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Trusts No More: Rethinking the Regulation of Retirement Savings in the United States

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Trusts No More: Rethinking the Regulation of Retirement Savings in the United States

*Natalya Shnitser**

The regulation of private and public pension plans in the United States begins with the premise that employer-sponsored plans resemble traditional donative, or gift, trusts. Accordingly, the Employee Retirement Income Security Act of 1974 (ERISA) famously “imports” major principles of donative trust law for the regulation of private employer-sponsored pension plans. Statutes regulating state and local government pension plans likewise routinely invoke the structure and standards applicable to donative trusts. Judges, in turn, adjudicate by analogy to the common law trust.

This Article identifies the flaws in the analogy and analyzes the shortcomings of a regulatory framework that, despite dramatic changes in the nature of modern pension benefits, still regards employees as gift recipients, grants both settlor and trustee rights to employers, and relies increasingly on trust-based fiduciary obligations to prevent employers from prioritizing the interests of their non-employee stakeholders over the interests of pension plan participants.

Today, the mismatch between the trust-based legal framework and the parties’ rights and interests has contributed to the high cost of pension fund investing, the significant gaps in pension coverage, and the underfunding of public pension plans. As such challenges force U.S. policymakers to reconsider how and how much Americans save for their retirement, this Article shows that long-term retirement security for U.S. workers requires a fundamental reevaluation of the employer, employee, and government roles in the provision and management of retirement assets.

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I. INTRODUCTION

The donative trust, though often lauded for its flexibility and fiduciary regime, is an ill-suited model for modern employer-based retirement savings arrangements. Historically devised for the transfer of private wealth, the prototypical donative trust arises from and is structured to effectuate a particular kind of gift transfer in which the gift giver selects a third-party trustee to manage the gift on behalf of the gift recipient. The protection of the gift giver’s preferences is a central goal of modern trust law.¹

1. See, e.g., 1974 U.S.C.C.A.N. 4639, 4650 (noting trust law’s “attendant emphasis on carrying out the instructions of the settlor”).

Pension benefits are not gifts. To the contrary, they are a form of deferred compensation paid by employers to recruit and retain employees. And yet the Employee Retirement Income Security Act of 1974 (ERISA) famously “imports” major principles of donative trust law, including the fiduciary regime traditionally imposed on trustees.² Statutes regulating state and local government pension plans likewise routinely invoke the structure and standards traditionally applicable to donative trusts. The “trust” label has invited legislators and judges to regulate and adjudicate by analogy to the traditional donative trust.³ In its 2015 *Tibble v. Edison* decision, the Supreme Court urged the Ninth Circuit to determine the scope of the employer’s monitoring obligation while “recognizing the importance of analogous trust law.”⁴

The reliance on the trust form in employer-sponsored pension savings arrangements constitutes part of the trust’s under-analyzed—and increasingly problematic—“secret life.”⁵ Leading trust treatises acknowledge the appropriation of the trust label outside the donative context but refuse to assess the merits of such non-traditional uses of

2. Daniel Fischel & John H. Langbein, *ERISA’s Fundamental Contradiction: The Exclusive Benefit Rule*, 55 U. CHI. L. REV. 1105, 1108 (1988); see also John H. Langbein, *The Secret Life of the Trust: The Trust as an Instrument of Commerce*, 107 YALE L.J. 165, 169 (1997) (noting that “ERISA’s legislative history makes clear that Congress meant to track the common law of trusts”).

3. See, e.g., *Beck v. PACE Int’l Union*, 551 U.S. 96, 101 (2007) (noting that determination as to the employer’s liability “is an inquiry that is aided by the common law of trusts which serves as ERISA’s backdrop”); see also *Varity Corp. v. Howe*, 516 U.S. 489, 496 (1996) (“[W]e recognize that these fiduciary duties draw much of their content from the common law of trusts, the law that governed most benefit plans before ERISA’s enactment.”); *Cent. States v. Cent. Transp., Inc.*, 472 U.S. 559, 570 (1985) (“[R]ather than explicitly enumerating *all* of the powers and duties of trustees and other fiduciaries, Congress invoked the common law of trusts to define the general scope of their authority and responsibility.”); Definition of the term “Fiduciary”; Conflict of Interest Rule—Retirement Investment Advice, 81 Fed. Reg. 20,946 (Apr. 8, 2016) (to be codified at 29 C.F.R. pt. 2509, 2510, and 2550) (“ERISA safeguards plan participants by imposing trust law standards of care and undivided loyalty on plan fiduciaries, and by holding fiduciaries accountable when they breach those obligations.”).

4. *Tibble v. Edison Int’l*, 135 S. Ct. 1823, 1829 (2015).

5. Langbein, *supra* note 2 at 166 (“It will be seen that well over 90% of the money held in trust in the United States is in commercial trusts as opposed to personal trusts.”); see also Paul B. Miller, *The Future for Business Trusts: A Comparative Analysis of Canadian and American Uniform Legislation*, 36 QUEEN’S L.J. 443 (2011); Robert H. Sitkoff, *Trust As “Uncorporation”: A Research Agenda*, 2005 U. ILL. L. REV. 31, 34 (2005) (observing that “the business trust is something of an orphan in the domestic legal academy”).

the trust form.⁶ Scholars have analyzed—and criticized—the initial adoption of the trust form for the traditional defined benefit private-sector pension plans prevalent in the 1970s and 1980s. The changes in the pension landscape over the last two decades, however, have rendered the analysis incomplete.

Trust law was not intended to play a major role in the governance of U.S. public and private pension plans. When Congress borrowed from donative trust law in the 1970s, it did so for the limited purpose of curbing asset mismanagement—or “internal defalcation”—by insiders with access to funds set aside to pay employee pensions.⁷ At the time, employers generally promised traditional defined benefit pensions to their employees, and also bore the risk and responsibility of setting aside and managing the money to pay for such benefits. In passing ERISA, Congress looked to trust law to protect pension assets, but simultaneously imposed extensive vesting, funding, and insurance requirements to regulate employer conduct in the provision and administration of defined benefit pension plans.

Trust law—and particularly the fiduciary regime—inadvertently assumed a much greater governance role as the pension landscape evolved in the decades after ERISA’s passage. As defined benefit plans in the private sector gave way to defined contribution arrangements, and as defined benefit public pension plans expanded in size and coverage,⁸ many of ERISA’s substantive provisions lost

6. See, e.g., RESTATEMENT (THIRD) OF TRUSTS § 1 cmt. b (AM. LAW INST. 2003) (“The law relating to the use of trusts as devices for conducting business and investment activities outside the express private- and charitable-trust context is not within the scope of this Restatement. Although many rules of trust law may also apply to business and investment trusts, many of these rules do not; instead other rules are drawn from other bodies of law that are specially applicable to those activities even when conducted in trust form. Thus, the business trust is a business arrangement that is best dealt with in connection with business associations; and most pooled investment vehicles are properly governed by laws applicable to investment companies and to the issuance and sale of securities.”). The Uniform Trust Code is also directed “primarily at trusts that arise in an estate planning or other donative context,” but acknowledges that “express trusts can arise in other contexts Commercial trusts come in numerous forms, including trusts created pursuant to a state business trust act and trusts created to administer specified funds, such as to pay a pension or to manage pooled investments. Commercial trusts are often subject to special-purpose legislation and case law, which in some respects displace the usual rules stated in this Code.” UNIF. TRUST CODE § 102 cmt. (2000).

7. Fischel & Langbein, *supra* note 2 at 1110.

8. In a defined contribution plan, an employee’s benefits during retirement are not fixed, but depend on the contributions made by the employee and/or employer to the

relevance. At the same time, employee participants became increasingly exposed to the plan management, investment, and funding decisions of their employers. In the absence of applicable substantive regulation, the trust-based fiduciary regime took on a prominent role in regulating employer and employee conduct in the provision of retirement benefits.

Is trust law well suited for this leading role? This Article suggests that the answer is no. The structural differences that have emerged between traditional donative trusts and modern pension plans undermine the effectiveness of trust law's protective fiduciary regime and its ability to safeguard the retirement security of America's workers.

In the prototypical donative trust, an owner of property, called the settlor, wishes to gift the property to one or more beneficiaries. Rather than giving a direct gift to the beneficiary, the settlor wishes to have the property managed by a third party serving as trustee.⁹ The settlor enters into a management agreement with the trustee and transfers to the trustee the legal title to the property. The settlor's rights with respect to the trust property terminate, the trustee retains legal control, and the beneficiary receives an equitable interest. The beneficiary cannot easily transfer the equitable interest or exercise meaningful control over the trustee.¹⁰ To protect the beneficiary from trustee misconduct, trust law subjects the trustees

employee's account, as well as the investment performance of the assets in that account. An employee in a defined contribution plan will ultimately receive the nonforfeitable accrued balance in his or her account, which is based on contributions plus or minus investment gains or losses. In contrast, a defined benefit plan promises a specified monthly benefit at retirement, which is typically based on the final average salary and the number of years worked for a particular employer. While an employee may have to contribute a portion of his or her earnings to a defined benefit plan, the employer is responsible for managing the assets and ensuring that the benefits will be paid. *See also infra* Part II.

9. The settlor, trustee, and beneficiary roles do not necessitate three different persons as parties to the trust. One person can wear two hats, or sometimes even all three. The trustee, however, must owe equitable duties to someone other than himself. UNIF. TRUST CODE § 402 (2000).

10. Robert H. Sitkoff, *Trust Law, Corporate Law, and Capital Market Efficiency*, 28 J. CORP. L. 565, 570–71 (2003) (observing that “donative trust beneficiaries are awarded their stake in the trust by the donative fiat of the settlor, and there is no well-developed aftermarket for the beneficiaries’ interests Moreover, trust beneficiaries cannot easily replace the trustees. Both of these limits on the beneficiaries’ control are designed to give effect to the preferences of the settlor, thereby facilitating the donative trust’s often (but not exclusively) paternalistic function.”).

to strict fiduciary obligations, including the duty of loyalty and the duty of prudence.

Non-donative trust arrangements—including pension plans—deviate from these characteristics in fundamental ways. The traditional settlor, trustee, and beneficiary roles do not map well onto modern pension arrangements; instead, both employers and employees take on elements of each role. Under existing regulation, employers do not have to establish any kind of pension plan for their employees. They take on the “settlor” role of setting up a plan only if the benefits *to the employer*—typically in the form of recruitment and retention gains—exceed the employer’s costs. And just as employers share the beneficiary role with employees, by contributing a portion of their compensation to the pension plans, employees take on the settlor role alongside employers.

The trustee role is also shared by employers and employees. Employee participants in defined contribution plans choose how to invest their retirement assets from among investment options selected by their employers. Participants in public-sector defined benefit plans have certain voting rights with respect to the selection and oversight of plan trustees. In both the public and private sectors, pension law tasks employers—who have a clear interest in maximizing the benefits to the *employers*—with certain trustee-like responsibilities over the plans.¹¹ Thus, as the settlors, employers decide whether or not to establish a pension plan in the first place, and set both the terms of the plan and the magnitude of any employer contributions to the plan. As the trustees, employers must then disregard their own beneficiary interests and serve as fiduciaries of the employee-beneficiaries.

Despite these overlapping roles, the governance of modern pension plans relies heavily on the tools of trust law, and especially the trust-based fiduciary regime. As this Article suggests, however, the current trust-based governance regime for pension plans does not—and could not—properly recognize the interests and incentives of employers and employees. The traditional donative trust is premised upon the existence of clearly defined settlor preferences and provides no mechanism for adjudicating between competing interests of settlors, particularly where such settlors are also the beneficiaries of the trust. The current trust-based regime therefore

11. Fischel & Langbein, *supra* note 2 at 1126–28.

necessarily oversimplifies the interests of the parties to the pension trust. The statutory framework and case law regard employees as beneficiaries, while sweeping over their role as earners of the assets that are contributed into the trusts. The same trust-based framework treats employers as both the settlors and the trustees of the pension trusts, but effectively ignores their interest in minimizing the employer costs associated with the plans.

