shared by the US and the UK is that employees, who had pension plans at their employers, retired knowing that they would receive a monthly check for the rest of their lives. In benefits terminology, these plans are called defined benefit (DB) plans. All of the plan assets are held in a single retirement-specific account and the terms promise a monthly life-time pension check to retirees who meet minimum criteria. The amount of the pension promise is based on a formula often related to salary and years of work at the employer that established and funded the DB plan. The employer accepts responsibility to ensure the account holds sufficient funds to pay the promised benefits. The employer, therefore, takes on the investment risk of the pension promise.\(^5\) In the US these types of accounts date back to 1875 when the American Express Company, then in the railroad business, established a DB plan for its workers.\(^5\)

In both the US and the UK DB plans are on their way to becoming historical artifacts. Commentators typically point to the unpredictable and significant funding burdens borne by employers and increasing regulatory burdens as primary factors that caused many employers in the US and UK to terminate or freeze their DB obligations and the accounts that hold the assets.\(^5\) Regardless of the impetus, which also may be affected by employee mobility, diminished rates of unionization, and the increase in global competition,\(^5\) the number of US workers who participated in DB accounts fell to approximately 18.5 percent of workers in 2003 from 22.9 percent in 1995. Much of the drop in DB coverage occurred earlier in the US than in the UK. One has to go back to 1980 to find a 35 percent coverage rate in the US.\(^5\) But, although the trend in the UK is more recent, employers there also have reduced their use of DB accounts, often by not permitting new employees to earn those benefits.\(^5\)

The decrease in the numbers and coverage of DB accounts did not spell the end, however, of employment-related retirement-specific accounts in either the US or the UK. Instead, employers shifted their focus to accounts that function very much like individual brokerage or savings accounts.

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\(^5\) See infra Section III.A.
\(^5\) EMPLOYEE BENEFITS LAW (Jane Stanley ed., 2000).
\(^5\) GHILARDUCCI, supra note 44, at 67-80.
\(^5\) Pension Benefit Guaranty Corp., PENSION INSURANCE DATA BOOK 60 (2005).
\(^5\) Four out of five DB plans in the UK have been closed to new employees. James Salmon & Ian Drury, Final Salary Pensions now ‘Extinct’ for Private Sector Workers – as State Staff Enjoy ‘Gold-plated’ Deals, THE MAIL ON SUNDAY, Aug. 25, 2008. Between 2000 and 2006 the number of open private sector occupational DB plans with only one section dropped from 18,350 to 3,470. During the same period, membership in those plans fell from 4.1 million to 1.6 million employees. UK Office for National Statistics, OCCUPATIONAL PENSION SCHEMES ANNUAL REPORT 8, 16 (2007) (hereinafter “UK ANNUAL REPORT”).
Those are known as defined contribution (DC) plans or, in this article’s terms, DC retirement-specific accounts. All employer-sponsored DC accounts establish an individual investment account for each employee who participates in the employer’s plan. And, for purposes of this article, I only include accounts governed by terms that make the assets held in the account eligible for tax incentives explicitly intended to encourage retirement savings. Even within the constraints imposed on tax-favored plans, the terms of the DC plan that wraps around the assets can vary widely. A plan may cover one individual or thousands of employees. Those individuals may work for one employer or a variety of employers. It may be formed as a trust or the terms may be set out in a contract. Contributions to DC retirement-specific accounts may come from employers, individuals, or both. Here, I exclude all programs where benefits are paid by a government, such as the US social security program.\(^{58}\)

In the US, 401(k) accounts, named after the Internal Revenue Code (Code) section that authorizes the accounts, constitute the most frequently held type of employer-sponsored DC retirement-specific account.\(^{59}\) Sponsorship of accounts that conform with Code section 401(k) has grown from essentially zero in 1981\(^{60}\) to the point that those plans now have more participants and assets than any other type of employer-sponsored DB or DC account. At year-end 2006, approximately 50 million US workers owned 401(k) accounts with assets totaling an estimated $2.7 trillion or about 66 percent of all assets in work-based retirement-specific accounts.\(^{61}\)

Federal tax law also recognizes a number of types of employer-sponsored DC retirement-specific accounts with terms that differ from those of 401(k)s. Profit sharing plans exist to allow employers to contribute a portion of their profits to retirement accounts for their employees.\(^{62}\) Regulation provides streamlined options for retirement plan sponsorship to small employers such as the Simplified Employee Plan (SIMPLE).\(^{63}\) All of these accounts hold what is shown in Figure 1 above as ER$s.

In addition, federal tax law permits individuals to open retirement-specific accounts without any employer sponsorship or action. For example, individuals may establish Individual Retirement Accounts (IRAs), which even are permitted to accept rollovers from employer-sponsored tax-favored plans.\(^{64}\) The detailed differences certainly matter for tax policy but, regardless of those details and the technical plan designations, all of these accounts provide an opportunity for the accumulation of

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\(^{58}\) This definition matches generally to the scope of DC plans covered by ERISA and used by widely-available surveys and research.

\(^{59}\) In addition to work-based DB and DC plans, in the US other formal and informal financial vehicles provide mechanisms for the accumulation of retirement wealth. A full catalog of the many possibilities would require a level of detail not necessary for purposes of this Article. One example of such a vehicle that many readers are familiar with is Individual Retirement Accounts (IRAs). In the US, Individual Retirement Account (IRA) assets have risen from $1.1 trillion in 1994 to $4.2 trillion in 2006. Paul Brady & Sarah Holden, *The US Retirement Market, 2006*, 16 ICI RESEARCH FUNDAMENTALS 1, 4 (2007). To complicate matters further, these retirement savings vehicles that are based outside the workplace may contain assets that originated in work-based plans. For example, about one-half of the assets held in IRAs originated in work-based plans. *Id.* at 6. Of course, individuals also may save for retirement using methods that are not retirement-specific, whether that involves cash stuffed in a mattress or the purchase of an exotic financial instrument.

\(^{60}\) Muir, *supra* note 39, at 6.


\(^{63}\) *Id.*

\(^{64}\) *See id.*
retirement wealth in individual accounts. The assets held in these kinds of accounts are shown in Figure 1 above as IR$. The non-tax regulatory treatment varies significantly between accounts hold ER$ and those holding IR$.

The UK has approved a variety of DC retirement-specific accounts in an attempt to encourage employees to accumulate assets for retirement. The first wave of DC accounts in the UK consisted of private sector occupational (employer-based) accounts that were established after 1979. The number of those plans has fallen from a peak of 46,730 in 2004 to 33,770 in 2006. Those accounts were established through the use of a trust and membership has remained at about 1 million.

Beginning in 1998 the UK provided opportunities for far more people to open a kind of DC account known as a personal pension. Workers were allowed to opt out of a portion of the UK public pension system (the portion then known as SERP) and open a personal pension instead. Alternatively they could opt out of their current or former employer-sponsored occupational pension scheme in favor of a personal pension. The personal pension accounts could be made available by employers to their employees or individual workers could establish accounts on their own. When it announced expanded access to personal pensions in 1988, the UK estimated that about half a million workers would establish a personal pension in lieu of SERP or a trust-based account established by their employer. The actual take-up rate was dramatically higher. By 1994-95, approximately 5.6 million people had established personal pensions. Unfortunately, as discussed below, many of those people were worse off because of their election to open a personal pension.

The UK next created a new type of retirement-specific account in 2001, which was intended to avoid the problems it had encountered with personal pensions. The goal of those accounts, known as stakeholder pensions, was to operate at low cost while meeting a set of minimum requirements intended to protect account holders. The UK requires most employers that do not offer any other type of pension plan that meets minimum standards to select a stakeholder scheme and make it available to employees. There is no obligation, though, for either employers or employees to contribute to stakeholder pensions. For this reason, pension participation in the UK remains much lower than in Australia. As of 2004 only about one million individuals had contributed to a stakeholder plan. The UK continues to adjust its pension regulation in an effort to increase pension coverage and income.

Currently the UK has another set of pension reforms underway. It plans in 2010 to introduce a type of retirement-specific account it is calling personal accounts. The UK’s goal with personal accounts is to increase the number of individuals saving for retirement and the amount they save. The first goal would be achieved by automatically enrolling most adult workers in a personal account.

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65 One type of tax-favored plan that is different is known as an Employee Stock Ownership Plan (ESOP). While similar in many ways, including individual accounts, longevity risk, and assignment of investment risk, ESOPs must invest primarily in employer stock. Therefore, the choice of investment alternatives issue typically does not occur in ESOPs.

66 UK ANNUAL REPORT, supra note 57, at 8-9, 16.


69 See infra Section IV.B.1.b.

70 Id.


72 Waine, Personal Provision, supra note 71.

73 Id.
A minimum contribution requirement and caps on account fees are expected to be used to increase the amount saved.\textsuperscript{74}

Unlike the US and UK, Australia never developed a widespread system of employer-sponsored pension coverage. The early development of pension entitlement resulting from employment in the private sector has been best explained as “haphazard[] covering some occupations and not others and providing markedly variable conditions and benefits.”\textsuperscript{75} Finally, in the mid-1980s DC pensions became widespread through union agreements with coverage reaching 79 percent in the early 1990s.\textsuperscript{76}

Against that backdrop, Australia made an especially bold move in 1992 by adopting a mandatory private pension scheme known as its Superannuation Guarantee.\textsuperscript{77} It began as a requirement that employers contribute three or four percent of earnings for almost all employees to individualized accounts. The accounts are then invested and administered by third-parties.\textsuperscript{78} The amount of the mandatory contribution made by employers has increased over time and currently is nine percent of earnings.\textsuperscript{79} The mandatory, employment-based nature of the Australian system has resulted in a participation rate above 90 percent.\textsuperscript{80}

Superannuation Guarantee accounts operate as DC accounts, which are invested and administered by not-for-profit funds or by for profit commercial enterprises.\textsuperscript{81} Those entities create account products that meet the required regulatory terms. Employers designate one or more entities to accept the employer’s contributions. In 1996 the Australian government adopted a policy to encourage competition among the funds that could receive superannuation contributions by permitting individuals to have some choice among funds.\textsuperscript{82} The policy of choice was so controversial that legislation to permit choice was not enacted until 2004 and implementation of choice began in mid-2005.\textsuperscript{83}

\begin{footnotes}
\item[74] Id.
\item[75] Bateman & Piggott, supra note 51, at 2.
\item[76] Id. at 3.
\item[77] See infra text accompanying notes 78-80.
\item[78] Hazel & Piggott, supra note 51.
\item[79] Id. at 9.
\item[81] Id. at 15-17.
\item[82] Gail Pearson, You’ll Need at Least a Million Dollars’ – The Regulation of Superannuation in Australia, 5 presented at ALSB Annual Conference, St. Petersburg, FL, 2006 (copy on file with author).
\item[83] Id.
\end{footnotes}
**Figure 2. Retirement-Specific Accounts with Individual Accounts**