In the case of defined contribution plans, which are the dominant form of retirement savings today, the notion of the employer as a fiduciary to its employees has been in tension with the fiduciary obligations owed to the corporate shareholders. Enforcement of the employers' fiduciary obligations to employees has been limited by the courts' deference to the preferences of employers as settlors, while the employee-as-beneficiary framework has perpetuated the kind of beneficiary "lock-in" characteristic of donative trusts. By restricting employees to the pension plan terms selected by a particular employer, the trust-based framework has left employee "beneficiaries" at the mercy of their employer "trustees" for critical decisions regarding the management and investment of money set aside for retirement. Although such limitations may be appropriate for *gift* recipients, they have inappropriately caused employees to forego hundreds of millions of dollars in investment returns as a result of suboptimal investment menus and service-provider arrangements constructed by the employers.¹² Meanwhile, the trust-based "gift" paradigm has also led to significant gaps in coverage. With many private U.S. employers choosing not to provide the "gift" of pensions to their employees, some sixty-eight million workers are without access to an employer-sponsored plan.¹³

12. See Chris Arnold, *Is Wall Street Eating Your 401(k) Nest Egg?*, NPR (Oct. 19, 2015), <http://www.npr.org/2015/10/19/445322138/is-wall-street-eating-your-401-k-nest-egg> (noting that "Americans collectively are losing billions of dollars a year out of their retirement accounts because they're paying excessive fees"); *infra* Section IV.A.2.

13. See Savings Arrangements Established by States for Non-Governmental Employees, 80 Fed. Reg. 72006 (proposed Nov. 18, 2015) (to be codified at 29 C.F.R. pt. 2510); see also Craig Copeland, *Employment-Based Retirement Plan Participation: Geographic Differences and Trends, 2012*, EMP. BENEFITS RES. INST., No. 293, Nov. 2013, at 9, http://www.ebri.org/pdf/briefspdf/EBRI_IB_011-13.No392.Particip.pdf (noting that "[a]mong the 156.5 million Americans who worked in 2012, 76.0 million worked for employers or unions that sponsored a pension or retirement plan, and 61.6 million participated in a plan," which translates into a sponsorship rate of 48.6 percent).

In the case of public-sector pension plans, most of which still take the traditional defined-benefit form, the trust-based fiduciary regime has failed to ensure that government promises of pension benefits are actually funded. The tenets of donative trust law have not limited the ability of legislative “settlers” to make payout promises that greatly exceed the trusts’ assets, with the current gap approaching several trillion dollars.¹⁴ As in the private defined contribution arrangements, the donative trust model has deferred to conflicted trustees while treating employees who make contributions into the pension trusts as gift recipients with limited control over the trust assets or their interests in the trusts.

To be clear, analogizing to trust law may improve participant outcomes in certain cases and, under the status quo, it may be at times the best strategy for plaintiffs seeking to challenge employer actions (or inaction).¹⁵ In the long-term however, the donative trust paradigm fails to facilitate universal access to low-cost retirement savings products, which is critical to retirement security in the United States. After reviewing the range of recently enacted and proposed reforms—all of which implicitly acknowledge the limitations of the current trust-based model—this Article suggests that the fiduciary regime, though reflexively invoked by the trust label,¹⁶ should no longer be the centerpiece of retirement plan governance. Drawing on lessons from the regulation of investment companies, this Article outlines a research agenda for a national system of individual retirement savings accounts to track and administer individual retirement savings throughout an individual’s lifetime and across all employers. As it has done in other jurisdictions, the individual account system would free employers from their trustee roles. Public and private employers would continue to make contributions on behalf of employees but would

14. Robert Novy-Marx & Joshua Rauh, *The Crisis in Local Government Pensions in the United States*, in *GROWING OLD: PAYING FOR RETIREMENT AND INSTITUTIONAL MONEY MANAGEMENT AFTER THE FINANCIAL CRISIS* 47 (Yasuyuki Fuchita et al. eds., 2011).

15. See, e.g., Brief for Law Professors as Amici Curiae Supporting Petitioners, *Tibble v. Edison Int’l*, 135 S. Ct. 1823 (2015) (No.13-550), 2014 WL 7783960 (citing extensively to trust law authorities to show that participants’ claims are not barred by ERISA’s statute of limitations because ERISA fiduciaries, like donative trust trustees, have an ongoing duty to monitor plan investments).

16. Langbein, *supra* note 2 at 182 (noting that “the trust automatically invokes the distinctive protective regime of trust fiduciary law for safeguarding the interests of investors or other beneficiaries”).

not be tasked with plan design or administration. Employees would select from among readily comparable options the investments for their retirement account assets. Instead of relying primarily on fiduciary law to discipline pension plan providers, the individual account model would treat pension plans as products subject to safety and standards regulation, and, in turn, to the disciplining power of consumer choice.

This Article proceeds as follows: Part II describes how donative trust law came to govern modern pension plans and compares the traditional donative trust to modern day retirement savings arrangements. Part III reviews the existing scholarship and explains the need for a revised assessment. Part IV shows how the reliance on the donative trust model of regulation has contributed to the high cost of pension fund investing, the gaps in pension coverage, and the underfunding of public pension plans. Part V analyzes recently proposed and enacted changes and introduces long-term reforms to properly recognize employer, employee, and government incentives in the provision and management of retirement assets. Part VI concludes.

II. HOW DONATIVE TRUST LAW CAME TO GOVERN MODERN PENSION PLANS

How did the trust—long considered the characteristic device for organizing intergenerational wealth transmission—come to play such a prominent role in the regulation of public and private pension plans?¹⁷ What made trust law an appealing model for the Treasury, for state legislators, and for the drafters of ERISA? The answer lies in two prominent features of the common law trust: first, its ability to shield a pool of assets for a particular purpose or person,¹⁸ and second, the protective regime of trust fiduciary law.¹⁹ Each feature is discussed in turn below.

17. See Langbein, *supra* note 2 at 165.

18. See, e.g., Henry Hansmann & Ugo Mattei, *Trust Law in the United States. A Basic Study of Its Special Contribution*, 46 AM. J. COMP. L. SUPP. 133, 134 (1998) (arguing that “the most important contribution of the law of trusts is that it facilitates the partitioning of assets into bundles that can conveniently be pledged separately to different classes of creditors. Of particular importance in this respect is the use of trust law to shield trust assets from claims of the trustee’s personal creditors.”).

19. Langbein, *supra* note 2, at 182.

A. The Donative Trust

A trust is an arrangement in which a settlor engages a trustee to manage property as a fiduciary for one or more beneficiaries. Although that definition does not in itself situate the trust in any particular context and, indeed, variations of the trust form have been adopted for a wide range of commercial purposes, in the culture of Anglo-American law, the trust is considered a branch of the law of gratuitous transfers.²⁰ Having originated at the end of the Middle Ages as a means of transferring wealth within the family, the trust remains the characteristic device for organizing intergenerational wealth transmission and is regarded as “essentially a gift, projected on the plane of time and so subjected to a management regime.”²¹

In a prototypical trust, a settlor wishes to gift property to a beneficiary. Under the Uniform Trust Code, a settlor is “a person . . . who creates, or contributes property to, a trust.”²² Often the intended beneficiary is a minor or someone who the settlor believes may not be well suited to manage the property.²³ Therefore, rather than make a gift directly to the beneficiary, the settlor places control of the property in the hands of an intermediary to manage the property on behalf of the beneficiary. Trust law permits the settlor, as the owner of the property with absolute freedom to give it away as he or she prefers, to effect almost any management and distribution arrangement that the settlor desires.²⁴ Importantly, however, unless the settlor explicitly retains an interest in the trust, the settlor’s legal interest in the trust terminates once the trust is formed.²⁵

20. *Id.* at 165.

21. *Id.* at 185 (citing Bernard Rudden, *John P. Dawson’s Gifts and Promises*, 44 MOD L. REV. 610, 610 (1981) (book review)).

22. If more than one person creates or contributes property to a trust, each person is a settlor of the portion of the trust property that is attributable to that person’s contribution and that may only be revoked by that person. UNIF. TRUST CODE § 103 (2000).

23. Fischel & Langbein, *supra* note 2 at 1114.

24. UNIF. TRUST CODE § 401 (2000). Deviation from either an administrative or dispositive term of the trust is generally permitted only where such deviation will further the purposes of the trust. *Id.* § 412; RESTATEMENT (THIRD) OF TRUSTS § 66 (AM. LAW INST. 2003); *see also* Langbein, *supra* note 2, at 184.

25. RESTATEMENT (THIRD) OF TRUSTS § 94 cmt. d(2) (AM. LAW INST. 2003) (“Neither the settlor of a private trust nor the personal representative or successors in interest of the settlor can, *as such*, maintain a suit against the trustee to enjoin or redress a breach of

Upon the formation of the trust, the beneficiary acquires an equitable interest in the trust while the trustee acquires the legal title. The assets in the trust are segregated from both the assets of the beneficiary and the assets of the trustee.²⁶ The beneficiary can neither freely transfer the trust interest,²⁷ nor, under the default trust rules, replace the trustee without court approval (and even then, only for cause).²⁸ Indeed, to enforce the trustee obligations, the beneficiary must pursue remedies in court.²⁹ These limits on control and exit promote the donative trust's "paternalistic function."³⁰

In the resulting arrangement, the beneficiary's fortunes depend on the trustee: if trust property is managed wisely, the beneficiary reaps the gains, and if the trust property is managed poorly, the beneficiary suffers the losses. In the absence of market-based checks on the trustee, the beneficiary of the modern donative trust is protected primarily by trust fiduciary law—particularly the duties of prudence and loyalty—which have replaced historic restrictions on trustee authority.³¹ The duty of prudence requires the trustee to administer the trust "as a prudent person would, in light of the

trust or otherwise to enforce the trust, absent contrary legislation. This does not, however, preclude settlor-standing based on a retained beneficial power or interest.").

26. See, e.g., Hansmann & Mattei, *supra* note 18 at 134, 145.

27. John H. Langbein, *Questioning the Trust Law Duty of Loyalty: Sole Interest or Best Interest?*, 114 YALE L.J. 929, 962 (2005) ("There is no counterpart in trusteeship to the market for corporate control . . . Interests in trusts are commonly inalienable, both on account of legal restrictions and because of practical impediments to valuing and marketing contingent interests."); Sitkoff, *supra* note 10, at 570 (noting that "there is no well-developed aftermarket for the beneficiaries' interests" and that "in many American trusts the beneficiaries are disabled by so-called 'spendthrift' clauses from alienating (even involuntarily) their interest in the trust").

28. See e.g., JOHN R. PRICE, PRICE ON CONTEMPORARY ESTATE PLANNING 1165 (2d ed. 2000) (noting that "it is difficult, if not impossible, to obtain the judicial removal of a trustee unless the trustee has engaged in an egregious breach of trust").

29. UNIF. TRUST CODE § 706(a) (2000) ("The settlors, a cotrustee, or a beneficiary may request the court to remove a trustee, or a trustee may be removed by the court on its own initiative."); *id.* § 1001(b) (setting forth the remedies that a court may impose for a breach of trust).

30. Sitkoff, *supra* note 10 at 571; John Morley, *The Separation of Funds and Managers: A Theory of Investment Fund Structure and Regulation*, 123 YALE L.J. 1228, 1272 (2014) (noting that settlors impose restrictions in order to protect beneficiaries from themselves or from others).

31. See John H. Langbein, *The Contractarian Basis of the Law of Trusts*, 105 YALE L.J. 625, 641 (1995) ("The need for active administration of the modern trust portfolio of financial assets rendered obsolete this scheme of disempowering the trustee to transact with the trust property.").

purposes, terms, and other circumstances of the trust” and with the “exercise of reasonable care, skill, and caution.”³² The duty of loyalty demands administration solely in the interest of the beneficiary and prohibits the trustee from self-dealing with trust assets and from partaking in any conflict-of-interest transactions.³³ In addition to making voidable all transactions in which the trustee has a conflict, the loyalty standard also includes the duty of impartiality, which applies if the trust has two or more beneficiaries. In deciding how to invest, manage, and distribute the trust property, the trustee must act impartially and “giv[e] due regard to the beneficiaries’ respective interests.”³⁴

In sum, the quintessential donative trust facilitates the conditioned transfer of gifts, and in particular, the intergenerational transfer of family wealth. Although various commercial enterprises have adopted modified versions of the trust form and have relied on certain elements of trust fiduciary law, pension funds have gone the furthest in structuring multiparty commercial arrangements by analogy to the private donative trust. As Section II.B. *infra* describes, key elements of the law developed primarily to regulate the behavior of donative trust settlors, beneficiaries, and trustees now permeate the statutory regime governing U.S. pension plans.

B. Private-Sector Defined Benefit Pension Plans

The use of the trust form for private-sector pension arrangements dates as far back as 1919 when the Bureau of Internal Revenue conditioned the deductibility of employer contributions for accrued pension expenses on the segregation of those contributions in a trust “organized entirely separate and distinct from the corporation . . . legal title of which [could] not remain in the

32. See, e.g., RESTATEMENT (THIRD) OF TRUSTS § 77 (AM. LAW INST. 2003).

33. The duty of loyalty is prophylactic in its approach. Langbein, *supra* note 31, at 656. It presumptively makes voidable any transactions in which the trustee acts for its own account, unless the conflict of interest is authorized by the settlor, approved by the beneficiaries, or granted advance judicial approval. Barring such approval, once the beneficiaries prove the existence of self-dealing, there is “no further inquiry.” See, e.g., UNIF. TRUST CODE § 802 cmt. (2000) (“Such transactions are irrebuttably presumed to be affected by a conflict between personal and fiduciary interests. It is immaterial whether the trustee acts in good faith or pays a fair consideration.”).