<table>
<thead>
<tr>
<th></th>
<th>Employer-based Schemes</th>
<th>Personal Vehicles</th>
</tr>
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<tbody>
<tr>
<td><strong>US</strong></td>
<td>Trust-based</td>
<td>Contract-based</td>
</tr>
<tr>
<td></td>
<td>• 401(K)</td>
<td>• Simplified Employee Plan, SIMPLE</td>
</tr>
<tr>
<td></td>
<td>• Profit-sharing</td>
<td>IRA, etc.</td>
</tr>
<tr>
<td><strong>UK</strong></td>
<td>- Occupational Money Purchase</td>
<td>• Group Personal Pension • Stakeholder Pension</td>
</tr>
<tr>
<td></td>
<td>- Superannuation account</td>
<td>• Individual Personal Pension • Stakeholder Pension</td>
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<tr>
<td><strong>Austr.</strong></td>
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</tbody>
</table>
Whether one looks at the UK, Australia, or the US, the new standard in work-related retirement plans is increasingly becoming similar to the equivalent of an individual savings account. Figure 2 summarizes pension-related savings vehicles with individual accounts in the US, UK, and Australia. Employers may, or in the US and the UK may not, contribute to the accounts. The details of the accounts vary widely in many details, including whether assets are held in a trust or governed by contract, the minimum and maximum annual contributions, and regulation of the distribution of account assets before and after retirement. All of those details are important from the perspective of tax policy, the rights of account holders, and obligations of employers. However, for purposes of considering the ways in which the regulation of DC retirement-specific accounts intersects with the regulation of the financial services industry, it is the individualized nature of the accounts and the relationship between the account holders and those, including employers and financial services firms, who sit on the other side of the equation that is relevant. And, while it is possible that the US paradigm could shift once again to DB entitlements, commentators generally view such a change as highly unlikely.84

B. Risks in a DC World for the Accumulation of Retirement Assets

The paradigm shift from DB plans to DC retirement-specific assets has rendered current regulation an outdated solution to a very different set of risks than existed in the 70s when the Employee Retirement Income Security Act of 1974 (ERISA),85 the primary federal statute regulating employer-sponsored retirement-specific accounts, was enacted. Commentators have written extensively on the implications of the convergence of work-related retirement plans on a DC model have for the adequacy of retirement income.86 This section focuses on a different question -- the changes in the risk profile of asset accumulation that have resulted from the movement to a DC model. Unlike in DB plans, individuals, not employers, may choose whether they will participate in a work-related retirement plan. Individuals, not employers, typically choose how to invest the assets. Individuals, not employers, bear the investment risk on the accounts. And, individuals, not employers, decide how the accumulated assets will be distributed in retirement. The effect of these changes on risk can be categorized as participation risk, investment risk, and longevity risk.87 The regulatory challenges


87 See ZELINSKY, supra note 84, at 6-23 (referring to participation risk as funding risk). Professor Zelinsky explains that DB pension recipients are not insulated from all risks. They face reduction in the real value of their pensions through inflation, a possibility of payment default, and backloading, which causes the final years of a worker’s career and long service at one employer to be especially important. Id. at 23-27.
created by these risks differ significantly in a DC model from those that existed under the DB plan model in place when Congress enacted ERISA in 1974.

Consider participation risk first. Both the percentage of employees in the US covered by and the number of employees who participated in either a DB or a DC style work-related retirement-specific account dropped between 1999 and 2003. Coverage rates decreased to 46.7 percent in 2003 from 50 percent in 1999. This decrease is more problematic than is first apparent. Full time employees who worked for an employer that provided a DB plan, as would have been more typical in 1999 than in 2003, would automatically be covered (meaning they were eligible to participate) in the DB plan. Once an employee met the age and service requirements established by the DB plan, the employee would participate (begin to accrue benefits) and the employer was responsible for funding the promised benefit promised. DC accounts typically permit the employee to decide whether to participate in the plan, and often let the employee choose how much to contribute. Evidence shows that significant numbers of employees covered by (eligible to participate in) DC plans do not choose to contribute and that lower-paid workers are less likely to contribute (participate) as compared to more highly paid workers. Thus, the shift to DC retirement-specific accounts arguably has increased the participation risk for employees.

The shift to DC retirement-specific accounts has also increased the investment risk for employees. In DB plans, employers must fund the plan sufficiently to pay promised benefits. As a result, the employer bears the investment risk. Accordingly, employees typically determined the investment policy for DB plans and either made the investment decisions or hired investment professionals to implement the investment policy.

Most DC accounts delegate investment choice to employees. Since the benefit an employee receives from such a plan is whatever amount is in that employee’s account at retirement or distribution of the assets, the employee bears the investment risk. The result is to shift to employees not just the risk that a particular asset might perform poorly but also the risk that the appropriate holding period for some investments in a diversified portfolio may be longer than an individual employee can tolerate and the capital markets may be weak at the time that an individual employee retires or draws down assets. DB plans, which typically were adopted with the intent that they would be in place for many years, could at least theoretically spread the risk of a down period in the markets or the risk of assets with long holding periods over the life of the DB plan.

Finally, in a DB plan the requirement that the employer fund the plan sufficiently to pay promised benefits combined with the fact that benefits are paid for a retiree’s lifetime means that employers bore the longevity risks in those plans. Most DC plans provide that assets will be distributed in a lump sum. Tax regulation requires that minimum distributions occur after a set age. Although nothing prevents the owner of assets held in a DC account to use those assets, either before or after distribution, to purchase an annuity, most retirees choose not to do so. As a result, retirees risk the possibility of outliving their accumulated assets. This risk is higher for women who

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88 GHILARDUCCI, supra note 44, at 34.
89 Id. at 34-35.
90 Id. at 118 (finding that 27% of workers with incomes between $20,000 and $39,999 did not contribute to a 401(k) when eligible whereas only 4% of workers earning over $100,000 did not contribute when eligible).
91 See ZELINSKY, supra note 84, at 6-13.
92 Of course, any minimum funding obligations impose requirements on DB plan sponsors, especially in an environment of low interest rates and falling equities markets. See, e.g. Jillian Mincer, Record Losses Hit Pensions of Big Firms, WALL ST. J. D7 (Nov. 18, 2008) (stating that the average funding for DB plans of employers referenced in the article fell from 100% at the beginning of the year to 76 percent).
93 GHILARDUCCI, supra note 44, at 122-25.
statistically have longer life spans than men and tend to accumulate lower levels of assets for retirement.\textsuperscript{94} The UK has experienced a similar shift in risk as the US. As in the US, the UK has seen a shift from DB to DC retirement-specific accounts.\textsuperscript{95} The current voluntary system means UK pension savers face participation risk, as illustrated by the low number of individuals who contribute to stakeholder plans. Individuals in the UK typically have fewer investment choices and usually there is a default investment so the risk in choosing the wrong investment is lower. However, individual account holders still bear the investment risk in the sense that their entitlement is equivalent to the amount accumulated in their retirement-specific account. And, the defined contribution nature of accounts combined with a lack of annuity distributions means that individuals also bear longevity risk.

Australia avoids the first of these risks – that of participation – by mandating employer contributions to Superannuation Guarantee accounts. However, even in Australia, individual account holders bear both investment and longevity risk.

IV. Risk, Regulation and the Division of Regulatory Authority

This Part considers how current regulation addresses the risks inherent in DC retirement-specific accounts. It begins by examining the allocation of regulatory authority vis-à-vis employer-sponsored retirement-specific accounts and shows that the allocation is a historical artifact attributable to the DB pensions that were the standard at the time of ERISA’s enactment. That approach is contrasted to the regulatory oversight of retirement-specific accounts that are not employer sponsored and of generalized investment accounts, which have increased in similarity to retirement-specific accounts. For perspective and alternative approaches, the Part compares the regulatory challenges and the distribution of authority in the US to the approaches used in the UK and Australia.

A. Current Allocation of Regulatory Authority

The current US regulatory regime, which applies to all employee benefit plans sponsored by private-sector employers, is found in ERISA. Congress enacted ERISA in 1974 after ten years of debate.\textsuperscript{96} A defining event for pension regulation was Studebaker’s closing of its automobile assembly plant in South Bend, Indiana in 1963. Studebaker had sponsored a DB pension plan for its employees but that plan was drastically underfunded when Studebaker failed.\textsuperscript{97} As a result, most employees and retirees received only a small portion of the pensions they expected or nothing at all. The severe economic impact on retirees and workers attracted the attention of law makers.\textsuperscript{98} Eventually, the Senate held subcommittee hearings featuring testimony by workers from a number of companies who did not receive the pensions their employers had promised.\textsuperscript{99} As a result of the unmet worker expectations, much of the congressional focus when enacting ERISA was on ensuring that employers kept the benefit promises they made to their employees.\textsuperscript{100} The statutory mechanisms used to achieve security of DB pension promises included enhanced disclosure requirements, imposition of fiduciary standards, vesting and funding provisions,

\textsuperscript{94} Id. at 49-51.
\textsuperscript{95} See supra text accompanying notes 66-73.
\textsuperscript{97} Id. at 51.
\textsuperscript{98} Id. at 73-74.
\textsuperscript{99} Id. at 168-69.
\textsuperscript{100} Id. at 271; see also ERISA § 3, 29 USC. § 1001 (“[I]t is desirable in the interests of employees and their beneficiaries,… that minimum standards be provided assuring the equitable character of [pension] plans and their financial soundness.”).
and private rights of enforcement.\textsuperscript{101} Congress was also concerned with the amount and proper use of the tax expenditure for pension plans. Thus, ERISA limits both benefits from and contributions to retirement plans.\textsuperscript{102}

Throughout the wrangling over benefits legislation, the DOL and IRS competed to receive regulatory authority over the benefits field.\textsuperscript{103} The fight extended to arguments over which subcommittees in the House and Senate had jurisdiction over the proposed legislation.\textsuperscript{104} Congress ultimately resolved the turf battles by, as Rep. John Erlenborn put it, “cutting the baby in half… [and leaving each committee and agency with] half this dead child.”\textsuperscript{105}

There was little pretense that the division of authority was other than a politically expedient solution. Even at the time, some legislators anticipated the inefficiencies that would result from overlapping jurisdiction.\textsuperscript{106} Because Congress’s technical solution was to write many of the statutory provisions into both the labor and the tax sections of the US Code,\textsuperscript{107} the IRS and DOL eventually agreed to cede each other authority over specific types of regulation. Under the agreement, the IRS received responsibility for funding, eligibility to participate in plans, and ensuring entitlement to plan funds. The DOL received authority over fiduciary issues, proper disclosure, and claims procedures. Currently the Employee Benefits Security Administration (EBSA), an agency within the DOL, exercises most of the DOL’s responsibilities for oversight of benefit-related issues.\textsuperscript{108} The anomalous approach to duplicative legislative provisions continues to this day as does the agreed upon division of responsibility between the IRS and DOL.\textsuperscript{109}