34. *Id.* § 803 (2000); RESTATEMENT (THIRD) OF TRUSTS § 79 (AM. LAW INST. 2003).

corporation.”³⁵ The Revenue Act of 1921 further required that pension trusts wishing to avoid taxation be created “for the exclusive benefit” of the employees.³⁶ Thus, preferential federal tax treatment was conditioned on the use of the trust form to segregate the assets for employee pensions from the general assets of the employer.

The tax rules did not, however, impose substantive restrictions on the nature of pension benefits. Indeed, most employers that offered pensions to their employees paid them out of current income, took careful precautions to retain the right to change or terminate benefits, and intentionally referred to such benefits as “gifts” whose continuation depended on the fortune of the employer.³⁷ To the extent that pensions encouraged younger employees to stick with an employer (through vesting requirements) and older employees to retire, they were seen by employers primarily as means of “managing workers.”³⁸

Employer interest in pensions soared during World War II when the National War Labor Board restricted increases in cash compensation.³⁹ In the post-war period, employers typically adopted defined benefit pension plans that promised their employees fixed monthly benefits—a check in the mail—from the time of retirement until death. Despite such promises, in the 1950s and 1960s, many employers failed to set aside adequate assets to pay for the promised benefits, often leaving employees empty-handed when financial fortunes turned south.⁴⁰ To the extent money was set aside, it made for a tempting target for unscrupulous insiders with access to the funds. Evidence of looting by union leaders charged with pension

35. JAMES A. WOOTEN, *THE EMPLOYEE RETIREMENT INCOME SECURITY ACT OF 1974: A POLITICAL HISTORY* 25 (2004).

36. Revenue Act of 1921, ch. 136, § 219(f), Pub. L. No. 42-98, 42 Stat. 227, 247.

37. Standard boilerplate plan language included the following:

The allowances are voluntary gifts from the company and constitute no contract and confer no legal rights upon any employee. The continuance of the retirement allowance depends upon the earnings of the company and the allowances may at any time be reduced, suspended, or discontinued on that, or any other account, at the option of the Board of Directors.

JOHN LANGBEIN, DAVID PRATT & SUSAN STABILE, *PENSION AND EMPLOYEE BENEFIT LAW* 9 (5th ed. 2010).

38. WOOTEN, *supra* note 35, at 4.

39. LANGBEIN, *supra* note 37, at 13.

40. *Id.* at 51–79.

fund administration made headlines in the national press and helped usher in a movement for pension reform.⁴¹

The reform effort culminated with the passage of the Employee Retirement Income Security Act (ERISA) in 1974. ERISA sought to address three main risks associated with defined benefit plans in the private sector: first, that plan officials would steal or misuse plan pension fund assets; second, that employees would lose their pensions if they were fired or quit before meeting the extensive and idiosyncratic vesting requirements commonly imposed by employers; and third, that employers would not set aside enough money to pay for the promised benefits, thus endangering the benefits of employees whose firms terminated the plan or went bankrupt.⁴² To address the latter two risks, ERISA mandated minimum funding standards, required plans to participate in a termination insurance program, and imposed minimum vesting standards that granted employees “a legal right to benefits” after a period of service specified in the statute.”⁴³

To address the looting and mismanagement that had previously plagued private pensions, the drafters of ERISA turned, in part, to trust law, whose common law fiduciary regime had evolved to protect beneficiaries from mismanagement by trustees.⁴⁴ Although some have described this move as a mere afterthought, added only in later versions of the bill,⁴⁵ the final version of ERISA incorporated the “rules and remedies similar to those under traditional trust law.”⁴⁶ The trust-law duty of loyalty became the centerpiece of

41. As Fischel and Langbein note, “In the 1950s and 1960s, investigative hearings on the subject of labor union racketeering . . . achieved immense notoriety.” Fischel & Langbein, *supra* note 2, at 1110.

42. WOOTEN, *supra* note 35, at 5.

43. *Id.*

44. Fischel & Langbein observe that the drafters sought to protect pension funds against “internal defalcation.” Fischel & Langbein, *supra* note 2, at 1110.

45. Frank Cummings, Panel Discussion, *ERISA and the Fiduciary*, Symposium, *ERISA at 40: What Were They Thinking?*, 6 DREXEL L. REV. 359, 376 (2014) (noting that the fiduciary provisions were essentially stapled on after the substantive rules had already been drafted); see also Henry Rose, Panel Discussion, *Setting the Stage: History Before the Ninety-Third Congress*, Symposium, *ERISA at 40: What Were They Thinking?*, 6 DREXEL L. REV. 265, 280 (2014) (noting that early bills “didn’t attend to fiduciary issues in any detail”).

46. H.R. CONF. REP. NO. 93-1280, at 295 (1974), reprinted in 1974 U.S.C.A.N. 5038, 5076.

ERISA fiduciary requirements.⁴⁷ The drafters of ERISA also incorporated the prudent man standard of care for trust administration and the requirement that plan assets be diversified.⁴⁸

Though controversial, the trust-based fiduciary regime was relatively inconsequential in the context of defined benefit pension plans. ERISA's substantive rules significantly limited the discretion of defined benefit plan administrators. For example, not only did ERISA subject plan sponsors to statutory funding requirements and a mandatory federal insurance scheme, it also sought to limit the misuse of plan assets by explicitly prohibiting transactions between an employee benefit plan and parties that had a pre-existing relationship with the plan.⁴⁹ Although such transactions would also be prohibited under the fiduciary standard, ERISA's drafters chose to rely on an explicit ban rather than a mere fiduciary obligation. Indeed, the prohibited transaction provisions, together with the mandatory vesting, funding, and insurance rules, reflected the understanding that trust law alone was inadequate to protect the interests of plan participants and beneficiaries.⁵⁰

The role of the fiduciary regime was also limited by the very design of the then-prevalent private-sector defined benefit pension plans. Employee pension benefits were generally fixed as a percentage of salary (for example, sixty percent of final average salary) and did not depend on the investment returns generated by the trust assets. Employers bore the investment risk and were subject to statutory funding requirements and a mandatory federal insurance scheme. The asset management practices that the trust-based fiduciary regime was intended to regulate were "seldom of concern" to participants in defined benefit plans.⁵¹

47. See e.g., Dana Muir & Norman Stein, *Two Hats, One Head, No Heart: The Anatomy of the ERISA Settlor/Fiduciary Distinction*, 93 N.C. L. REV. 459, 462 (2015).

48. Fischel & Langbein, *supra* note 2, at 1008.

49. Employee Retirement Income Security Act of 1974 § 406, 29 U.S.C. § 1106.

50. See *Varity Corp. v. Howe*, 516 U.S. 489, 497 (1996) ("After all, ERISA's standards and procedural protections partly reflect a congressional determination that the common law of trusts did not offer completely satisfactory protection."); 1974 U.S.C.C.A.N. 4639, 4650 ("[E]ven where the funding mechanism of the plan is in the form of a trust, reliance on conventional trust law often is insufficient to adequately protect the interests of plan participants and beneficiaries.").

51. John H. Langbein, *The Conundrum of Fiduciary Investing under ERISA*, in PENSION RESEARCH COUNCIL, PROXY VOTING OF PENSION PLAN EQUITY SECURITIES 132 (Dan M. McGill ed., 1989); see also Norman Stein, *Trust Law and Pension Plans*, in PENSION RESEARCH COUNCIL, PROXY VOTING OF PENSION PLAN EQUITY SECURITIES 52 (Dan M.

C. Private-Sector Defined Contribution Pension Plans

Over the last four decades, private-sector employers have gradually ceased to offer defined benefit plans and have shifted to employer-sponsored, employee-directed arrangements.⁵² Today, employees shoulder the investment risk and bear the costs of imprudent or self-serving employer decisions with respect to the design and management of the plans. Under the typical 401(k) participant-directed plan, employees elect to defer pre-tax earnings to what are effectively individual investment accounts.⁵³ Employers may also make contributions to the employees' accounts. Employees then select how to invest the funds in their accounts using menus of investment options and terms selected by their employers. However the investments perform, the employees bear the entire investment risk: at retirement, employees are entitled to receive only the amounts that have accumulated in their individual accounts.

McGill ed., 1989) (noting that “it is possible that the employer has the ability to pass a part of [the poor returns and of capital losses] to the employee-participants either by reducing wages, future benefit accruals, or other concessions.”).

52. Scholars like Edward Zelinsky posit that ERISA unintentionally “started the trend toward the defined contribution society as we know it today.” See Edward A. Zelinsky, *The Defined Contribution Paradigm*, 114 YALE L.J. 451, 471 (2004). He argues that ERISA’s “regulatory burdens” on defined benefit plans made the “more flexible defined contribution devices . . . more attractive to employers.” *Id.* at 471–72. Also, “ERISA’s fiduciary rules incited employers to shift to self-directed defined contribution arrangements under which participants control the investment of their own retirement resources.” *Id.*; see also Alicia Munnell, *Private Sector Defined Benefit Plans Vanishing*, MARKETWATCH.COM (Dec. 30, 2011), <http://blogs.marketwatch.com/encore/2011/12/30/private-sector-pensions-are-really-disappearing/> (observing that defined benefit plans in the private sector are disappearing and noting that only 13 Fortune 100 companies offered new employees a traditional defined benefit plan in 2011, compared to 58 in 2000). The assets held in defined contribution plans have grown from \$385 billion in 1990 to approximately \$6.5 trillion by 2015, with \$4.5 trillion held in 401(k) plans. See Jill E. Fisch, *Rethinking the Regulation of Securities Intermediaries*, 158 U. PA. L. REV. 1961, 1983 (2010); Investment Company Institute, *Retirement Assets Total \$23.5 Trillion in Third Quarter 2015*, https://www.ici.org/research/stats/retirement/ret_15_q3.

53. Section 401(k) of the Internal Revenue Code (IRC) permits employees to defer recognition of the amounts contributed into the plans and of the investment gains until such amounts are distributed from the plan, typically upon retirement. Employer contributions are deductible on the employer’s federal income tax return to the extent that the contributions do not exceed the specified contribution limitations. I.R.C. §§ 404, 415 (2012). Although this Article refers to 401(k) plans, the same analysis generally applies to 403(b) plans and 457 plans. IRC § 403 and IRC § 457 provide for similar salary-deferral arrangements for public schools, certain 501(c)(3) tax-exempt organizations, and state and local governments.

Though not designed for such plans, ERISA's donative trust framework nevertheless applies. The statute and corresponding regulation generally require that plan assets be held in trust by one or more trustees and used only to benefit the participants or to pay reasonable plan expenses.⁵⁴ Moreover, because ERISA extends its trustee-like fiduciary standards to anyone that has discretionary authority or control respecting management of plan assets, or discretionary authority or responsibility in the administration of the plan, employers assume fiduciary status with respect to the plan.⁵⁵ The 401(k) arrangement also adopts the lock-in feature of the donative trust.⁵⁶ Just as donative trust beneficiaries generally cannot transfer or sell their trust interests, 401(k) participants cannot assign or alienate benefits. Employees are severely restricted in their ability to withdraw money from 401(k) plans while employed by the plan sponsor.⁵⁷ Nor can employees simply avoid the plan terms selected by their employers by setting up Individual Retirement Accounts (IRAs).⁵⁸ If an employer provides any kind of retirement plan, then

54. Employee Retirement Income Security Act of 1974 §§ 403–04, 29 U.S.C. § 1104(a)(1)(A)(i)–(ii) (2012) (Section 403(b) provides limited exceptions to the trust requirement).

55. Employee Retirement Income Security Act of 1974 § 3(21), 29 U.S.C. § 1002(21) (2012). For a discussion of recent efforts to “outsource” fiduciary responsibility, see *infra* note 96 and accompanying text.

56. See, e.g., Anne M. Tucker, *Locked In: The Competitive Disadvantage of Citizen Shareholders*, 125 Yale L.J. F. 163 (2015), <http://www.yalelawjournal.org/forum/locked-in-the-competitive-disadvantage-of-citizen-shareholders> (emphasizing that “exit is not a viable option” for participants in 401(k) plans).

57. Rules under IRC § 401(k)(2)(B) restrict the distribution of assets from 401(k) plans. Distributions may not be taken unless the employee severs employment, dies, becomes disabled, faces certain hardships, turns 59 1/2, meets reservist deployment requirements, or if the plan itself is terminated by the employer. 26 U.S.C. § 72(t)(2) (2012). Distributions that do not meet these terms are subject to immediate taxation, as well as additional 10% tax. 26 U.S.C. § 72(t)(1) (2012). Apart from the tax consequences, certain distribution options are left to the discretion of the plan sponsor. Employers decide, for example, whether or not to permit hardship distributions or distributions to employee participants who have attained the age of 59 1/2. IRC § 401(k)(2)(B)(i)(IV); Treas. Reg. § 1.401-1(b)(1)(ii).

58. The regulation of IRAs is also the subject of great debate, albeit one that is not explored in this Article. The Department of Labor has expanded the definition of “fiduciary” under ERISA to include, for the first time, those who provide investment advice to IRA owners. Notably, the regulation permits “fiduciaries” who meet certain conduct and disclosure requirements to continue to operate with conflicts of interest. See definition of the term “Fiduciary”; Conflict of Interest Rule—Retirement Investment Advice, 81 Fed. Reg. 20,946, (Apr. 8, 2016) (to be codified at 29 C.F.R. pt. 2509, 2510, and 2550).

its employees cannot access the same federal tax benefits outside the employer plan.⁵⁹

Most importantly, because ERISA provides relatively fewer substantive rules for defined contribution plans, trust-based fiduciary obligations now play a far greater governance role.⁶⁰ As discussed in Section IV below, employers, together with other service providers who exercise discretionary control or authority over the management of plan assets, are subject to the “catchall” fiduciary obligations of loyalty and prudence, the scope of which is commonly determined by analogy to the donative trust.⁶¹

D. Public-Sector Pension Plans

Trust law also figures prominently and problematically in the management of U.S. public pension plans, which today cover approximately twenty-seven million public-sector employees, retirees, and beneficiaries.⁶² Although state and local governments are increasingly experimenting with defined contribution arrangements, for now, most public plans are defined benefit arrangements that promise fixed monthly benefits to retirees.⁶³

59. The Individual Retirement Account (IRA) does permit individuals to save for retirement in individual tax preferred accounts that are not associated with any employer. INTERNAL REVENUE SERV., CAT. NO. 15160X, PUBLICATION 590: INDIVIDUAL RETIREMENT ARRANGEMENTS (IRAS) 7 (2013). However, the Internal Revenue Code limits the maximum contributions to such plans (below the limit for contributions to employer sponsored plans) and limits the deductibility of such contributions. *See id.* at 14.

60. *See, e.g.*, Brendan S. Maher, *Regulating Employment-Based Anything*, 99 MINN. L. REV. 15 (2015) (unpublished manuscript) (on file with the Minnesota Law Review), <http://ssrn.com/abstract=2581329> (observing that for defined contribution plans, “ERISA regulation is of a more modest character”); *see also* Dana M. Muir, *Revenue Sharing in 401(k) Plans: Employers as Monitors?*, 20 CONN. INS. L.J. 485, 487 (2014) (noting that “the governing fiduciary framework has not adapted to the increased importance and complexity of 401(k) plans”).

61. Dana M. Muir, *Decentralized Enforcement to Combat Financial Wrongdoing in Pensions*, 53 AM. BUS. L.J. 46 (2016) (unpublished manuscript) (on file with the American Business Law Journal) (describing ERISA’s fiduciary provisions “as an indispensable catchall to prohibit harmful conduct that is imprudent or contrary to the best interests of participants but is not otherwise prohibited by the statute or regulations”).

62. U.S. GOV’T ACCOUNTABILITY OFF., GAO-12-322, STATE AND LOCAL GOVERNMENT PENSION PLANS: ECONOMIC DOWNTURN SPURS EFFORTS TO ADDRESS COSTS AND SUSTAINABILITY 1 (2012), <http://www.gao.gov/assets/590/589043.pdf>.

63. Alicia H. Munnell, Jean-Pierre Aubry, and Mark Cafarelli, *Defined Contribution Plans in the Public Sector: An Update*, CENTER FOR STATE AND LOCAL GOV. EXCELLENCE (2014). http://www.nasra.org/files/Topical%20Reports/Plan%20Design/Defined_Contribution_Pla

ERISA explicitly does not cover public pension plans, but the trust form is statutorily mandated by most state and local governments, who both make the pension promises and are also in charge of putting aside the money to fund such long-term obligations.⁶⁴ To manage and administer pension plans, state and local governments typically set up pension systems, which are separate legal entities governed by boards of trustees.⁶⁵ The trustees are either appointed by elected officials or elected by plan participants.⁶⁶ By statutory design, the trustees are charged with “plan administration” and, in most cases, given discretion over the investment of assets set aside in public pension trusts.⁶⁷ Although exact statutory requirements vary across states, public plan trustees are generally subject to the traditional trust law duties of prudence and loyalty.⁶⁸ In cases of alleged fiduciary breach, state courts have

ns_An_Update.pdf (“Most state and local workers are covered by a traditional defined benefit plan”). Such benefits are often calculated through a formula that considers final salary and years of service. For example, a worker might be entitled at retirement to two percent of final average salary for each year worked. An employee who has worked for thirty years for the particular employer would be entitled sixty percent of her final average salary; an employee whose final average salary was \$50,000 per year would be entitled to \$30,000 per year in pension benefits, not counting retiree healthcare benefits.

64. 29 U.S.C. § 1003(b) (2012) (“The provisions of this subchapter shall not apply to any employee benefit plan if (1) such plan is a governmental plan.”). Because ERISA’s funding requirements do not apply to public pension plans, state and local governments write their own rules for pension funding and administration. *See, e.g.*, Natalya Shnitser, *Funding Discipline for U.S. Public Pension Plans: An Empirical Analysis of Institutional Design*, 100 IOWA L. REV. 663, 668 (2015); *see also* RESTATEMENT (THIRD) OF TRUSTS § 4 cmt. g (AM. LAW INST. 2003) (“Some forms of trusts that are created by statute, especially public retirement systems or pension funds . . . are administered as express trusts, the terms of which are either set forth in the statute or are supplied by the default rules of general trust law.”).

65. *See generally* JUN PENG, STATE AND LOCAL PENSION FUND MANAGEMENT 16–17 (2009).

66. The trustees may be teachers or firefighters or local government administrators. But in most cases, they are not investment professionals. *See* Thomas J. Fitzpatrick IV & Amy B. Monahan, *Who’s Afraid of Good Governance? State Fiscal Crises, Public Pension Underfunding, and the Resistance to Governance Reform*, 66 FLA. L. REV. 1317, 1326 (2014).

67. *See, e.g.*, ARK. CODE ANN. § 24-4-104 (LEXIS through 2015 Reg. Sess. and First Ex. Sess.) (“The administration and control of the Arkansas Public Employees’ Retirement System shall be vested in a board called the ‘Board of Trustees . . .’”); KAN. STAT. ANN. § 74-4921(1), (2) (LEXIS through 2015 Reg. Sess.) (stating that “[t]he fund is a trust fund” and that “[t]he board shall have the responsibility for the management of the fund”).

68. For example, the New Mexico Constitution mandates that “[a]ll funds . . . paid into . . . a public employees retirement system . . . shall be held . . . in a trust fund to be administered and invested by each respective system for the sole and exclusive benefit of the members, retirees and other beneficiaries of that system. Expenditures from a system trust fund shall only be made for the benefit of the trust beneficiaries and for expenses of administering

looked to the Restatement of Trusts to assess whether public pension trustees acted in accordance with the “well-established rules of the law of trusts.”⁶⁹

Although public employees are frequently required to directly contribute portions of their salaries into the pension trusts (and always do so indirectly by trading lower salaries for pension benefits), state statutes effectively regard employees as the trust beneficiaries.⁷⁰

the system.” N.M. CONST. art. XX, § 22(A). The retirement board is “the trustee[] for [its] respective system[] and ha[s] the sole and exclusive fiduciary duty and responsibility for administration and investment of the trust fund held by [its] respective system.” *Id.* at § 22(B). *See also* CAL. CONST. art. XVI, § 17(b) (“The members of the retirement board . . . shall discharge their duties with respect to the system solely in the interest of, and for the exclusive purposes of providing benefits to participants and their beneficiaries, minimizing employer contributions thereto, and defraying reasonable expenses of administering the system. A retirement board’s duty to its participants and their beneficiaries shall take precedence over any other duty.”); IDAHO CODE § 59-1301(2) (LEXIS through 2015 Reg. and First Ex. Sess.’s) (“[T]he fiduciaries of the fund shall discharge their duties with respect to the fund solely in the interest of the members and their beneficiaries”); KAN. STAT. ANN. § 74-4921(1) (LEXIS through 2015 Reg. Sess.) (“The fund is a trust fund and shall be used solely for the exclusive purpose of providing benefits to members and member beneficiaries and defraying reasonable expenses of administering the fund.”); Fitzpatrick & Monahan, *supra* note 66, at 1339 (reporting that in a sample of six state plans, the statutory provisions for each plan require plan assets to be held in trust, and also require the plan trustees to act solely in the interest of beneficiaries, and with the care, skill, and caution of a prudent person in light of the circumstances at the time of the decision).

69. *City of Sacramento v. Pub. Emps. Ret. Sys.*, 229 Cal. App. 3d 1470, 1494–95 (Ct. App. 1991) (holding that “[u]nder well-established rules of the law of trusts, a trustee’s primary duty of loyalty is to the beneficiaries of the trust,” and thus, in interpreting relevant definitions, pension fund trustees must subordinate consideration of employer costs to the obligation to act solely in the interest of the beneficiaries); *see also In re Barney*, 710 A.2d 408, 410 (N.H. 1998) (stating that “[u]nder the common law of trusts, the [board] [of trustees of the New Hampshire Retirement System] owe the [NHRS] members and beneficiaries a fiduciary obligation to manage the [NHRS] for the benefit of its members and beneficiaries”); *White v. Pub. Emps. Ret. Bd.*, 268 P.3d 600, 601, 608 (Or. 2011) (relying on a trustee’s common law obligation to both “protect capital and secure reasonable return” to hold that pension fund trustees “do[] not necessarily breach [their] fiduciary duty” by “administer[ing] the system to create and maintain long-term stability and viability in the system,” even if “in so doing [they] fail[] to maximize the benefits that will be paid to [current plan beneficiaries]”); *Arken v. City of Portland*, 263 P.3d 975, 1006 (Or. 2011) (finding that trustees do breach their fiduciary duties through administrative decisions that favor some beneficiaries over others, since the Restatement of Trusts “makes clear that a trustee has a duty of impartiality and . . . must administer the trust ‘impartially and with due regard for the diverse beneficial interests created by the terms of the trust’”) (quoting RESTATEMENT (THIRD) OF TRUSTS § 79(1)(a) (AM. LAW INST. 2003)).

70. “[E]mployee contribution rates typically are between four and eight percent of pay.” NAT’L ASSN. OF STATE RETIREMENT ADMINS., NASRA ISSUE BRIEF: EMPLOYEE CONTRIBUTIONS TO PUBLIC PENSION PLANS 1 (2015),

Like beneficiaries of traditional donative trusts, the employees cannot sell or transfer their interests in the pension trusts.⁷¹ Unlike donative trust beneficiaries, however, public plan beneficiaries are not directly affected by the trustees' investment management performance. The promised pension benefits are generally fixed and subject to legal restrictions on some forms of benefit reductions, although there is significant variation and legal uncertainty as to the extent of the protections.⁷²

III. PRIOR SCHOLARSHIP

While scholars have analyzed ERISA's initial adoption of donative trust principles, the pension landscape has changed dramatically since 1974. Most importantly, the shortcomings of the trust model as adopted in 1974 were limited by the very nature of the then prominent but now largely extinct private-sector defined benefit plans, which decoupled employee benefits from trustee performance. Plan benefits were protected by funding requirements and by a federal insurance scheme. Still, the transplanted trust regime presented challenges in plan administration decisions and decisions regarding the use of plan assets in corporate

<http://www.nasra.org/content.asp?contentid=122>. “[S]ince 2009, more than 35 states (including Puerto Rico) have increased required employee contribution rates.” *Id.*

71. *See, e.g.*, KAN. STAT. ANN. § 74-4923 (West) (providing that the pension benefits “shall not be subject to execution, garnishment or attachment . . . and shall be unassignable.”).