Those interested in the reform of financial services oversight will immediately notice that there is no obvious role for the SEC\textsuperscript{110} in the regulation of employer-sponsored retirement-specific accounts. Although the SEC is responsible for regulatory implementation of disclosure requirements that govern the release of information by public companies and mutual funds to investors,\textsuperscript{111} EBSA has authority over the disclosure requirements imposed on employer-sponsored retirement-specific accounts, including on certain of the investments in those accounts.\textsuperscript{112} While the SEC works with self-

\begin{footnotesize}
\begin{enumerate}
\item See WOOTEN, supra note 96, at 266-67.
\item Id. at 267.
\item See id. at 154-55 (competing for authority over fiduciary standards); 202 (arguing over which agency could best enforce the legislative standards);
\item Id. at 194-96 (outlining the jurisdictional problems between the Senate Labor Committee and the Senate Finance Committee); 224-26 (discussing the clash between the House Labor Committee and the House Ways and Means Committee).
\item Id. at 237.
\item Id.
\item WOOTEN, supra note 96. In part this division of authority between a tax regulator and a workplace regulator may exist because US pension policy has long reflected the tension between balancing tax and other incentives for employer sponsorship of pension plans with provisions that protect employees from malfeasance and unfairness.
\item http://www.dol.gov/ebsa/
\item STANLEY, supra note 52, at 39.
\item In this article, I focus on the lack of a role for the SEC because of the SEC’s authority over many standard investment products; however the same point applies to regulators of insurance products, certificates of deposit and any other form of financial investment held in employment-related retirement-specific accounts.
\item See Corey Ciocchetti, The Privacy Matrix, 12 J. TECH. L. & POL’Y 245,331, n.89 (2007) (“The Securities and Exchange Commission (SEC) requires some prospectus documents that must be distributed to potential investors by public companies and mutual funds to possess certain sections drafted in plain English.”).
\end{enumerate}
\end{footnotesize}
regulatory organizations such as the Financial Industry Regulatory Authority (FINRA) to set standards for the conduct of broker-dealers and other industry participants who deal directly with investors,\(^{113}\) it is EBSA that oversees the fiduciary obligations of those individuals and entities who interact with employees who invest through employer-sponsored retirement-specific accounts.\(^{114}\) The scope of (is widely recognized for its breadth in reaching material misrepresentations or omissions connected with the purchase and sale of any security as defined by the federal securities laws.\(^{115}\) For employer-sponsored retirement-specific accounts, claims of misrepresentations or omissions fall within ERISA’s fiduciary regime and are subject to ERISA’s limitations on remedies.\(^{116}\) Another dimension of complexity is added by those accounts, such as IRAs that are retirement-specific accounts but are not employer-sponsored. EBSA has little to no regulatory authority over those accounts. Even though they have much the same tax treatment and share many other characteristics with employer-sponsored retirement-specific accounts, federal regulation treats the non-employer accounts differently from retirement-specific accounts in plans sponsored by employers.

Concentration of oversight responsibilities at DOL and IRS for employer-sponsored benefit plans was a rational approach when the primary risks to employees were, as was true in DB pension plans, that employers would not keep the promises that they were making of lifetime pension payments. The relationship risks were that an employer would not properly fund a plan, would commit malfeasance with respect to plan assets, or would be dishonest in explaining pension entitlement to employees. The employer’s role and actions were the main determinant of whether an employee would receive the pension promised by the employer. As explained above, however, the DB plan is no longer the paradigmatic pension plan and the primary risk faced by employees is no longer that employers will not keep promises of life time pension payments. The methods used to accumulate wealth for retirement have changed but the regulation and division of regulatory responsibility has not.

The UK and Australia have taken quite different fundamental approaches to the regulation of retirement-specific accounts and to the integration of that regulation with oversight of other types of investment activities. Australia, where the employment-related pension system, the Superannuation Guarantee, is relatively new and simple, does not have a workplace regulator as one of its key regulators for the Guarantee. Instead, it divides authority among the Australian Prudential Regulation Authority (APRA), the Australian Securities and Investments Commission (ASIC), and the Australian Taxation Office (ATO).\(^{117}\) ASIC’s primary function is to regulate the business activities of all corporate entities in Australia. Included among those corporate entities are the financial entities that are active in providing the investment funds in which superannuation contributions are held and invested.\(^{118}\) In 1998, ASIC assumed responsibility for consumer protection vis-à-vis pension accounts and investments.\(^{119}\) APRA regulates the financial services sector from a prudential standpoint. As such, it is responsible to ensure prudent management so that the entities offering funds as investment


\(^{115}\) See Thomas W. Joo, Legislation and Legitimation: Congress and Insider Trading in the 1980s Summer, 82 Ind. L.J. 575, 608 (2007) (referring to “the broad, generic anti-fraud prohibition of Section 10(b) of the 1934 Act and the similarly broad SEC Rule 10b-5 promulgated thereunder”).

\(^{116}\) See id.


\(^{118}\) Parliamentary Joint Committee on Corporations and Financial Services, The Structure and Operation of the Superannuation Industry, 9 (Aug. 2007).

\(^{119}\) Id.
vehicles for superannuation maintain the financial resources to meet their obligations. In addition, APRA is responsible for overseeing disclosure to holders of pension accounts.120

Thus, retirement-specific accounts are included in the regulatory authority of ASIC and APRA in a way that does not generally differentiate between those accounts and other, non-retirement specific investment activities. Furthermore, Australia’s regulation of superannuation follows the objectives-based approach that it applies more generally to financial services regulation.121 For example, the objective is to ensure that funds maintain sufficient assets to meet their obligations. Supervision of that objective is the task of APRA regardless of whether the financial services entity is holding assets that in the US would constitute A$, B$ or R$.

Compare the approach of the UK where the Financial Services Authority (FSA) and The Pensions Regulator (TPR) divide primary regulatory responsibility for pension plan oversight.122 The FSA and TPR have entered into a detailed memorandum of understanding that allocates authority between the two entities. At the conceptual level, the memorandum divides authority on the basis of the entities subject to oversight. The FSA, as an integrated part of its mission to “regulate[] the financial services industry in the UK,”123 regulates the financial and insurance firms that advise on the marketing, sale, and provision of personal pensions and annuities. The FSA also has responsibility for improving investor knowledge and understanding of financial products and markets.124 This includes the responsibility to improve employees’ understanding of pension products through education and disclosure. The FSA’s view is that disclosure from fund managers would not be useful to individual fund investors “since most of them would probably find the information too technical to get any benefit from it.”125 In contrast, the FSA regulates the financial and insurance firms that advise on the marketing, sale and provision of personal pensions and annuities. The FSA also has responsibility for improving investor knowledge and understanding of financial products and markets.126

The TPR’s role is to oversee and provide advice to employers and to trustees of work-based pension plans. In general TPR has responsibility for oversight of and providing advice to employers and to trustees of work-based pension plans. TPR is a public body accountable to the Department for Work and Pensions (DWP).127

The specific differences in the way the US, UK, and Australia have assigned regulatory authority for work related pension savings are traceable to differing philosophies on division of that

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120 Id. at 7-8.
121 See BLUEPRINT, supra note 3, at 142.
122 HM Revenue & Customs’s role generally is limited to ensuring that the tax expenditure associated with tax-favored retirement-specific accounts remains in check.
124 See Ian Greenstreet, Stakeholder Pensions – The Compliance Regime, 8 PENSIONS 152 (2003). Dispute resolution also is handled differently in the US, UK and Australia. The US leaves dispute resolution to the benefit plan in the first instance with appeals heard primarily in the federal court system. In the UK, three different ombudsman services and The Pensions Advisory Service share responsibility for assisting individuals with pension-related questions, disputes and compensatory rights. Australia is similar to the US in that the benefit plan has the first opportunity and obligation to resolve benefit disputes. Australia differs, however, in that it has established a specific tribunal, the Superannuation Complaints Tribunal (SCT), to hear benefits-related complaints. Only a limited right of appeal exists from the decisions of the SCT.
127 Although DPW, not TPR, develops pension policy and law in the UK, TPR is widely-recognized as a regulatory body. See Clearance Guidance (“The Pensions Regulator (the ‘regulator’) is the regulatory body for work-based pension schemes in the UK.”) http://www.thepensionsregulator.gov.uk/guidance/clearance/introduction.aspx
authority. Looking at the division between the IRS and EBSA, the US divides authority according to the types of legal issues that arise in the accounts – what I will call an issue oriented approach. If it is a fiduciary or disclosure issue, it belongs to the EBSA. If it is an issue of plan funding, it belongs to the IRS. The SEC and other financial services regulators are not part of that mix.

At the conceptual level, in the UK the FSA and TPR divide authority on the basis of the entities subject to oversight. The FSA oversees the relationship between the individual employees who have pension accounts and the financial services firms that administer those accounts and provide the underlying investment products. The result is that, for purposes of oversight of the financial services firms involved and the employees who own the accounts, the UK largely treats these employment-related, tax-favored pension accounts in the same way it treats other investment accounts that are not designated and tax-favored as retirement savings. In contrast, the US assigns to EBSA regulatory authority over the relationship between the individual employees who have pension accounts and the entities that administer the accounts. Disputes over mishandled investment directions are governed by ERISA as fiduciary disputes, and thus are the territory of EBSA. Similarly, EBSA has responsibility for disclosure requirements regarding benefits statements and such investment-related material as account fees.

B. An Operational Analysis of Risk

As DC retirement-specific accounts have become more prevalent, the risks to employees in their accumulation of retirement wealth have changed. The risks of participation, investment return, and longevity all pose challenges to the ability of individuals to save enough to support themselves in retirement. This subpart analyzes specific examples of ways these risks have affected retirement savings, thereby highlighting the problems posed for substantive regulation and the division of regulatory authority.

1. Choice of Investments

One of the risks associated with DC accounts is investment risk. In DB plans, employers that sponsored the plans typically determined, directly or indirectly, the investment allocation of plan assets. That made sense in a style of plan where the employer also bore the investment risk. In DC plans, however, individuals typically must make their own investment allocation decisions and bear the resulting risk. This assumption of risk becomes particularly perilous when individuals make undiversified bets in their account investments or choose the wrong type of retirement-specific account. If employees are given a choice of investments or accounts, the regulatory system must anticipate that not all employees will make efficient choices. The alternative, of course, is a paternalistic system that constrains employees’ ability to make investment choices. That too, though, requires regulatory consideration.