72. The promised pension benefits are generally treated as contractual obligations, and some are further protected by constitutional amendments prohibiting the reduction of benefits. *See* Amy Monahan, *Understanding the Legal Limits on Public Pension Reform*, AM. ENTERPRISE INST. 3 (2013), http://www.aei.org/files/2013/05/29/-understanding-the-legal-limits-on-public-pension-reform_104816268458.pdf (observing that “[s]ome states have amended their constitutions to specifically provide that public pension benefits shall be considered contractual in nature”). The extent of benefit protection remains subject to significant uncertainty and legal challenges. For a summary of recent litigation challenging benefit reductions, see Pension Litigation Tracker, <http://pensionlitigation.org/category/all/topics/reduced-benefits/?submit=View> (last visited Dec. 1, 2015). Furthermore, the scope of protection in municipal bankruptcy likewise remains unclear. Scholars such as David Skeel have suggested that public plan participants have pension benefit claims that are secured only to the extent of the assets set aside in the pension trusts; for any benefit amounts not secured by assets, participants become unsecured creditors of the municipality not entitled to priority in any reorganization. *See* David Skeel, *Can Pensions be Restructured in (Detroit's) Municipal Bankruptcy?* 11–12 (Oct. 1, 2013) (unpublished manuscript), http://scholarship.law.upenn.edu/faculty_scholarship/508.

reorganizations.⁷³ In such contexts, employer trustees with discretion over the use of plan assets faced strong incentives to use such assets to benefit the corporate shareholders rather than the pension plan beneficiaries.⁷⁴

Scholars such as John Langbein and Daniel Fischel have argued that “it was unwise for ERISA to attempt to capture the complex responsibilities of plan fiduciaries by analogy to the simpler world of the private gratuitous trusts”⁷⁵ when the latter benefits only the donees while the former provides mutual economic advantage.⁷⁶ Settlers of donative trusts have no continuing interests in the trusts, but employers retain strong economic interests in their retirement plans, including the liability for defined benefit plan funding.⁷⁷ Accordingly, Langbein and Fischel have called for more forthright recognition of the *employers’* interests as beneficiaries in the pension trusts, arguing that both employers and employees should be considered trust beneficiaries and that courts should evaluate whether particular trustee decisions are “consistent with the *ex ante* understanding between the parties.”⁷⁸ Acknowledging that this kind of legal analysis would not be simple, the authors have not offered any guidance on how courts should determine whether a particular action is consistent with the *ex ante* understanding among the parties. The lack of concrete guidance for the task reflects the inherent tension in the undertaking: while donative trust law has always required trustees to be impartial with respect to the interests of different beneficiaries, requiring a trustee to adjudicate between the interests of the employer-beneficiaries and employee-beneficiaries would frustrate the very concept of a fiduciary.

Similarly, although scholars have recognized that pension trusts are “self-settled” insofar as they are “created in consideration of services rendered by the employees, and that the employees are

73. See Fischel & Langbein, *supra* note 2, at 1138–43, 1155–57; see also Stein, *supra* note 51 at 54–55.

74. *Id.*; see also Langbein, *supra* note 51, at 132.

75. *Id.* at 1157.

76. *Id.* at 1113–14, 1117–18; see also John H. Langbein, *The Supreme Court Flunks Trusts*, 1990 SUP. CT. REV. 207 (Gerhard Casper et al. eds., 1991) (observing that “there are important differences between the private trust and the pension trust, and ERISA is sometimes insensitive to these differences”).

77. Fischel & Langbein, *supra* note 2, at 1112–13.

78. *Id.* at 1158–59.

therefore the settlors,”⁷⁹ the acknowledgment has been purely theoretical.⁸⁰ After all, if the law recognized employees not just as beneficiaries of the pension trust but also as its settlors, then, under trust law principles, the employees would have to be afforded the corresponding control rights, including control over the selection of the trustees. But a trust in which the employers and employees were both to be properly recognized as “settlor-beneficiaries” would be unworkable.⁸¹ The donative trust assumes the existence of clearly defined settlor preferences and provides a mechanism for imposing such preferences on a trustee, and ultimately on the beneficiaries. The donative trust model does not provide a mechanism for the coordination of the preferences of multiple settlors, particularly where such settlors are also the trust beneficiaries.

The current regulatory framework for private and public plans therefore continues to rely on the fiction that treats employers as the trust settlors and trustees, and employees as the trust beneficiaries. Pursuant to this fiction, the current system relies on traditional donative trust fiduciary obligations to protect locked-in employees, all while saddling them with the investment risk.⁸² Indeed, the regulatory landscape for defined contribution plans now resembles that of welfare benefit plans prior to the passage of the Affordable

79. 1 AUSTIN WAKEMAN SCOTT & WILLIAM FRANKLIN FRATCHER, *THE LAW OF TRUSTS* § 156.3 (4th ed. 1987).

80. See e.g., Dana Muir & Norman Stein, *Two Hats, One Head, No Heart: The Anatomy of the ERISA Settlor/Fiduciary Distinction*, 93 N.C. L. REV. 459, 517 (2015) (noting that a rule in which the fiduciary had to consider and balance the competing interests of employers and employees “would be difficult to fashion and difficult for both fiduciaries and courts to apply”).

81. Business trusts, however, have recognized a version of “settlor-beneficiaries” in the form of “investors,” who voluntarily acquire their interests in the trusts and who may also exit from trust arrangements if they are displeased with the trustee. See, e.g., DEL. CODE ANN. tit.12, § 3805 (West 2016) (“A beneficial owner’s beneficial interest in the statutory trust is freely transferable except to the extent otherwise provided in the governing instrument of the statutory trust.”). Recent analysis of mutual funds—most of which are organized as business trusts—has shown that when investors can exit easily from the trusts, the exit strategy eliminates the investors’ incentives to enforce fiduciary obligations. John Morley & Quinn Curtis, *Taking Exit Rights Seriously: Why Governance and Fee Litigation Don’t Work in Mutual Funds*, 120 YALE L.J. 84, 102 (2010).

82. In contrast, under the default provisions of the statutory business trust statutes, beneficiary interests in statutory business trusts are generally freely transferable and holders of beneficial interests generally have certain control rights, including the right to direct the trustees with respect to certain events. See, e.g., DEL. CODE ANN. Tit. 12, §§ 3805–06 (West 2016) (stating that a “beneficial interest in the statutory trust is freely transferable” and giving persons the right “to direct the trustees . . . in the management of the statutory trust”).

Care Act. In the absence of substantive regulation and in the presence of employer incentives to minimize healthcare expenses, the discretion and deference afforded by ERISA's trust-based framework to conflicted employer fiduciaries became, perversely, "a shield against liability."⁸³

Recent scholarship on retirement savings identifies the numerous shortcomings of the current private and public pension arrangements, including the poor performance of employer fiduciaries,⁸⁴ but rarely directly questions the persistence of the donative trust paradigm across private and public plans.⁸⁵ A number of authors continue to advocate for greater reliance on the fiduciary standard.⁸⁶ However, in what might be considered an implicit

83. See, e.g., Dana M. Muir, *Fiduciary Status as an Employer's Shield: The Perversity of ERISA Fiduciary Law*, 2 U. PA. J. LAB. & EMP. L. 391 (2000) (examining the "perverse operation of ERISA's fiduciary regime" in the "administration of modern health care and pension benefit plans"); see also Langbein, *supra* note 76, at 216; Brendan S. Maher & Peter K. Stris, *ERISA & Uncertainty*, 88 WASH. U. L. REV. 433, 472-73 (2010); Beverly Cohen, *Divided Loyalties: How the Metlife v. Glenn Standard Discounts ERISA Fiduciaries' Conflicts of Interest*, 2009 UTAH L. REV. 955, 974 (2009).

84. On private-sector pension plans, see generally 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 (2002) and Zelinsky, *supra* note 52. On public-sector plans, see generally David Hess, *Protecting and Politicizing Public Pension Fund Assets: Empirical Evidence on the Effects of Governance Structures and Practices*, 39 U.C. DAVIS L. REV. 187 (2005) and Jack M. Beermann, *The Public Pension Crisis*, 70 WASH. & LEE L. REV. 3 (2013).

85. But see Dana M. Muir, *Choice Architecture and the Locus of Fiduciary Obligation in Defined Contribution Plans*, 99 IOWA L. REV. 1 (2013) (criticizing the employer-centric trust model used in 401(k) plan regulation and advocating for the shifting of fiduciary responsibility onto financial service providers); Michael J. Collins, *It's Common, But Is It Right? The Common Law of Trusts in ERISA Fiduciary Litigation*, 16 LAB. LAW. 391 (2001) (analyzing and criticizing the following specific "situations in which courts have utilized the common law of trusts in developing a federal common law of ERISA: (i) a fiduciary duty to disclose early retirement windows that are under 'serious consideration' by management; (ii) a right to contribution from a breaching co-fiduciary; (iii) nonfiduciary liability; and (iv) a requirement that an employee stock ownership plan diversify its investments beyond employer stock").

86. See, e.g., Emily Adams, *Protecting America's Financial Future: Why Courts Should Enforce ERISA's Duties of Prudence and Disclosure*, 26 A.B.A. J. LAB. & EMP. L. 345, 358 (2011) (arguing for stricter court enforcement and "enhanced" fiduciary obligations); Anne Tucker, *Retirement Revolution: Unmitigated Risks in the Defined Contribution Society*, 51 HOUS. L. REV. 153, 215 (2013) (proposing "strengthening fiduciary duties for structural plan decisions"); Dana M. Muir, *Reflections on ERISA's Fiduciary Provisions: An Integral and Integrated Part of the Statute*, 6 DREXEL L. REV. 539, 552 (2013) (arguing that "ERISA's success in significant measure rests on its fiduciary provisions, which are integral to keeping fiduciaries focused on the basics: loyalty and prudence").

acknowledgement of the model's failure, recent academic proposals put forth a variety of regulations to restrict the authority of employers and mandate certain investment options for employee participants.⁸⁷

This Article considers a more fundamental shift. The next Section sets the foundation for the proposed reforms by showing why the donative trust framework has proven inadequate for both private-sector defined contribution plans and public-sector defined benefit plans.

IV. LIMITATIONS OF TRUST-BASED GOVERNANCE

The current regulatory regime for retirement savings centers on the employee-employer relationship. The central role of the employer in individual retirement savings, however, is a historical artifact that reflects an era in which employers used pension and healthcare benefits to avoid wage caps, to encourage bonding to the firm during the employee's most productive years, and to facilitate timely employee departure after a certain age.⁸⁸ Early pension arrangements often did not require employees to directly contribute anything to the pension fund and employers bore the entire investment responsibility and risk. Although the pension benefits were still a form of employee compensation, given the greater employer control and the lack of direct employee contributions or involvement, such arrangements had something of a gift-like quality, which facilitated ERISA's (and public plan) reliance on donative trust fiduciary principles to regulate pension plans. The legacy of the gift analogy is discussed below.

87. See, e.g., James Kwak, *Improving Retirement Savings Options for Employees*, 15 U. PA. J. BUS. L. 483, 511 (2013); Ian Ayres & Quinn Curtis, *Beyond Diversification: The Pervasive Problem of Excessive Fees and "Dominated Funds" in 401(k) Plans*, 124 YALE L.J. 1476, 1501 (2015).

88. Douglas A. Wolf & Frank Levy, *Pension Coverage, Pension Vesting, and the Distribution of Job Tenures*, in RETIREMENT AND ECONOMIC BEHAVIOR 23, 27 (Brookings Institution) (Henry J. Aaron & Gary Burtless eds., 1984) ("[An] employee's productivity begins to decline at some point in his career, but because of the customs of the internal labor market, a firm cannot reduce a long-term employee's wages. For this reason, a firm has an interest in encouraging employees to retire at certain ages. The retirement income provided by a pension facilitates such induced retirement.").

A. Private-Sector Plans

This Section considers the shortcomings of the private-sector 401(k) plans that stem from the reliance on the donative trust framework as a primary regulatory tool.⁸⁹ Today, employees are at the mercy of employer “settlers” to establish a plan in the first place, leaving more than forty percent of private-sector employees without access to an employer-sponsored retirement plan.⁹⁰ Those with access to an employer plan and who choose to make salary deferrals to save for retirement remain subject to employer control over plan design and administration. In the absence of market checks, to protect locked-in employees, the current framework imposes fiduciary obligations on employers that administer such plans. Such obligations are not consistent with the employers’ economic interests and are not readily enforceable by the employees or relevant regulatory agencies. Empirical and anecdotal evidence suggests that as a result of having the employers as mandatory investment intermediaries, employees are frequently subjected to poorly constructed investment menus and non-transparent fee structures.

1. Employers as both settlers and fiduciaries

According to the Department of Labor, the decision to offer a retirement plan can be “one of the most challenging, yet rewarding” decisions that an employer can make.⁹¹ No employer is required to establish a retirement plan. Many do not. The ability of employers to simply cease offering retirement plans at any time animates the current regulatory framework.⁹²

89. Although ERISA does impose a disclosure and reporting regime on 401(k) plans, as well as certain non-discrimination, anti-alienation and vesting rules, the *administration* of 401(k) plans is regulated primarily by the imposition of trust-based fiduciary obligations on those who administer such plans. The application of such obligations in practice has generated much confusion. *See, e.g.*, Advisory Council on Emp. Welfare & Pension Benefit Plans, *Outsourcing Employee Benefit Plan Services*, <http://www.dol.gov/ebsa/publications/2014ACreport3.html> (last visited Apr. 23, 2016).

90. BUREAU OF LABOR STATISTICS, *EMPLOYEE BENEFITS IN THE UNITED STATES – MARCH 2014* (2014).

91. *Meeting Your Fiduciary Responsibilities*, U.S. DEP’T OF LABOR, <http://www.dol.gov/ebsa/publications/fiduciaryresponsibility.html> (last visited Apr. 23, 2016).

92. *See, e.g.*, Daniel Halperin, *Employer-Based Retirement Income—the Ideal, the Possible, and the Reality*, 11 *ELDER L.J.* 37, 44 (2003) (observing that because private pensions

The decision to offer a retirement plan is itself purely a business or “settlor” decision that is not governed by ERISA’s fiduciary standards. Similarly, decisions to determine the benefit package, to include certain features in a plan, to amend a plan, and to terminate a plan—in effect, the infinite number of choices that shape a plan’s design—are also business decisions in which an employer may act on behalf of the business and presumably in the best interest of the shareholders.⁹³

Once the plan is established, however, the employer, like a trustee in a donative trust, must take on fiduciary responsibilities with respect to the plan. With the exception of the so-called “business” decisions enumerated above, employers who have discretion over the plan or plan assets must exercise their discretion *solely* in the interest of plan participants and for the exclusive purpose of providing benefits and defraying reasonable expenses. They must carry out their duties prudently and in accordance with the plan documents.⁹⁴

In practice, the fiduciary duty of 401(k) plan sponsors (i.e., the employers) extends primarily to (1) the day-to-day administration of the plan, including the establishment of a trust to hold plan assets, a recordkeeping system to track the flow of monies going to and from the retirement plan, and a reporting system to provide adequate disclosure to participants and to the government; and (2) the selection and monitoring of an investment menu from which individual participants select their investments.⁹⁵ In each case, although a plan sponsor may hire third-party service providers with relevant expertise to assist with the enumerated tasks, the selection

are voluntary arrangements, “[t]he greater the pressure put on employers to provide more widespread benefits, the less likely it is they will maintain pension plans at all”).

93. *See, e.g., Lockheed Corp. v. Spink*, 517 U.S. 882, 890 (1996) (“Plan sponsors who alter the terms of a plan do not fall into the category of fiduciaries When employers undertake those actions, they do not act as fiduciaries . . . but are analogous to the settlors of a trust.”).

94. 29 U.S.C.A. § 1104(a) (2012).

95. ERISA Section 404(c) allows employers to delegate individual investment decisions to employees. The employer is then relieved of fiduciary responsibility for the employees’ selections if the investment menu provides the employees with a range of diversified investment options, with enough information about the alternatives to enable employees to make informed investment decisions, and with the right to change their investment selections with reasonable frequency. 26 I.R.C. § 404(c) (2012); 29 U.S.C.A. § 1104(c) (2012).

and oversight of such providers is itself a fiduciary task that remains with the employer.⁹⁶

Employer decisions regarding the investment menu and the selection of third-party service providers have a significant impact on the long-term savings of individual plan participants. The impact comes primarily in the form of plan costs and the extent to which an employer is prudent in ensuring that the costs charged to the employees are reasonable relative to the services provided. Fees and expenses paid by employees substantially reduce the growth in employee retirement accounts. As the Department of Labor has warned, over thirty-five years, a “1 percent difference in fees and expenses [reduces an] account balance at retirement by 28 percent.”⁹⁷

96. See, e.g., Dana M. Muir, *Revenue Sharing in 401(k) Plans: Employers as Monitors?*, 20 CONN. INS. L.J. 485, 504 (2014) (“ERISA’s exclusion of mutual funds from fiduciary status and de facto exclusion of nearly any service provider that wants to be excluded leaves employers holding the fiduciary bag for 401(k) plans.”). In recent years, multiple employer plans (MEPs), including so-called “open MEPs,” have gained some traction among small and mid-sized employers. MEPs generally purport to take on plan administration for participating employers, thus reducing employers’ fiduciary liability. See, e.g., Dan Toomey, *Is a Multiple Employer Plan the Right Retirement Option for Your Business?*, TRINET (May 2012), http://www.trinet.com/newsletter/05_12/multiple_employer_plan.htm. Although the Department of Labor has expressed concern over such arrangements particularly with respect to the “open” MEPs that bring together unrelated employers, there appears to be growing momentum to resolve the current limitations of the open MEP arrangements. See Hazel Bradford, *Multiple employer plans grabbing more attention*, PENSIONS & INVESTMENTS (Mar. 17, 2014) (noting that Phyllis Borzi, Assistant Secretary of Labor of the Employee Benefits Security Administration, has suggested that promoters of open MEPs are “falsely claiming the employers will have no ERISA reporting or fiduciary obligations if they sign up for an open MEP”); Sean Forbes, *Support for Open MEPs Builds at Senate Panel Hearing*, PENSION & BENEFITS DAILY (Oct. 28, 2015). In 2015, the Department of Labor even expressed its support for the creation of state-sponsored multiple employer plans. See Employee Benefits Security Administration, *Interpretive Bulletin Relating to State Savings Programs that Sponsor or Facilitate Plans Covered by ERISA*, 80 Fed. Reg. 71936 (2015), <http://webapps.dol.gov/federalregister/PdfDisplay.aspx?DocId=28540>. At the same time, certain service providers have begun to encourage plan sponsors to name an external investment manager directly in the plan documents in order to transform such act from a fiduciary one to a “non-fiduciary settlor act.” See, e.g., Heath Miller & Al Otto, *Conflicts Bring Liability to Retirement Plan Fiduciaries: The Ethics of Serving Two Masters*, AM. CONF. INST. (May 2014), <http://www.americanconference.com/blog/wp-content/uploads/2014/05/2014-ICLE-Article.pdf>. The merits of this legal theory have not been tested and the strategy, while likely to foster the entrenchment of particular service providers, would not absolve plan sponsors from ongoing monitoring obligations.

97. *A Look At 401(k) Plan Fees*, U.S. DEP’T OF LABOR, http://www.dol.gov/ebsa/publications/401k_employee.html (last visited Apr. 23, 2016).

What sorts of costs must the employer negotiate and monitor for its employees? The largest component of 401(k) plan fees and expenses is associated with managing plan investments. Fees for investment management and other investment-related services are generally assessed as a percentage of assets invested by particular employees and are ultimately deducted from the investment returns. A particular investment fund may, for example, charge individual participants 75 basis points as an investment management fee. In addition, there are the administrative costs of setting up and operating the plans, including the provision of recordkeeping, accounting, legal, and trustee services.

At present, there are a myriad of fees and fee arrangements that service providers and employers use to cover the various costs of providing a 401(k) plan to employees.⁹⁸ For example:

- The employer may choose to cover some or all of the administrative expenses of the retirement plan using its corporate assets. Such a decision is not a fiduciary decision and the expenses covered by the employer are not subject to any kind of “reasonableness” test under ERISA; or
- The employer may pass both the administrative and the investment costs onto the plan. In this case, the administrative costs may be shared equally by all participants or allocated in proportion to the value of assets in individual accounts; or
- The employer may negotiate a revenue sharing arrangement whereby service providers offer to apply some of the revenue from certain investment management fees toward the costs of plan administration; in such cases, either the employer’s “out of pocket” bill may decrease, or a smaller administrative expense may be charged to the plan. Importantly, because only certain investment options (for example, certain actively managed funds) may offer the revenue sharing feature, the fees collected from individuals who select such investment

98. Plan sponsors currently have to navigate the revenue sharing fees, sub-TA fees, shareholder servicing fees, 12b1 fees, finder’s fees, wrap fees, mortality fees, and market adjustment fees. See Matthew D. Hutcheson, *Uncovering and Understanding Hidden Fees in Qualified Retirement Plans*, 15 ELDER L.J. 323, 339 (2007); see also Deloitte Consulting LLP, *Inside the Structure of Defined Contribution/401(k) Plan Fees, 2013: A study assessing the mechanics of the ‘all-in’ fee* 6 (Aug. 2014) (noting that “[t]here are a variety of fee arrangements to pay for the wide array of services used by defined contribution plans,” all of which can be combined together in a variety of different ways based on the needs of the plan sponsor).

options may subsidize the administrative expenses for the plan as a whole.⁹⁹

In each case, the employer meanders between settlor and trustee roles,¹⁰⁰ all while serving as a critical intermediary between individual employees and the capital markets. The next sections present the empirical evidence of poor employer performance in this intermediary capacity, as well as the reasons why such empirical findings should not be surprising.

2. *Assessing fiduciary performance*

The decisions of private-sector employers with respect to plan administration, though subject to the fiduciary standard, have frequently left employees with investment options and fee arrangements that are suboptimal relative to what is available in the marketplace.¹⁰¹ Despite extensive empirical evidence documenting the desirability of low-cost index funds, employer-constructed 401(k) menus have continued to add relatively expensive actively managed funds,¹⁰² including those whose above-average expenses could not be justified by the added diversification.¹⁰³ According to a recent study, in the average 401(k) plan, “an investor making optimal menu allocations [has been] forced to pay forty-three basis

99. Jill E. Fisch, *Rethinking the Regulation of Securities Intermediaries*, 158 U. PA. L. REV. 1961, 1983 (2010). As Fisch recounts, the issue is whether companies managing the plans are receiving payments in return for including certain fund companies in their plans. Such payments might encourage employers to include inferior funds in their investment menus and to reject strong performers that do not participate in revenue sharing. *Id.*

100. See *infra* Section IV.A.3.

101. Ayres & Curtis, *supra* note 87, at 1501 (concluding that the study’s empirical findings show that “high fees are a significant issue for participants in 401(k) plans”). For an overview of the nearly forty cases related to 401(k) fees that had been commenced as of September 2015, see *401(k) Fee Cases, Chartered*, GROOM L. GROUP, (Sep. 30, 2015), http://www.groom.com/media/publication/1636_401k_Fee_Cases%20Detailed_Chart_September%20_2015.pdf.

102. See Kwak, *supra* note 87, at 511; see also Jeffrey R. Brown, Nellie Liang, & Scott Weisbenner, *Individual Account Investment Options and Portfolio Choice: Behavioral Lessons from 401(k) Plans*, 91 J. PUB. ECON. 1992, 1992-2013 (2007) (finding that “the vast majority of the new funds added to 401(k) plans are high-cost actively managed equity funds, as opposed to lower-cost equity index funds.”).

103. Ayres & Curtis, *supra* note 87, at 1504–07 (discussing the problem of so-called “dominated funds,” which the authors describe as “funds that are so clearly inferior to other funds or groups of funds offered in the same plan menu that investors are clearly better off avoiding them” and finding that in a sample of 3,534 plans, 52% had at least one dominated fund on the menu).

points in expenses over [a low-cost] benchmark,” with “19% of plans hav[ing] menu additional fund fees of more than seventy-five basis points.”¹⁰⁴ In some cases, the additional fees from poorly constructed plan menus have eliminated the preferential tax treatment afforded to 401(k) plans.¹⁰⁵ Although poorly constructed menus have been found across all types of employers, losses from additional fees have been particularly high for employees in smaller plans, which have had both higher costs and lower quality menus.¹⁰⁶

The high fees in 401(k) plans reflect two underlying weaknesses of employer-fiduciaries. First, despite their obligation to act prudently—that is “with the care, skill, prudence and diligence under the circumstances then prevailing that a prudent man acting in a like capacity and familiar with such matters would use in the conduct of an enterprise of a like character and with like aims”¹⁰⁷—employer fiduciaries have demonstrated profound gaps in their understanding of retirement plan arrangements. The Government Accountability Office (GAO) has documented employers’ struggle to understand the fees that they and their participants are charged, as well as their tendency to underestimate the fees to which their employees are subject.¹⁰⁸ For example, approximately half of the employers surveyed by the GAO in 2011 “did not know if they or their participants paid investment management fees” or whether their plans incurred transaction costs, while a third did not know whether or not the plan paid for trustee, legal, or audit services.¹⁰⁹ Scholars have observed that it has been seemingly “impossible to require employers to take more of an interest in their employees’ retirement savings options”¹¹⁰

104. *Id.* at 1501.

105. *Id.*

106. *Id.* (finding that “the problem of fees is especially acute in small plans”); *see also* Deloitte Consulting LLP, *supra* note 98, at 4 (finding plan size to be a significant fee driver).