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128 This division of authority is detailed in a memorandum of understanding that allocates authority between the two entities. Memorandum of Understanding Between the Financial Services Authority and the Pensions Regulator (Apr. 6, 2005, as updated Oct. 2007), available at http://www.thepensionsregulator.gov.uk/pdf/moufsa.pdf.
131 Supra Section III.A.
132 Regulations permit plans to shift the investment risk from the plan sponsor to the individual account holders if minimum regulatory standards are met. For a discussion of the standards and other issues with delegation of investment choice, see Muir, supra note 39, at 8-10.
a. US - Employer Stock

In the US, legal issues relating to the investment of pension assets in the stock of the plan’s sponsoring employer were largely dormant, other than in the context of potential corporate takeovers and Employee Stock Ownership Plans, until two events occurred in rapid succession. Those events resulted in large losses in investments held in employer stock in retirement-specific accounts by employees of a variety of companies. The first event was the dramatic drop in the US stock markets after the bursting of the tech bubble in early 2000. The second event was the collapse of Enron Corporation in 2001, which was followed by a surge in governance and accounting scandals at other US companies.

Estimates of the amount lost by employees who participated in Enron’s 401(k) plan range from $1 to $2 billion. WorldCom employees allegedly lost more than $1 billion. Nor were losses limited to the companies that appeared at the top of news stories about corporate malfeasance around the turn of this century. An accurate count of the number of companies that faced claims by employees associated with use of employer stock in DC retirement-specific accounts is not available. However, legal commentators in the US appear to be unanimous in their view that the claims were widespread and of substantial importance.

In the employer stock cases, employees alleged wrongdoing against an array of individuals and institutions including the companies sponsoring the plans, individual plan fiduciaries, company directors and directed trustees. The legal claims brought under ERISA can generally be divided into three categories, all based in fiduciary obligation. As such, EBSA was the agency responsible for providing regulatory oversight and interpretation and it took an active role in some of the litigation.

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137 One typical allegation was that plan fiduciaries continued to permit the use of employer stock in the plan even after they knew or should have known that stock had become an imprudent investment. Second, plan fiduciaries allegedly made material omissions or misstatements in their direct or indirect communications with employees about the employer stock. Third, plaintiffs claimed that high level plan fiduciaries failed to properly appoint or monitor those lower level fiduciaries that had responsibility for decisions regarding communications or plan use of employer stock. Dana Muir & Cindy Schipani, *The Challenge of Company Stock Transactions for Directors’ Duties of Loyalty*, 43 HARV. J. LEGIS. 437, 459-60 (2006). Some cases have settled. See, e.g., Rankin v. Rots, No. 02-CV-71045, 2006 US Dist. LEXIS 45706 (E.D. Mich. June 28, 2006). Others have been dismissed for various reasons, including the unavailability of relief. In re McKesson HBOC Inc. ERISA Litig., 391 F. Supp. 2d 812 (N.D. Cal. 2005). The Fifth Circuit recently granted summary judgment in favor of an employer based upon limitations on the employer’s fiduciary duties and ERISA’s reflection of policy goals favoring investment in employer stock. Kirschbaum v. Reliant Energy, Inc., No. 06-20157, 2008 US App. LEXIS 9124, at *12, *21-34 (5th Cir. Apr. 25, 2008).
Employee losses in DC retirement-specific accounts were particularly large as a result of declines in value in employer stock. It was not unusual for account investments to be particularly concentrated in employer stock at companies that permitted or required such investments. As a result, some commentators have called for caps on the amount of employer stock that employees are permitted to hold in DC retirement-specific accounts. But, the problem of melt down in an undiversified investment applies across many investment options in retirement-specific accounts.

The employer stock cases do serve, though, to illustrate the distinctions drawn in the regulation of employer-sponsored retirement-specific accounts compared to generalized investment accounts and retirement-specific accounts not sponsored by employers. Assume an employee, Saver, invests $100 in the stock of Saver’s employer, Employer, through Employer’s 401(k) (a retirement-specific account) and another $100 in the same stock through a brokerage account (a generalized investment account). Saver loses most of the investment when the stock’s value drops. If Saver then alleges that Employer intentionally misrepresented its business prospects, Saver might bring a lawsuit for fiduciary violation under ERISA for losses in the retirement-specific account but would claim securities fraud under section 10b of the ’34 Act for losses in the generalized investment account. The agency responsible for regulatory oversight of the ERISA claim would be EBSA but the SEC would be responsible for oversight of regulation regarding securities fraud. Similarly, if an investor alleges fraud in a retirement-specific account not sponsored by an employer, EBSA would have no responsibility for oversight. Burdens of proof, the right to sue, and other litigation-related matters can be quite different between ERISA and securities law claims. Yet, Saver’s basic claim is the same in each instance – Employer intentionally misrepresented its business prospects. Perhaps the fragmentation is sensible but the question deserves a careful review as part of the reform of financial services regulation.

Another complication arises because of the different approach to regulation in the different types of investment accounts. Saver might claim that Employer’s misrepresentation was one of omission. Saver’s legal theory might be that the information Employer conveyed was misleading because it left out significant facts and thus what was communicated was misleading. Or, Saver might allege that Employer had information that Employer did not communicate to Saver but, if Saver would have known the information, Saver would not have purchased additional Employer stock or may have sold Employer stock. This scenario raises the question of whether ERISA’s general fiduciary provisions require more frequent or more extensive disclosure to employees holding stock in retirement-specific accounts than the securities laws require public companies to make to their employees.

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139 Susan J. Stabile, Freedom to Choose Unwisely: Congress’ Misguided Decision to Leave 401(k) Plan Participants to Their Own Devices, 11 CORNELL J.L. & PUB. POL’Y 361, 401 (2002) (“Finally, Congress should consider specific changes that would cabin participant choice, such as the adoption of limitations on acquiring employer securities.”).
140 Commentators have called for limitations or outright bans on the holding of employer stock in DC retirement-specific wrappers. See, e.g. The Evolving Pension and Investment World After 25 Years of ERISA: Hearing Before the Subcomm. On Employer-Employee Relations of the Comm. on Education and the Workforce, 106th Cong. 49-50 (2000) (statement of John H. Langbein, Professor, Yale Law School) (arguing for caps on employer stock); Jeffrey Gordon, What Enron Means for the Management and Control of the Modern Business Corporation: Some Initial Reflections, 69 U. CHI. L. REV. 1233, 1248-49 (2002) (arguing that the risk profile of undiversified holdings of employer stock may be incompatible with the tax incentives provided to those accounts). The US Congress has considered capping employee account holdings of employer stock but to date has refused to do so. Instead it enacted legislation in 2006 that requires plans to grant 401(k) account holders certain rights to diversify out of employer stock. The scope of those rights depend on whether the employer stock was purchased through employer or employee contributions. Stanley, supra note 52, at 208-09.
141 Muir & Schipani, supra note 135, at 343-51.
shareholders. 142 This question creates another layer of difficulty. If employees who hold stock in employer-sponsored retirement-specific accounts are entitled to superior disclosure as compared to general public shareholders then compliance with the disclosure requirements to the employees would violate the federal securities law prohibition on tipping and insider trading. Similarly, the employees’ resulting trades would violate the insider trading rules.

EBSA’s position on the insider trading issues has been that the ERISA and federal securities law obligations can be rationalized. 143 According to EBSA’s view, which has been accepted by a majority of courts, 144 companies must make public disclosures at the earliest time and to the highest standard of disclosure required by either ERISA or the securities laws. 145

Most of the reporting requirements under the federal securities laws impose quarterly and annual disclosure obligations. Even then, companies have wide latitude in not reporting material facts so long as the omissions do not cause the disclosures that are made to be misleading. So, for example, the securities laws typically would not require a company to report, mid-quarter, a significant decrease in sales or increase in costs. If, however, ERISA imposes an affirmative obligation on fiduciaries to report material information that investors in retirement-specific accounts would find important in making investment decisions, the fiduciaries would have to report the sales or costs information to the employee investors. Then the securities laws would require simultaneous reporting of the information to the public shareholders in order to avoid repercussions for the company and the employee investors under insider trading theories. The result is that implied reporting requirements under a pension law, which is interpreted by EBSA, would effectively require reporting of information by a company to all of its shareholders in numerous situations where the federal securities laws, as interpreted by the SEC, would not otherwise require reporting. That is not a totally incoherent result but it is an odd way to set public disclosure requirements.

The risks of choosing an investment strategy obviously derive from more than disclosure. As noted above, basic finance theory provides that employees who hold stock of their employer concentrate their risk by investing their human capital and financial capital in the same company. Empirical studies suggest that investing in company stock exposes employees to greater risks without

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142 The extent that ERISA’s fiduciary provisions require disclosure beyond the reporting requirements explicitly set forth in ERISA has been controversial. See Shelby D. Green, To Disclose or Not to Disclose? That is the Question for the Corporate Fiduciary who is also a Pension Plan Fiduciary Under ERISA: Resolving the Conflict of Duty, 9 U. PA. J. LAB. & EMP. L. 831 (2007); Andrew S. Hartley, Making the Case for Mandatory Removal of Imprudent Investment Vehicles: Inside Information Can Make Employer Securities a Bad 401(k) Option, 5 APPALACHIAN J. L. 99 (2006); Susan J. Stabile, I Believed My Employer and Didn’t Sell My Company Stock: Is There an ERISA (or ’34 Act) Remedy for Me?, 36 CONN. L. REV. 385, 416-17 (2004).


144 Not all courts have agreed. One court granted summary judgment to the defendants, suggesting that if the employer would have disclosed otherwise non-public information about the company to employees holding employer stock in their 401(k) accounts then the employer would have violated securities laws. The court refused to interpret ERISA as requiring pension plan sponsors to violate the federal securities laws In re McKesson HBOC Inc. ERISA Litigation, No. C00-20030 RMW, 2002 US Dist. LEXIS 19473, at *24 (N.D. Cal. Sept. 30, 2002) (stating that “fiduciaries are not obligated to violate the securities laws in order to satisfy their fiduciary duties.”); see also Kirschbaum, 2008 US App. LEXIS 9124, at *33-34 (referring to the potential of a securities law violation as a factor weighing against fiduciary liability).

commensurately compensating them for it.\textsuperscript{146} Nor do employees as a general matter seem to benefit from any increased access to information about their company. Research indicates that no correlation exists between employees’ elections to invest in company stock in their retirement-specific accounts and later performance of that stock.\textsuperscript{147} Wider access to investment advice on such basic investing concepts might help retail investors increase diversification and lower their risks.

The implications of investment advice go beyond addressing the concentration of assets in employer stock. A recent study of mutual fund investors by the Investment Company Institute found a variety of ways in which misunderstandings of finance and investing concepts appear to affect investor decision making. For example, 42 percent of investors responded that a mutual fund’s price per share was “very important” to their investment decision.\textsuperscript{148} Price per share, however, is dependent on the number of outstanding shares as well as on the value of the underlying assets. As such, it should not be on the top of an investor’s considerations when making an investment decision.

Regulation affects the availability of investment advice across the full range of an investor’s accounts. In the US, investment advisors are subject to EBSA regulation for advice given in employer-sponsored retirement-specific accounts and to regulation by the SEC for advice provided on other retirement-specific and generalized investment accounts. In some respects, the ERISA standards, being fiduciary-based, are the harsher of the two standards. As a result, it is a frequent practice for investment advisors to provide advice across the entire spectrum of an individual’s financial planning needs with the sole exclusion of employer-sponsored retirement-specific investment accounts.\textsuperscript{149} The outcome is likely to be a lack of an integrated investment strategy.

The problem in the US remains, though perhaps to a lesser extent, even after statutory changes in 2006, which were intended to expand 401(k) participants’ access to investment advice.\textsuperscript{150} Rather than eliminate differences in the standards governing advice or allocate authority to a single regulator, the legislative changes authorized advice to 401(k) plan account holders. The legislation improved access to investment advice but failed to address the underlying structural issue of regulatory fragmentation.

\subsection*{b. UK - Misselling}

As discussed above,\textsuperscript{152} the UK experimented as early as 1988 with giving individuals the right to opt out of certain government or employer-based retirement-specific accounts and instead to establish personal pensions. In some senses the choice of personal pensions gave individuals power over investments because they were able to choose any authorized financial services vendor to provide the personal pensions. The choice, also, though was one of participation. Individuals could choose what type of account, the government-sponsored scheme, the employer-sponsored scheme, or the personal pension, they preferred.

\begin{footnotesize}
\begin{enumerate}
\item[\textsuperscript{146}] See Lisa Meulbroek, \textit{Company Stock in Pension Plans: How Costly Is It?}, 48 J.L. \& Econ. 444 (2005).
\item[\textsuperscript{149}] See, \textit{e.g.} id at 12, 45 (finding that 73% of recent mutual fund investors obtained advice from professional advisors prior to investing but that the survey excluded investments made through employer-sponsored retirement plans).
\item[\textsuperscript{150}] See supra text accompanying notes 39-40.
\item[\textsuperscript{151}] In mid-2008, EBSA issued proposed regulations that would implement new standards for investment advice. Investment Advice--Participants and Beneficiaries, 73 Fed. Reg. 49895 (Aug. 22, 2008).
\item[\textsuperscript{152}] See supra text accompanying note 67.
\end{enumerate}
\end{footnotesize}
From the standpoint of demand, personal pensions were an immediate success. Financial services firms established commissioned sales programs and aggressively advertised their products. The marketing worked and individuals opened personal pensions at rates that far exceeded projections.153

When analyzed from the perspective of asset accumulation for retirement, however, an entirely different story on personal pensions emerges. Reports began to surface that sales of personal pensions were not complying with the relevant regulatory standards. In 1992 the Securities and Investments Board (SIB) reviewed a sample of the records associated with personal pension sales and found that only nine per cent substantially complied with regulatory rules.154 As a result of its concern, the SIB commissioned a study of industry practices. That study found “widespread regulatory compliance failure.”155

It was the marketing of personal pensions as an opt out from employer-sponsored retirement schemes that drew most of the regulatory focus. The investigations found that the records kept by the sellers of personal pensions were insufficient to demonstrate compliance with best advice and know your customer rules. Regulatory evaluations showed that numerous employees who had bought a personal pension would clearly and unambiguously have been better off in the offered employment-based pension scheme. Two factors tended to cause employment-based pension schemes to be more lucrative for most individuals who had that option. First, employers typically contributed to them but not to personal pensions. Second, the benefits formula of the employment-based pension schemes offered at the time typically were more generous than the investment growth that could be expected in a personal pension.156

Ultimately regulators required financial services firms that had sold personal pensions and independent financial advisors who provided advice to purchasers to undertake a two-part review process intended to identify misselling that occurred between April 1988 and June 1994. The priority phase covered older purchasers who were at or near retirement. Phase two extended to younger purchasers, who typically were younger than 50. As of June 2002, FSA estimated that the pensions industry would pay out £11.8 billion (approximately $20.1 billion at the current exchange ratio) after reviewing the records of 1.7 million customers.157

Professors Julia Black and Richard Nobles attribute the misselling to failures on the part of both the responsible regulators and the financial services firms involved in misselling. At the time, finger-pointing went both ways between the regulators and financial services industry. One allegation by financial services firms was that the regulators retrospectively changed the standards for suitability and know your customer requirements. Nobles and Black effectively explain that although additional guidance was eventually given by the regulators, that guidance constituted a more thorough explanation rather than a change in standards.158

Professors Black and Nobles chastise the regulators for failing, until the 1992 SIB audit, to focus their regulatory efforts on personal pensions as a product line. The regulators allegedly suffered from a lack of expertise with personal pensions, which constituted a new line of products. Instead of watching for patterns of problematic activity in personal pensions, the regulators established review processes that tended to focus on the behavior of particular financial services

153 See supra text accompanying note 68.
154 Richard Nobles & Julia Black, *The Privatization Process: Pensions Mis-selling – The Lessons for Regulating Privatised Social Security*, 64 BROOKLYN LAW REVIEW 933, 939 (1998). The SIB was one of a number of entities later combined to form the FSA.
firms. According to Professors Black and Nobles, the regulators emphasized reviews of the activities of internal firm controls. As a result, the regulators missed the problems that existed across the financial services industry in the marketing and sale of personal pension accounts. Both the government inquiry and Nobles and Black concluded that the incentives for aggressive sales created by the commission salary structures for salespeople were at the heart of the industry-wide misselling.159

Finally, the government inquiry concluded that division of authority among multiple regulators created coordination problems among the regulators.160 During the misselling period, responsibility was divided among three regulators. Lautro, which regulated insurance companies, and Fimbra, which regulated financial advisors, both were self-regulatory organizations. The primary governmental regulator was SIB, which regulated the banks and the equivalents of US credit unions.161 The UK’s transition to a single regulatory financial system was undertaken in stages, starting with SIB’s formal change in name to the Financial Services Authority (FSA) in 1997. FSA subsequently usurped regulatory powers from other agencies, acquiring Bank of England’s responsibility for banking supervision in 1998, taking the role of UK Listing Authority from the London Stock Exchange in 2000, and assuming responsibility for mortgage regulation and general insurance business in 2004.162

**c. Australia – A “Bad” Investment**

Australians received the right in 2005 to direct the investment of assets in their retirement-specific accounts.163 To date, individual investment directions have not generated a great deal of reported controversy. One recent case, however, illustrates how the Australian system addresses an investor’s claim that his money was improperly invested. In the case, the investor, Mr. Wallace, alleged that the trustee of his account did not follow his verbal direction to convert the investments in his account from “high risk, high tech” shares to a more “secure portfolio.”164 Between the time that the trustee allegedly should have implemented the direction in March 2000 and February 2001 Mr. Wallace’s account lost its entire value of over $380,000.165

The claim was initially heard by the Australian Superannuation Complaints Tribunal (Tribunal), a specialized tribunal authorized to hear benefits-related disputes. In a decision later reversed on other grounds,166 the Tribunal found in favor of Mr. Wallace. Its decision, though, was not based on the trustee’s failure to follow Mr. Wallace’s purported investment direction. Instead, the Tribunal

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159 Id. at 947-951; Select Committee on Treasury, supra note 156, at 3.
160 Select Committee on Treasury, supra note 156, at 3.
161 Nobles & Black, supra note 154, at 936-37.
163 Supra text accompanying notes 82-83.
164 Perpetual Trustees Australia Ltd. V. Wallace FCA 527, BC200702612 (2007).
165 Id.
166 The Tribunal’s jurisdiction is conferred by the Complaints Act, which the court interpreted as confining the Tribunal’s jurisdiction to the review of discretionary decisions. The real issue in the context of the appeal was whether the respondent’s claim was a claim against the Fund or a claim against the Trustee. If it was a claim against the Fund, then the discretion was involved and the exercise of that discretion by the Trustee was within the Tribunal’s jurisdiction of review. The court ruled in this case, however, that the claim was against the Trustee (not against the Fund) since there were no true assets left in the Fund by the time the claim was made in 2004. Thus, the Tribunal had no jurisdiction under the Complaints Act to address the complaint. Perpetual Trustees Australia Limited, FCA 527.
considered whether the trustee breached its legal duty in adopting the initial investment strategy, which permitted a pensioner aged 70 to invest nearly his entire retirement-specific account in highly speculative stock. The Tribunal found that trustees have an obligation to ensure that the investment strategy was correctly formulated for the individual circumstances of the investor.\textsuperscript{167} In Mr. Wallace’s circumstances the original aggressive investment strategy was considered too aggressive. Although Australian case law is limited, the Wallace case indicates that Australia takes a significantly more paternalistic approach to the selection of investments for retirement-specific accounts than does the US.

2. Account Fees

Along with the rates of contributions and return on investment, account and investment fees fundamentally impact the accumulation of assets in all types of investment accounts. In the world of traditional economic theory and perfect markets, one would expect rational investors and fiduciaries to consider fees as a factor in the selection of investment products and account services.\textsuperscript{168} Behavioral economics, however, has offered a number of possible explanations for how and why traditional economic theory breaks down in situations involving decision making and have focused particular efforts on retirement-specific accounts.\textsuperscript{169}

The UK anticipated the problem of inefficiently high account fees when it established stakeholder pensions. At the time they were first made available for investment in 2001 the UK capped stakeholder scheme charges at 1.0 per cent per year. Effective in 2005 the UK increased the cap to 1.5 per cent a year for the first 10 years of a customer account. Thereafter the account fee cap drops back to 1.0 per cent.\textsuperscript{170}

In the UK a recent study of fees charged by stakeholder plan default funds implies that the regulatory caps have had a significant impact on account fees. Expectations based on general fee data would lead to the expectation that the approximately fifty per cent of default funds which utilize a passive investment style would have lower fees than the default funds that consist of actively managed funds. The actual modal investment fee however is 1.0 per cent across both active and passive default funds. It appears from this data that, in practice, the fee cap has been established as a floor for stakeholder scheme fees. The mean charge of passive default funds is 20 basis points lower than the mean for active default funds, which is somewhat more in accordance with expectations. And a number of other factors may impact the fees charged, including the level of services provided by the scheme and the size of the employee population at a particular workplace.\textsuperscript{171} But, the point remains that available data indicate that regulation has had an impact on account fees.

\textsuperscript{167} Id.


\textsuperscript{170} Alistair Byrne, et. al, Default Funds in UK Defined- Contribution Plans, 63 FIN. ANAL. J. 40, 48 (2007).