107. 29 U.S.C.A. § 1104(a)(1)(B) (2012).

108. *See* U.S. GOV’T ACCOUNTABILITY OFFICE, GAO-12-325, 401(K) PLANS: INCREASED EDUCATIONAL OUTREACH AND BROADER OVERSIGHT MAY HELP REDUCE PLAN FEES (2012) (citing various consultants’ observations regarding common employer misunderstanding and finding, for example, “that at least 45 of the 91 plan sponsors [surveyed] had revenue sharing arrangements, despite reporting not having or not knowing of such arrangements”).

109. *Id.* Lack of relevant knowledge was more prevalent among small employers (those with fewer than 50 employees). *Id.* at 17–18.

110. Kwak, *supra* note 87, at 511; *see also* Brown et al., *supra* note 102.

and that “few employers regularly audit their plans to lower costs.”¹¹¹ Phyllis Borzi, the Assistant Secretary of Labor of the Employee Benefits Security Administration, observed that as of 2013, many plan sponsors did not understand the pricing structure for bundled services and mistakenly thought that “services like recordkeeping were being provided free of charge.”¹¹² The Department of Labor has since promulgated fee-disclosure regulations to help both plan fiduciaries and plan participants make better-informed decisions.¹¹³ Though the effectiveness of these disclosure requirements remains to be determined, the need for such an intervention underscores the limitations of fiduciary-based governance in the current pension landscape.¹¹⁴

The regulatory efforts also reflect the challenges facing employer fiduciaries in navigating relationships with—and payments to—third-party service providers, some of whom provide both plan-related and non-plan-related corporate services to the plan sponsors.¹¹⁵ As recent litigation has revealed, such service providers may discount non-plan

111. John Wasik, *Why 401(k)s Have Failed*, FORBES (Apr. 24, 2013), <http://www.forbes.com/sites/johnwasik/2013/04/24/why-401ks-have-failed/#199dc50d4a7e>.

112. Christopher Carosa, *Exclusive Interview with Phyllis C. Borzi: Why Plan Sponsors Shouldn't Treat Their 401k Plans Like Cheap T-Shirts*, FIDUCIARYNEWS.COM (Sept. 24, 2013, 12:03 AM), <http://www.fiduciarynews.com/2013/09/exclusive-interview-with-phyllis-c-borzi-why-plan-sponsors-shouldnt-treat-their-401k-plans-like-cheap-t-shirts/>.

113. See 29 C.F.R. § 2550.408b-2(c)(iv) (establishing specific disclosures that plan service providers must provide to plan fiduciaries to help ensure that the fiduciaries are provided the information they need to assess both the reasonableness of the compensation to be paid for plan services and potential conflicts of interest that may affect the performance of those services); Fiduciary Requirements for Disclosure in Participant-Directed Individual Account Plans, 29 C.F.R. § 2550.404a-5(c)-(d) (requiring plan administrators to provide participants with certain “plan-related” and “investment-related” information).

114. The regulations—and employer fiduciaries—face an uphill battle since “service providers are going to considerable lengths to make the mandated fee disclosures difficult for employers to comprehend and analyze.” See Dana M. Muir, *Revenue Sharing in 401(k) Plans: Employers as Monitors?*, 20 CONN. INS. L.J. 485, 509 (2014).

115. See, e.g., *Tussey v. ABB, Inc.*, 746 F.3d 327, 337–41 (8th Cir. 2014) *cert. denied*, 135 S. Ct. 477 (2014) (finding an ERISA violation in the plan sponsor’s failure to evaluate the reasonableness of fees charged by its recordkeeper); *Kruger v. Novant Health, Inc.*, No. 1:14CV208, 2015 WL 5511052 (M.D.N.C. Sept. 17, 2015) (denying a motion to dismiss plaintiffs’ claims that the plan sponsor violated its fiduciary obligations by failing to monitor the compensation, including the increase in fees, paid to the plan recordkeeper); Complaint, *Troudt v. Oracle Corp.*, D. Colo., No. 1:16-cv-00175 (Jan. 22, 2016) (alleging that Oracle breached its ERISA fiduciary duties by paying excessive fees for record-keeping and administrative services and resulting in more than \$40 million of losses to the plan).

services provided to plan sponsors while charging above-market rates for the plan services.¹¹⁶ Alternatively, investment fund providers have commonly offered to “share” or channel a portion of the investment management fees from *certain* funds toward the cost of various administrative services provided for 401(k) plans, thereby lowering employers’ out-of-pocket costs.¹¹⁷ Recent scholarship has also shown that employers have not successfully resisted the tendency of mutual fund companies serving as plan trustees to include their own affiliated funds in the investment menus, even when such funds have performed poorly.¹¹⁸

3. *The shortcomings of ERISA’s fiduciary standard*

ERISA’s fiduciary standard, though arguably an afterthought in the original 1974 legislation, has become the centerpiece of 401(k) plan governance. Yet while ERISA’s drafters understood that a fiduciary standard borrowed from trust law and superimposed on private employers could not substitute for substantive pension regulation, current pension regulation aims to protect U.S. employees primarily by subjecting those who administer private pension plans to trust law’s care and loyalty obligations.

This Section shows that while the fiduciary regime may be an efficient governance mechanism for a traditional donative trust, it is ill suited for the non-donative, dual-settlor, dual-beneficiary arrangement that is the modern 401(k) plan. The trust-based fiduciary standard for plan administration is generally inconsistent with employers’ economic interests and “settlor” rights and, in the absence of rules-based guidance, creates costly uncertainty for plan sponsors. Furthermore, because both employee rights and judicial review of plan administration draw on trust-law principles, employees have limited access to either judicial or market remedies for plan mismanagement.

a. Employer conflict, confusion, and costs. First and foremost, the current fiduciary regime perpetuates ERISA’s long-standing fiction

116. *Tussey*, 746 F.3d 327 (finding that the employer defendants knew that removing a particular Wellington Fund and mapping its assets to the Fidelity Freedom Funds would ultimately benefit ABB).

117. See Muir, *supra* note 114, at 487–95 (2014).

118. Veronika K. Pool, Clemens Sialm, & Irina Stefanescu, *It Pays to Set the Menu: Mutual Fund Investment Options in 401(k) Plans*, J. FIN. 1 (Dec. 2015).

about the employer's ability to successfully wear and switch between two "hats"—one for its role as settlor, which permits the employer to consider its own interests in establishing and designing a plan, and another for its role as plan fiduciary, which requires the employer to act solely in the interest of plan participants in the course of plan administration.¹¹⁹ The second hat requires employers—who are otherwise conditioned to further the interests of shareholders—to act solely in the interest of employees when dealing with what is, in effect, a form of employee compensation. But employers do not conceive of themselves as fiduciaries of the employees when negotiating and managing other forms of employee compensation, and indeed are typically in a kind of adversarial position with respect to the employees.¹²⁰

Although ERISA does not require employers to wear the fiduciary hat when determining the generosity of the plan terms, the problem is that the line between settlor and fiduciary decisions has never been, and indeed, can never be, clear.¹²¹ Many administrative "settlor" decisions, in practice, have the same effect as "fiduciary" implementation decisions. For example, employers can freely choose to offer less generous contributions or not to pay for certain administrative costs of the plan (settlor decisions), yet they may not take employer costs into consideration when selecting service providers or investment options (fiduciary decisions). It is not surprising that a sample of recent settlements reflects employers' unwillingness to heed this artificial distinction.¹²²

119. At its inception, the drafters of ERISA were cognizant of the fact that employers liable for the funding of defined benefit plans would demand control over such plans. Accordingly, ERISA permitted employers to have their own officers, employees, or agents serve as trustees and manage the administration of the plan and the investment of plan assets. See Fischel & Langbein, *supra* note 2, at 1126–27. The courts subsequently held that nonneutral trustees must make their decisions "with an eye single to the interests of the participants and beneficiaries," but would not be found at fault if particular decisions "incidentally" benefitted the corporation. See *Donovan v. Bierwirth*, 680 F.2d 263, 271 (2d Cir. 1982).

120. See, e.g., Maher, *supra* note 60, at 43 (noting that in negotiating the terms of employee benefits such as pensions, "the employer is presumptively the employee's adversary").

121. For a discussion of the limitations of the Supreme Court's settlor/fiduciary doctrine, see Muir & Stein, *supra* note 80, at 514–36.

122. Robert Steyer, *Recent Fiduciary Breach Settlements*, PENSIONS & INVS. (Feb. 23, 2015), <http://www.pionline.com/article/20150223/PRINT/302239972/recent-fiduciary-breach-settlements> (describing various "revenue sharing" arrangements in which fees for certain investments were used to offset employer costs); see also Amy B. Monahan, *Employers as*

Among the employers who recognize the obligation to wear the fiduciary hat in administering the plan, many struggle to understand precisely what the fiduciary hat requires. Fiduciary obligations do not set clear rules and requirements for plan administration or investment menu selection, but instead operate on the basis of vigorously litigated loyalty and prudence standards. Current litigation reveals a striking lack of consensus about what the fiduciary standard requires of plan fiduciaries.¹²³

Consequently, retirement experts observe that “plan sponsors just aren’t aware of the nature of their responsibilities as plan sponsors” and many “don’t recognize the true nature of their personal fiduciary liability.”¹²⁴ Even scholars and practitioners who embrace the current fiduciary framework seek to simplify the fiduciary standard by replacing it with a list of permissible investments that limit the employer’s fiduciary discretion.¹²⁵ At the same time, a whole industry has emerged to find ways of helping employers skirt the fiduciary label and limit participants’ ability to bring suit, thereby frustrating the very purpose of the federal legislation.¹²⁶

Risks, 89 CHI.-KENT L. REV. 751, 773 (2014) (“An employer may select a 401(k) plan administrator, and 401(k) plan investment options based on which company will provide them with the lowest out-of-pocket costs, not which will deliver the most retirement security to participants.”).

123. See, e.g., Jacklyn Wille, *Justices Wrangle With Monitoring Duties of 401(k) Fiduciaries During Oral Arguments*, PENSION & BENEFITS DAILY (Feb. 25, 2015), http://news.bna.com/pdln/display/batch_print_display.adp?searchid=26395545 (noting the lack of consensus among Supreme Court justices in determining what 401(k) fiduciaries monitoring plan investments must do to satisfy their fiduciary obligations); see also Advisory Council on Employee Welfare and Pension Benefit Plans, *supra* note 89 (calling on the Department of Labor to clarify fiduciary obligations in outsourcing administrative tasks).

124. Carosa, *supra* note 112.

125. Kwak, for example, suggests that the Section 404(c) fiduciary safe harbor should be limited to plans that only include low-cost index funds. Kwak, *supra* note 87, at 530.

126. See, e.g., John J. Cannon III & Kenneth J. Laverriere, *Just Say No: Why Directors Should Avoid Duties That Will Subject Them to ERISA*, PENSION & BENEFITS DAILY (Feb. 25, 2015), http://news.bna.com/pdln/display/batch_print_display.adp?searchid=26395549 (noting that “ERISA imposes standards of conduct on fiduciaries that are more restrictive than those imposed on directors generally, and complying with these standards can lead to potential conflicts with a director’s overall responsibility to the corporation and its shareholders.”); Heath Miller & Al Otto, *Conflicts Bring Liability to Retirement Plan Fiduciaries: The Ethics of Serving Two Masters*, AM. CONF. INST. (May 2014), <http://www.americanconference.com/blog/wp-content/uploads/2014/05/2014-ICLE-Article.pdf> (discussing the strategy of designating investment managers directly in the plan document as a means of limiting the liability of the plan sponsor); *Defined Contribution*

The search for ways to escape the fiduciary label reflects the fact that fiduciary decision-making is not costless for employers, who, by deciding to offer a 401(k) plan, accept the risk of fiduciary liability for any actions taken in a fiduciary capacity. The time and effort necessary to understand the 401(k) landscape; to find, evaluate, and monitor service providers; and to construct investment menus that will pass fiduciary muster is not trivial for the many employers who are not in the business of investment management and whose staffs have no special skills or preparation for the task.¹²⁷

The benefits of employee retention and satisfaction, however, are more likely to correlate with the generosity of the “settlor” (non-fiduciary) decisions like employer matches, than with the degree of menu or fee optimization.¹²⁸ The latter is relatively difficult to assess and of varying consequence to different employees. To the extent that an employer offers in its 401(k) menu both “good” and “bad”

Outsourcing with Russell, RUSSELL INVESTMENTS, <http://www.russell.com/us/institutional-investors/solutions/defined-contribution-outsourcing.page> (last visited Apr. 23, 2016); see also Christopher Carosa, *Exclusive Interview: ERISA Attorney Stephen Rosenberg Says Litigation's Legacy is Improved Plan Design*, FIDUCIARYNEWS.COM (Oct. 20, 2015), <http://www.fiduciarynews.com/2015/10/exclusive-interview-erisa-attorney-stephen-rosenberg-says-litigations-legacy-is-improved-plan-design/> (observing that, in response to the recent uptick in 401k litigation, plan sponsors have sought to design and draft retirement plans in ways that “limit, either substantively or tactically, the ability of participants or beneficiaries to successfully bring suit . . .”).