\textsuperscript{171} Id.
To date the US has failed to adopt legislation directly addressing 401(k) account fees. This author was a member of the 2004 EBSA Advisory Council working group that studied the disclosure of account fees in 401(k) accounts. The working group published a report, which included both factual findings regarding failings in current fee disclosures and recommendations intended to enhance fee disclosure. The issue was widely recognized as a concern. After evaluating a variety of problems with current methods of disclosing, or failing to disclose, fees in 401(k) plans, one commentator observed that “[t]he disclosure of fees paid by 401(k) participants currently is closer to what behavioral economics would prescribe for hiding information than it is to clear, informative disclosure.”

In 2006 plan sponsors were forced to pay attention to the fees question after a number of lawsuits were filed alleging that 401(k) plan fee structures violate ERISA’s general fiduciary requirements. Some of the suits claim that plan fiduciaries violated their ERISA obligations by failing to understand or capture for the plan fees paid by one plan service provider (such as a mutual fund) to another service provider (such as a record keeper). Suits also have presented claims that plan fiduciaries failed to appropriately consider the fees charged by plan investment alternatives and, thus, did not make prudent selections of available investment options.

3. Default Investments

There are a variety of routes through which individuals with employer-sponsored retirement-specific accounts may have their account assets allocated to a default investment. Default investments raise both of the issues just analyzed – selection of the investment vehicle and the amount of plan fees. If an employee’s assets are invested into a default investment vehicle, someone had to choose what that vehicle would be. And the fees associated with that vehicle will affect the employee’s investment returns.

In the US, the terms of a 401(k) plan may include automatic enrollment. If an employer adopts automatic enrollment, new employees are enrolled automatically in the 401(k) plan unless they affirmatively opt out of the plan. Research and experience indicates that such automatic enrollment features help overcome employee inertia and thereby increase the take-up rate for 401(k) plans. Plans with automatic enrollment, though, need to determine a default investment for the contributions of those employees who are enrolled under the automatic feature. Similarly where an employee enrolls in a 401(k) plan or transfers funds from another plan but does not select among available investment options, the plan must default contributions to an investment vehicle.

Although issues associated with default investments had been observable in 401(k) plans since those plans became popular, EBSA did not issue guidance on default fund selection until October 2007. Prior to that guidance, survey data showed that forty-five per cent of US 401(k) plans provided for a stable-value fund or money-market fund as the default. The goal of selecting stable-value or money-market funds as default funds tends to be the preservation of capital as opposed to investment growth. Such conservative default investments have been heavily criticized particularly for younger investors. The 2007 guidance, in the form of regulations issued by EBSA, established a safe harbor protecting an employer from liability if the employer selects a default fund that possesses the characteristics of what EBSA terms a Qualified Default Investment Alternative (QDIA). An employer may, however, at its own risk designate as a default fund a fund that is not a QDIA. With

172 Turner, supra note 51.
176 Id.
the exception of investments that pre-date the regulation and investments during the first 120 days of an employee’s participation in a 401(k) plan, a QDIA must consist of a mix of investments that take into account either the characteristics of the individual account holder or of a group of employees.

An example of the use of default investments in the UK occurs in employer-selected stakeholder schemes. In order to meet the minimum requirements of a stakeholder scheme, the employer must designate a default investment vehicle. In the UK, a recent study of the stakeholder pension plan schemes registered with TPR as of December 2006 found that the default funds offered in those schemes are less uniform than one might expect. The study reviewed default funds selected by financial services firms that developed stakeholder pension products. When an employer chooses a particular stakeholder scheme, that employer has the option of designating a default fund that is different from the default fund selected by the financial services firm. The data indicate, however, that most employers accept the default option suggested by the financial firm that packaged the stakeholder pension product.

Among the registered stakeholder pension products, the default funds were almost evenly split between actively and passively managed funds. A few default funds were styled as UK equity funds but the majority were evenly divided between global equity funds and balanced funds. It is difficult to rationalize these significant differences in the types of funds chosen by financial services firms as default funds. A firm that markets a given stakeholder scheme typically markets that scheme to a wide variety of employers with various employee demographics. Perhaps the financial services firms do not agree on the appropriate type of default fund for the average individual who opens a stakeholder pension account. Or the firms may not be in agreement over the typical earnings, other investment holdings, risk tolerances and other characteristics of the average individual account holder. In the absence of specific rationales for the difference in the types of default funds chosen, however, some of those selections must be less than optimal.

In addition to its requirement that stakeholder schemes establish a default fund, in 2005 the UK began to require that every stakeholder default fund utilize a life-cycle profile. By ensuring that years remaining to retirement age is a consideration in the structure of a default portfolio, the requirement addresses some of the concern over the variance in default funds. Implementation of the life-cycle requirement is not totally uniform across stakeholder schemes but the vast majority of the schemes begin increasing the percentage of bonds and cash held in a portfolio between 5 and 10 years prior to retirement.

V. Regulatory Reform – Strategies for Addressing Risk in Retirement-Specific Accounts

The Blueprint approach to reform of the regulation that governs the US financial services sector concentrates on reorganizing responsibilities among existing and newly created federal agencies. Some of the focus, as it should be, is on the operation of the financial markets. Other ideas, at least in the Blueprint, are to decrease the jurisdiction of the SEC and create a new regulator of business conduct. Similarly, the Blueprint calls for creation of a prudential regulator and for federalization of some insurance regulation that is now the province of state regulators. In assigning responsibilities and in eventually developing the substantive regulation to be overseen by the SEC, the new business conduct regulator, and new prudential financial regulator, policymakers

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178 Byrne, supra note 170, at 42.
179 Id. at 42-43.
180 Id. at 42-45.
181 BLUEPRINT, supra note 3, at 137-38.
182 Id. at 137.
183 See infra note 188.
must determine the role these regulators will have with respect to retirement-specific accounts, particularly those accounts that are part of employer-sponsored plans. Effective regulation also will need to recognize the risks associated with retirement-specific accounts and the relationship of those risks with generalized investment accounts.

The Blueprint identifies regulation of the relationship between financial institutions and financial services customers as the province of the new business conduct regulator. That regulation would have two functions in governing the relationship between institutions and customers. Its first role would be to regulate disclosure practices. Second, it would regulate the institutions’ conduct of business practices.\(^1\)

In thinking about why – or if -- financial products and the entities that develop, market, sell, and trade those products should be regulated at all, some economists have suggested two roles for regulation. One role is to circumscribe the conduct of business to ensure fairness and appropriate disclosure.\(^2\) The second role is to ensure the financial system and the financial actors are fiscally sound.

### A. Disclosure

Whether they invest in retirement-specific accounts or in generalized investment accounts, disclosure occurs at two levels. Both levels can be seen as addressing information asymmetries, which are pervasive in capital markets. One level of disclosure applies to the investment product – for example, a specific mutual fund, the stock of a particular company, or a certificate of deposit – that the investor purchases. All retail investors, regardless of the type of account in which they hold assets, arguably require access to basic information about investment products, including the risk profiles, fees, and returns associated with those investments.\(^3\) Second, the investors arguably require access to information that would enable them to understand the terms of the accounts that will hold the investments. For generalized investment accounts that may be a brokerage account or a bank account. For retirement-specific accounts, terms of 401(k) plans are set by an employer or a financial services firm will have set terms of a product unrelated to employment such as an IRA.

Responsibility for implementing disclosure requirements for investment products in the US has been fragmented both within the realm of generalized investment accounts, a fragmentation the Blueprint recognizes,\(^4\) and between those accounts and retirement-specific accounts, a

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1. Id. at 170. The business conduct regulator would have a third function as well, chartering and licensing providers of financial products and services. Id.
2. Id.
4. Stewart, supra note 185, at 44-45.

There has been considerable scholarly debate about the value of disclosure to retail investors. See, e.g. Stephen J. Choi & A.C. Pritchard, Behavioral Economics and the SEC, 56 STAN. L. REV. 1 (2003) (suggesting that the inefficient behaviors identified by behavioral economics decrease the value of information); Jill E. Fisch & Hillary A. Sale, The Securities Analyst as Agent: Rethinking the Regulation of Analysts, 88 IOWA L. REV. 1035 (2003) (identifying conflicts of interest that inhibit the independence of securities analysts); Romano, supra note 185 (arguing that investors could would choose an efficient amount of disclosure if markets allowed ‘competition’ on that basis); Cynthia A. Williams, The Securities and Exchange Commission and Corporate Social Transparency, 112 HARV. L. REV. 1197, 1311 n.3 (1998) (recognizing that while mandatory disclosure has a long history in US securities regulation, “aspects of it are still controversial”).

5. Blueprint, supra note 3, at 170 (“Currently, various federal, state, and SROs supervising banking, insurance, futures, and securities activities have responsibility for promulgating and implementing consumer disclosure regulations and standards.”).
fragmentation the Blueprint does not explicitly recognize. The Blueprint is specific in establishing a
goal to consolidate responsibility for disclosure requirements for generalized investment accounts.
However, it is not clear whether it intends that consolidation to include responsibility for the disclosure
requirements over retirement-specific accounts. Such a consolidation would represent a significant
depture over the current approach.

Mutual funds provide the best example of the current divergence in regulatory responsibility
and substance. As noted above, in 2007 twenty-four percent of mutual fund investments were held in
a DC retirement-specific account. The SEC has primary responsibility for the regulation of mutual
funds, with its powers over mutual funds derived from the Investment Company Act. In 1998 the
SEC adopted a simplified form of disclosure for use by mutual funds, the profile prospectus or fund
profile, which the SEC hoped would make basic information about specific mutual funds more
accessible to investors. That simplified disclosure was available to mutual funds purchased
to through generalized investment accounts. In addition, the SEC announced when it permitted the
simplified disclosure that it expected information in that format to be particularly useful to individuals
saving in retirement-specific accounts. The result, however, has been characterized as “an
abysmal failure . . . in the retirement plan market.” That lack of success probably occurred, at least in part, because EBSA never explicitly approved the profile prospectus for use in the most popular
types of employer-sponsored retirement-specific accounts, those where employers delegate
investment choice and responsibility to their employees.

In November 2007 the SEC began another effort to simplify mutual fund disclosures, again
with the hope of making disclosures more useful to investors. This time the SEC voted in favor of
implementing what it refers to as short-form prospectuses. This shorter, more focused, version of the
full prospectus would meet the securities law requirement that a prospectus be delivered prior to or
contemporaneous with a mutual fund investment. The SEC made clear, by permitting specific
legending that would refer to DC retirement-specific accounts, that it hoped the short-form
prospectuses would be used to inform investors who considered buying mutual funds in those
accounts. That action put the ball in EBSA’s court to approve, ignore, or modify the use of short form
prospectuses in DC retirement-specific accounts.

In July 2008, EBSA responded when it issued proposed regulations, which address a variety
of disclosure issues that had been simmering for some time. Those proposed regulations eliminate
the former requirement that investors who purchase mutual funds through retirement-specific
accounts receive a prospectus prior to making the investment, a requirement that was widely

189 Supra text accompanying note 35.
190 Investment Company Act of 1940, 17 C.F.R. § 270.2a-7 (2001).
192 Mutual Fund Regulation in the Next Millennium Symposium Panels: II. Disclosure, 44 N.Y.L. Sch.
193 Id.
194 Id. at 470-71.
195 Enhanced Disclosure and New Prospectus Delivery Option for Registered Open-End Management
197 Pete Swisher, Death to the Prospectus Requirement! The New 401(k) Participant Disclosure
43014, 43040 (proposed July 23, 2008) (to be codified at 29 C.F.R. pt. 2550.404a-5(d)(4)(i)).
of this prospectus-on-request requirement, the EBSA proposed regulation states that a prospectus 
“(or any short form or summary prospectus, the form of which has been approved by the [SEC])”\(^{199}\) 
must be provided. This implies that that a short-form prospectus would only need to be provided to an 
investor who specifically requests the short-form.

It appears, then, that the SEC and EBSA disagree about the value of a simplified mutual fund 
disclosure document. The SEC requires disclosure for all mutual fund sales. EBSA requires 
disclosure only if the investor requests a prospectus. As a result, if the individual from our earlier 
example, Saver, purchases mutual funds though a standard brokerage account or directly from a 
mutual fund, SEC guidance requires that Saver receive a short-form prospectus. If Saver buys the 
same mutual fund through a retirement-specific account, Saver will not automatically receive a 
prospectus. Rather, Saver has the right to request a prospectus or short-form prospectus, assuming, 
of course, that Saver knows to make the request and understands the difference between a full 
prospectus and a short-form prospectus.

From a coordination standpoint, the proposed EBSA regulations are an improvement over past 
practice in that the proposed regulations explicitly accept forms of prospectus that are approved by 
the SEC. It has, however, taken 10 years from the implementation of the SEC’s fund profile to get to 
the point where EBSA formally accepts through regulation an SEC summary form of prospectus.\(^{200}\) 
And, differences in delivery requirements remain. Perhaps these differences in prospectus delivery 
requirements between retirement-specific and generalized investment accounts serve an important 
policy function. However, what that policy might be is not clear on the face of the regulations or in 
statements by the regulators. Nor, does the difference in requirements between the two types of 
accounts appear to be the product of coordination and agreement between the SEC and EBSA.

The difference in prospectus delivery requirements is only one recent example of the 
differences between disclosure requirements in investor accounts regulated by EBSA as compared to 
those regulated by the SEC. EBSA requires that information about investment options be presented 
in a particular, tabular format.\(^{201}\) As explained above, the amount and disclosure of investment 
account fees has troubled policy makers in the UK and Australia as well as the US. In 2008 EBSA 
issued proposed regulations detailing new account fee disclosure requirements in retirement-specific 
accounts.\(^{202}\) At the same time, but not necessarily in tandem, the SEC has been working on 
regulation of account fee disclosure in generalized investment accounts.\(^{203}\) Similarly, disclosures of 
conflicts of interest by investment advisors and other advisor regulation differ depending on whether 
the account under advice is a retirement-specific account or a generalized investment account.\(^{204}\)

These examples of tensions between the disclosure requirements imposed by securities law 
on the marketing and sale of investments on the one hand and the disclosures imposed by ERISA are 
not intended to be all inclusive. Instead, the point is that the fragmentation of responsibility for setting 
disclosure standards has led to inconsistencies and likely to inefficiencies. If the restructuring of 
financial services regulation results in the formation of a new business conduct regulation then careful 
attention should be given to the way authority for disclosure and other regulation related to the sale 
and purchase of investment products is divided between that regulator and EBSA.

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199 Id.
200 EBSA had technically permitted the use of the most recent profile prospectus, however, the 
consensus of lawyers was to advise plan fiduciaries not to rely on dissemination of profile 
prospectuses. See Fiduciary Guidance Counsel (Mar. 2008) (“Even if a retirement plan’s fiduciary is 
completely confident that the profile prospectus is the “most recent prospectus”, a cautious person 
shouldn’t rely on this strained interpretation.”).
201 See Fiduciary Regulation for Disclosure in Participant-Directed Individual Account Plans, 73 Fed. 
Reg. 43014, 43040 (proposed July 23, 2008) (to be codified at 29 C.F.R. pt. 2550.404a-5(d)(4)(i)).
204 See supra text accompanying note 149.
Differences in regulators and in substantive regulation also occur at the level of disclosure of the account terms (as compared to disclosure of the terms of the investment product). Although regulatory responsibility for setting the terms of employer-sponsored retirement-specific accounts—terms that are found in the benefit plan established by employers—is divided between the IRS and EBSA, EBSA has authority over the disclosure of those plan terms. Those disclosures have not tended to be particularly problematic either from the standpoint of their substantive content or in regulatory overlap. Substantively, the employee investors must receive information on the terms governing the accounts, such as how much they can save in these plans, whether the employer makes any contributions, whether they have access to the funds prior to retirement or other separation, and process-related concerns such as how they change investments or elect to receive their funds when the plan distributes their account assets. Certainly, errors and even malfeasance may occur in making these disclosures, but there are no indications of widespread systemic problems. An exception has been the recent attention, and litigation, over disclosure of account-level fees. EBSA has addressed that fee reporting in the proposed regulations on disclosure discussed above.

In the realm of generalized investment accounts, regulatory responsibility for oversight of disclosure of the account terms is splintered as it is with respect to products disclosure. It appears that the Blueprint would also consolidate regulatory authority over this level of disclosure under the authority of the new business conduct regulator. The Blueprint defines one of the key roles of the business conduct regulator as being the development of “adequate disclosures for all types of financial products and services.” It specifically recognizes the wide dispersion of existing authority over disclosures and indicates that consolidation of the regulatory oversight could increase the uniformity in disclosure approaches. This would have the benefit of rationalizing those disclosures so that investors can compare types of accounts as well as types of investment products.

It is even less clear at the level of account disclosure than it is at the level of investment product disclosure whether EBSA’s role should be assigned to the business conduct regulator as part of the redistribution of responsibility for financial services regulation. Through their regulation of benefit plans, EBSA and the IRS share responsibility for setting the terms of retirement-specific accounts. Arguably, given EBSA’s expertise in allowable plan terms it would be best positioned to develop disclosure requirements.

The line between EBSA expertise in employer-employee relationships as they extend to employee benefit plans and the SEC’s investment expertise, and which is more applicable is not always clear. Behavioral economics research shows that use of particular kinds of default provisions can increase participation, contribution, and appropriate investment choice in retirement-specific accounts. For example, automatically enrolling new employees in these accounts, automatically deducting contributions to the accounts from their wages, and investing the assets in particular

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206 See supra text accompanying notes 197-99.

207 See Swisher, supra note 197, at 2.

208 See BLUEPRINT, supra note 3, at 170.

209 Id. at 170. Regulation of the disclosure obligations of companies about the companies themselves, as compared to about financial products offered by the companies, would to be the province of the corporate finance regulator. This authority would include the oversight currently done by the SEC over corporate disclosure, corporate governance and auditing. Publicly held financial services firms would be subject to the same disclosure, governance, and auditing requirements as other publicly held companies. Id. at 145.

210 Id.
financial products all can positively affect the accumulation of retirement assets.\textsuperscript{211} In 2006 Congress amended ERISA to remove barriers to the use of these types of default provisions and to encourage their use.\textsuperscript{212} Automatic participation and investment account terms do not have a clear parallel in generalized investment accounts.

For disclosure matters, the UK and Australia have generally resolved the tension between consistency and specialized workplace expertise in favor of consistency. Both countries have consolidated authority for regulation of disclosure to investors. In the UK, the FSA, which regulates all types of investment accounts, has responsibility for ensuring that investors understand financial products and markets.\textsuperscript{213} Similarly, in Australia, APRA regulates disclosure by the financial services sector to investors regardless of whether the investments are held in retirement-specific accounts or in generalized investment accounts.\textsuperscript{214} One difference, though, among the US, UK and Australian pension systems in general is the amount of discretion that employers have over plan terms. Australia, which mandates a minimum employer contribution level, gives employers the least discretion. The US, which does not require any employer to offer either a DB or DC pension plan, gives employers the most discretion. That increased discretion may affect the balance between the importance of consistency and specialized workplace expertise.

B. “Business Practices” and Retirement-specific Accounts

In addition to authority over disclosure standards, the Blueprint would grant the business conduct regulator oversight responsibility for the substantive conduct of business practices. This responsibility would include regulation of the sales and marketing of financial products. Presumably, this authority also would extend to account maintenance and administration. Currently, as is true of regulation of disclosure, that authority is splintered among a variety of regulators depending on the particular financial product in question. The stated goal of consolidation of regulatory authority over the business practices of financial institutions is, as with other areas of consolidation, “greater consistency.”\textsuperscript{215}

EBSA currently has regulatory responsibility over all fiduciary activities connected with retirement-specific accounts and ERISA’s definition of fiduciary is unusually broad. The effect of those standards has been seen more clearly in the employer – financial services firm relationship than in the employee – financial services firm relationship. Competitive sales and marketing of investment products directly to investors in employer-sponsored retirement-specific accounts has not been extensive in the US. As a result, the US has not experienced widespread problems of the type that occurred in the UK in the misselling scandal. Instead, sales and marketing of investment products has typically focused on the employers that sponsor DC plans because those employers choose the investment options that are made available to the individual employees. Employers typically select a limited menu of mutual funds from one or a small number of fund families. Thus, the marketing competition among financial services firms occurs in the environment of the employer’s decision making. In recently proposed regulations, EBSA made clear that it believes that employers’ selection and ongoing monitoring of investment products constitutes a fiduciary function and is within EBSA’s oversight responsibility.\textsuperscript{216}


\textsuperscript{212} Pension Protection Act of 2006, § 902, adding 26 U.S.C. §§ 401(k)(13), 401(m)(12), & 414(w).

\textsuperscript{213} See supra text accompanying note 124.

\textsuperscript{214} See supra text accompanying note 120.

\textsuperscript{215} ld. at 170; see also Swisher, supra note 3, at 2.

\textsuperscript{216} 73 Fed. Reg. 43014.
Another subset of business practice concerns, however, occurs in the administration of retirement-specific accounts. The potential for problems varies depending on an assortment of factors such as the type of entities responsible for processing transactions and the type of investment. It appears that the business practices regulator would receive authority over all of these activities for generalized investment accounts. Currently, EBSA has regulatory responsibility and ERISA governs these activities in retirement-specific accounts. Here again, the fragmented regulatory approach produces outcomes dependent on whether investments are made in retirement-specific accounts or in generalized investment accounts.

Consider, for example, a situation where the investor directs the proper entity to liquidate one investment product and move the assets into another product. Assume the entity negligently or intentionally fails to follow the investor’s direction, creating a loss of $150,000 to the investor.\textsuperscript{217} If this were to occur in a standard brokerage account, currently the investor would pursue a claim through the securities industry self-regulatory organization, FINRA, which sponsors mediation and arbitration programs to address such disputes. The SEC has oversight over FINRA and could pursue widespread problems using its own authority. It appears that self regulatory organizations such as FINRA would continue to play a role in a reformed financial services regulatory framework and would be overseen by the business practices regulator. In comparison, the investor’s ERISA claim is a complicated one. Until 2008 there was a question of whether an investor had any rights to bring a fiduciary breach claim for such losses to the retirement-specific account. The Supreme Court resolved that in the affirmative.\textsuperscript{218} The fiduciary standards and remedies, however, remain governed by ERISA and are under the regulatory jurisdiction of EBSA.\textsuperscript{219} As a result, the investor’s recovery to the plan account may be limited and there may be no other remedial options.\textsuperscript{220}

The UK and Australia have consolidated regulatory authority over the business practices of financial services firms using the same principles each country used for assignment of regulatory oversight of disclosure. In the UK, the FSA has regulatory responsibility for the administration of all individualized investment accounts regardless of whether they are retirement-specific accounts.\textsuperscript{221} Similarly, investors make their complaints about the administration of investments to the Financial Ombudsman Services (FOS). According to the MOU between the FOS and the PO, “FOS deals with complaints and disputes which predominantly concern the sale and/or marketing of both personal and occupational pensions.” Thus, the UK has consolidated regulatory authority for sales and at least much of the administration of financial products under a single regulator.\textsuperscript{222}

Australia likewise confers regulatory authority over the administration of all individualized investment accounts on the ASIC. This is part of ASIC’s very broad authority, which extends over all corporate entities in Australia including those entities involved in the provision of products and services to investors in retirement-specific accounts. ASIC’s responsibilities include prevention of “misleading or deceptive and unconscionable conduct in relation to [retirement investment] products and advice.”\textsuperscript{223}

\textsuperscript{217} The facts are loosely drawn from \textit{LaRue v. DeWolff, Boberg & Assoc.}, 128 S. Ct. 1020 (2008).
\textsuperscript{218} \textit{Id.}
\textsuperscript{219} \textit{See id.}
\textsuperscript{221} \url{http://www.thepensionsregulator.gov.uk/pdf/moufsa.pdf}; \textit{see also The Governance of Work-based Pension Schemes}, at 42 (“From April 2007 the establishment, operation and winding up of all personal pension schemes are activities regulated by the FSA.”), \textit{available at http://www.thepensionsregulator.gov.uk/pdf/discussionPaperGovernance.pdf.}
\textsuperscript{222} An exception that might be considered the regulation of account administration might be the fees charged to accounts. The relevant MOU confers regulatory jurisdiction on TPR for “compliance with the charge cap.” \url{http://www.thepensionsregulator.gov.uk/pdf/moufsa.pdf} p. 4.
\textsuperscript{223} Parliamentary Joint Committee on Corporations and Financial Services, \textit{The Structure and Operation of the Superannuation Industry}, 9 (Aug. 2007).
C. Principles for Rationalizing Regulation of Retirement-Specific Accounts

The movement to DC retirement-specific accounts and the resulting tension in the regulation of those accounts as compared to generalized investment accounts means that decisions on allocation of regulatory authority and substantive regulation over retirement-specific accounts should be made as part of any broad reform of the US system of oversight of the financial services sector. At this stage, reform of that regulatory framework remains a glimmer in the eyes of policymakers, academics, and commentators. As it moves forward, a few basic principles can help guide reform in a way that supports the accumulation of retirement wealth. Inherent tension exists, however, in those basic principles, which will require reformers to balance a variety of values.

Coordination is one guidepost that encompasses principles important to efficient and effective regulatory oversight. For example, coordination of the reporting and disclosure regulations that push investment performance information to retail investors, whether those investors hold assets in retirement-specific accounts or in generalized-investment accounts, enhances efficiency for both financial services firms and investors. Coordinated requirements allow firms to minimize costs associated with either complying directly with multiple disclosure regimes or trying to ensure that a single set of disclosures meets the minimum standards of each applicable set of requirements. For investors, coordination minimizes confusion that may result from receiving significantly different communications for different categories of investment accounts. Other areas where coordination should reduce inefficiencies include communications regarding purchases, fees, and distributions, marketing, and methods of claims resolution.

Coordination can minimize the costs of multiple agencies devoting resources to identical issues. It also can reduce the number of touch points that a financial services firm has with regulators. Development and maximization of regulatory expertise is also supported by consolidation of regulatory function. For example, a regulator can leverage its experience in dealing with risk mitigation across similar products and types of investors. Consider the risks of insolvency and nonpayment. Those risks are substantially similar in an investment account regardless of whether it is a DC retirement-specific account or a generalized investment account. In an employer-sponsored account, the employer must ensure that its contributions and any employee contributions are properly forwarded to the appropriate plan agent. The result is that there is some additional risk at that level in employer-sponsored plans. But, otherwise, the accounts share similar characteristics. There is no reason to believe that the evaluation of financial reserves and other mechanisms to offset insolvency risk are substantially different in the context of retirement-specific accounts than they are with respect to other investment products.

Finally, coordination should minimize the opportunity for financial services firms to exploit regulatory differences between types of accounts. For example, if fees are capped or required to be disclosed in different ways in one set of accounts, that may permit an opportunistic financial services firm to exploit the differences by offering different financial products in those accounts as compared to other accounts. Similarly, if the law permits class actions for those who hold financial accounts in one type of account but not in another, investors or financial services firms may exploit those differences to the detriment of allocational efficiency.

As important as coordination is, the value gained through coordination may not outweigh the alternative of specialized, more focused regulation. A counter force to the values associated with coordination can be found within the underlying policies reflected in tax incentives, which are intended to increase the number of Americans who save for their retirement and how much they save. In the past, for example, the goal of increasing long term savings has resulted in restrictions on the early withdrawal of retirement-specific account assets. On the other hand, the notion that the tax incentive is intended to benefit the saver’s retirement, not the saver’s estate, has led to minimum distribution requirements to reduce the use of those accounts as estate accumulation devices. These retirement-specific account requirements tend to operate at the plan level rather than at the investment level. As
such, they are part of the set of rules that wraps around retirement-specific accounts and governs the eligibility of those accounts for tax-favored treatment.

Some commentators have argued that the tax support and policy goals inherent in retirement accounts mean it is appropriate for those accounts to be treated more paternalistically from a regulatory perspective than non retirement-specific accounts are treated.224 Similarly, as discussed above, Professors Nobles and Black argue that one factor in the misselling scandal in the UK was the failure of the relevant regulators, all of which had responsibility for aspects of investments and financial services firms, to focus on the unique issues associated with personal pensions.225 The gist of this concern is that regulators without particular expertise in the nuances of retirement-specific accounts will miss risks that are specific to those accounts and to the goal of building wealth for retirement. On a related front, research by behavioral economists shows that establishing retirement-specific accounts in which employees participate by default are effective in increasing savings in those accounts. Since 2006, legislation and regulation of retirement-specific accounts has begun to address barriers that discouraged employers from utilizing default provisions in the 401k and other plans they establish. The US system of retirement wealth accumulation is so fragile that it is important that regulatory reform, as it is put in that well-worn phrase, do no harm.

Another view of coordination is to look at coordination across the employer and employee relationship. Here, the touch points that may matter are the touch points of an employer when dealing with workplace regulators, or the touch points that an employee faces when trying to resolve work-related compensation disputes. The consequences for employers and employees may increase the value of coordination across the workplace regulators.

The level of employer intermediation in retirement-specific accounts distinguishes the US approach from the situation in Australia. Both the UK and US have traditions of pension programs being embedded in the workplace. In that context the employer’s retirement-specific account actions are a dimension of the employer-employee relationship. If the sponsorship of those plans becomes too onerous, employers may shift away from DC plans or stop sponsoring plans that contain retirement accounts. Most commentators think that the increase in regulation of DB plans was a factor in the decrease in sponsorship of DB plans.226 Unless, reform of regulation of financial services firms is coupled with reform of the US’s voluntary DC system,227 the risk of decreased employer sponsorship must be considered. The amount of employer intermediation, however, is much lower in DB retirement-specific plans, where the employer makes investment and other risk-related decisions than in DC retirement-specific account plans where those decisions are made by employees.228

Finally workplace-based retirement-specific account schemes in the US have traditionally been used by employers as workplace management tools. In industries where workforce stability was important, DB plans were implemented to increase employee retention. When workforce reductions were required, those same DB plans could provide early retirement programs to ease the impact on employees of the reduction in force. DC retirement-specific accounts provide fewer workplace management tools because they are transferrable among employers and the benefits are not back loaded in the way DB benefits typically are. However, employers still may view those plans as ways to differentiate themselves and attract workers, enhancing their willingness to sponsor such plans. Those circumstances increase the value of coordination value across workplace regulators, such as EBSA.

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225 Nobles & Black, supra note 154, at 948-49.
226 See supra text accompanying note 54.
228 See supra text accompanying note 91.
VI. Conclusion

The distress in US financial markets, bankruptcies of premier financial services firms, and the congressional rescue package will reinforce calls for reform of the regulatory framework for the financial services industry. The Treasury Department presented a thoughtful and reasonably comprehensive multi-step plan in its Blueprint. Although it almost certainly will not be enacted without lengthy debate and numerous modifications, the Blueprint provides a framework to begin the discussion of the interaction of pension policy, pension regulation, and regulation of the financial services industry. It is essential that as the debate on regulatory reform moves forward, however, policy makers recognize the symbiotic relationship among these areas.

Increasingly, Americans rely on DC retirement-specific accounts, such as 401ks, to accumulate assets for retirement. Although they receive favorable tax treatment, those accounts share many similarities with generalized investment accounts, such as brokerage accounts and bank savings. In each instance, the individual is likely to decide whether to save at all and what investments to make. The investor probably will have a variety of opportunities to access the account assets. However, regulation currently differentiates in many ways between retirement-specific accounts and generalized investment accounts.

The Blueprint fails to address the regulatory distinctions drawn among the various types of accounts. The proposed reform advocates consolidation of authority for regulation over disclosure and business practices under a new business conduct regulator. This approach should enhance efficiencies, prevent financial products from exploiting regulatory gaps and inconsistencies, and make it easier for investors to compare financial products. However, it is not clear whether the proposed reform would extend to regulation over areas such as disclosures associated with retirement-specific accounts.

Assets held in retirement-specific accounts in the US are a large portion of the total assets under investment in the US. At the same time it is questionable whether those assets will be sufficient to provide retirement security to many Americans. The UK and Australia have long recognized that the fate of capital markets and retirement wealth are intertwined. As the US moves forward with regulatory reform over the financial services industry, the country should not miss this opportunity to ensure that the regulatory structure best supports both the capital markets and working Americans who hope for a financially secure retirement.