127. See Nevin Adams, *Biggest Small Plan Barrier? Burdensome Administration*, ASPPA NET (Feb. 6, 2015), <http://www.asppa.org/News/Browse-Topics/Details/ArticleID/4232/Biggest-Small-Plan-Barrier-Burdensome-Administration> (reporting that burdensome plan administration was the largest obstacle to smaller employers offering a workplace retirement plan); Comment Letter from Norman Stein, Senior Policy Advisor, Pension Rights Center (Jan 19, 2016), <http://www.dol.gov/ebsa/pdf/1210-AB71-00065.pdf> (observing that “many small employers lack expertise to identify plan providers whose products comply with ERISA prudence without engaging expensive independent advisors, and many such employers may thus have concerns about potential liability when they act without such expertise.”).

128. See, e.g., Amy B. Monahan, *An Affordable Care Act for Retirement Plans?* 20 CONN. INS. L.J. 459, 465 (2014) (noting that “most employees, when deciding whether or not to accept or retain an offer of employment from a firm, probably do not examine plan details such as plan defaults, the quality of plan investments, investment fees, or forms of distribution”). Furthermore, the adequacy of employees’ retirement plan savings is seldom of concern to employers. See *Majority of U.S. Companies Do Not Measure Effectiveness of Retirement Plans for Employees, Wells Fargo Survey Reveals*, WELLS FARGO (Apr. 19, 2012), https://www.wellsfargo.com/about/press/2012/20120419_MajorityofUSCompanies/ (finding that as of 2011, only 11% of plan sponsors were “measuring each employee’s retirement income and comparing it to expected needs; the majority (51%) [did] not provide employees with estimates of annual retirement income they [could] expect based on plan balances”).

options, the employees who select the “good” options are no worse off for having certain “bad” options in the menu (indeed, they may actually be better off if the revenue sharing fees from the “bad” options are used to cover the administrative expenses of the plan as a whole). Thus, despite the obligations imposed by ERISA’s “fiduciary” hat, employers face significant hurdles in meeting those obligations. Enforcement of such employer obligations is limited by the features of the trust-based judicial review discussed below.

b. Trust-based judicial review. The 2015 Supreme Court opinion in *Tibble v. Edison* follows a long line of cases that invoke the donative trust analogy in determining the scope of ERISA fiduciary obligations and the appropriate standard of judicial review.¹²⁹ In applying the analogy, however, the courts have wrestled with the reality that employers who believe that the costs of 401(k) plans outweigh their benefits may terminate existing plans or refuse to form new ones.¹³⁰ In other words, the limits of fiduciary obligation in the context of retirement plans have been set, at least in part, by employer threats to stop offering plans to their employees.¹³¹ The fear of discouraging plan formation has resulted in the application of the trust analogy that places a great premium on the employers’ role as trust settlors, while ignoring the employees’ settlor role and the employers’ beneficiary interests. Employers, like donative trust settlors, have been afforded great deference in setting the scope of “trustee” authority to administer the trust and interpret its terms.¹³²

129. *Tibble v. Edison Int’l.*, 135 S. Ct. 1823, 1828 (2015) (stating that the court has “often noted that an ERISA fiduciary’s duty is derived from the common law of trusts”).

130. *See, e.g., Zelinsky, supra* note 52, at 524 (observing that “employers’ decisions to maintain and establish defined contribution plans are voluntary; if the costs of such plans outweigh the perceived benefits, employers will abandon such plans or will not establish them in the first place”).

131. The courts’ decisions have been made partly to “help[] keep administrative and litigation expenses under control” so that such expenses do not “discourage employers from offering [ERISA] plans in the first place.” *Tibble v. Edison Int’l.*, 711 F.3d 1061, 1078 (9th Cir. 2013) (quoting *Conkright v. Frommert*, 130 S. Ct. 1640, 1648 (2010)); *see also* *Varity Corp. v. Howe*, 516 U.S. 489, 497 (1996) (noting that “courts may have to take account of competing congressional purposes, such as Congress’ desire to offer employees enhanced protection for their benefits, on the one hand, and, on the other, its desire not to create a system that is so complex that administrative costs, or litigation expenses, unduly discourage employers from offering welfare benefit plans in the first place”).

132. In the seminal case *Firestone Tire & Rubber Co. v. Bruch*, the Supreme Court held that “principles of the law of trusts . . . establish that a denial of benefits . . . must be reviewed under a de novo standard *unless the benefit plan expressly gives the plan administrator or*

Consequently, courts have deferred to employer fiduciaries (by analogy to *impartial* donative trust trustees) on the interpretation of contested plan terms, even where employers have had a clear financial interest in such interpretations and even where the participants have claimed that plan fiduciaries breached their duties of prudence or loyalty.¹³³

At the same time, the delegation of investment selection to individual participants has challenged the courts to determine the scope and nature of the plan sponsor's remaining fiduciary liability. In the wake of class-action lawsuits against several large employers, the courts have sought to determine the plan sponsors' fiduciary obligations with respect to the selection and oversight of investment and administrative service providers.

The judicial focus to date has been on process and disclosure. Provided that adequate disclosure has been made and the employer's process for selecting funds was not unreasonable,¹³⁴ courts have

fiduciary discretionary authority to determine eligibility for benefits or to construe the plan's terms, in which cases a deferential standard of review is appropriate." 489 U.S. 101, 102 (1989) (emphasis added). Not surprisingly, subsequent plans' sponsors have ensured the availability of the deferential standard of review by drafting the plan documents to grant the required discretion to the plan administrators. Importantly, however, the deferential review in trust law is premised on decision making by *disinterested* fiduciaries. ERISA, however, explicitly authorizes nonneutral fiduciaries with dual loyalties. Plan sponsors routinely have their own employees and management personnel serving in fiduciary capacities for the retirement plans. See Langbein, *supra* note 76, at 213. The only limit the *Firestone* Court imposed on deferential review was that a reviewing court must consider a fiduciary's actual conflict of interest as a factor in determining whether there is an abuse of discretion. See *Metropolitan Life Ins. Co. v. Glenn*, 128 S. Ct. 2343 (2008) (holding that "circumstances" should be taken into account in evaluating the presence of the conflict but refusing to provide further guidance on the conflicts of interest).

133. For a survey of the conflicts of interest and the relevant case law, see Maher & Stris, *supra* note 83, at 471-73; Kathryn J. Kennedy, *Judicial Standard of Review in ERISA Benefit Claim Cases*, 50 AM. U. L. REV. 1083, 1146-52 (2001). See also Brief for the United States as Amicus Curiae, On Petition for a Writ of Certiorari, *Tibble v. Edison Int'l*, 135 S. Ct. 1823 (2014) (No. 13-550) ("Post-*Firestone*, there is some confusion in the circuits on the question whether deferential review applies to a claim of breach of the duties of loyalty or prudence, where the claim turns on plan interpretation and the plan grants the administrator discretionary authority.").

134. Only in extreme cases have disclosure and process been held to be inadequate. In *Braden v. Wal-Mart Stores, Inc.*, for example, the complaint attacked the plan's mutual funds on multiple substantive grounds (alleging that they charged unnecessarily high fees, underperformed available alternatives, offered expensive retail shares instead of cheaper institutional shares, and charged marketing fees that did not benefit participants). 588 F.3d 585, 600 (8th Cir. 2009). The Eighth Circuit's reversal was based on the disclosure issue. The plaintiffs alleged that mutual funds were included in their plans because such funds made

permitted investment menus to include “expensive” investment options alongside diversified offerings of less expensive alternatives.¹³⁵ In *Hecker v. Deere & Co.*, for example, the Seventh Circuit rejected an excessive fee claim because the plan in question offered more than twenty mutual funds, including some with low fees, and also allowed participants to select from over two thousand other funds through a brokerage service.¹³⁶ Although the “large menu” defense has since lost some favor, as currently interpreted by courts, the trust-based legal regime for 401(k) plans demands that plan fiduciaries select, via a reasonably well-documented process, investment options and service providers that are not, and do not become, significantly or uniformly more expensive than industry norms.¹³⁷ The recent wave of lawsuits reveals the challenges that even large, sophisticated employers face in meeting this basic standard.¹³⁸ And while the high dollar settlement amounts have certainly piqued plan sponsor attention, such enforcement strategies are not practical for the vast majority of smaller

payments to the plan trustee and administrator. *Id.* The Eighth Circuit agreed that information about revenue sharing could be material because it “could influence a reasonable participant in evaluating his or her options under the Plan.” *Id.* In *Tibble*, the Ninth Circuit focused on the menu selection process in evaluating the prudence of the trustees’ decision to include retail-class shares of three specific mutual funds as investment options. In the absence of any evidence that, as a matter of process, the fiduciaries considered the possibility of cheaper, but otherwise similar, institutional classes for the funds, the court found the trustees in breach of the fiduciary duty of prudence. *Tibble v. Edison Int’l*, 711 F.3d 1061 (9th Cir. 2013).

135. See, e.g., *Renfro v. Unisys Corp.*, 671 F.3d 314, 327–28 (3d Cir. 2011) (“In light of the reasonable mix and range of investment options in the Unisys plan, plaintiffs’ factual allegations about Unisys’s conduct do not plausibly support their claims.”); *Loomis v. Exelon Corp.*, 658 F.3d 667, 673–74 (7th Cir. 2011) (“[The plan sponsor] offered participants a menu that includes high-expense, high-risk, and potentially high-return funds, together with low-expense index funds that track the market, and low-expense, low-risk, modest-return bond funds. It has left choice to the people who have the most interest in the outcome, and it cannot be faulted for doing this.”).

136. *Hecker v. Deere & Co.*, 556 F.3d 575, 586 (7th Cir. 2009) (holding that because the plan sponsor disclosed to the participants the total fees for the funds and directed the participants to the fund prospectuses for information about the fund-level expenses, the omission of information about the revenue-sharing arrangement was not material).

137. See, e.g., Stephen D. Rosenberg, *Retreat from the High Water Mark: Breach of Fiduciary Duty Claims Involving Excessive Fees After Tibble v. Edison International*, 18 J. PENSION BENEFITS 12 (2011).

138. See *401(k) Fee Cases*, *supra* note 101.

retirement plans and do little to ameliorate the limits of the fiduciary obligation in the face of employer self-interest.¹³⁹

c. Employee complacency, lock-in, and lack of coordination. In addition to the problems described above, the current fiduciary-centric regime may have the perverse consequence of making employees more complacent and less vigilant of their “fiduciary” employers, even though such “fiduciaries” may lack the necessary expertise or have economic interests that conflict with the interests of the employees.¹⁴⁰ At the same time, even if employees were more vigilant, their enforcement options are limited as litigation is itself costly and requires employees to overcome significant free-rider and coordination problems.¹⁴¹ Employees receive limited support from the Department of Labor, which, in light of resource constraints, has chosen to focus its enforcement efforts on breaches of objective criteria, while leaving the higher-risk litigation over the “subjective” fiduciary standards to private litigants.¹⁴²

Apart from employee litigation or agency oversight, the employees of an employer who does not comply with ERISA’s fiduciary requirements have no meaningful recourse. As the trust “beneficiaries,” they are effectively locked in to their employer plans and cannot avail themselves of alternative investment options

139. See, e.g., Sara Randazzo, *Boeing Agrees to Settle 401(k) Plan Lawsuit*, WALL ST. J., (Nov. 5, 2015), <http://www.wsj.com/articles/boeing-agrees-to-pay-57-million-to-settle-401-k-plan-lawsuit-1446739640> (noting that Boeing’s \$57 million settlement is the ninth settlement that a single plaintiff’s firm has reached with large companies, resulting in more than \$271 million in payouts).

140. See, e.g., Larry E. Ribstein, *Fencing Fiduciary Duties*, 91 B.U. L. REV. 899, 900 (2011) (warning that an overbroad application of fiduciary duties “could unnecessarily constrain parties from self-protection in contractual relationships, impose excessive litigation costs, provide an unsuitable basis for contracting, and impede developing fiduciary norms of behavior”).

141. The class action and contingent fee mechanisms, though used against certain large employers, may not be as effective for smaller employers where aggregate recoveries would be smaller. See Sitkoff, *supra* note 10, at 580 (observing that “when liability rules are the chief check on agency costs, there is a practical limit to the number of residual claimants that the organization can effectively support. The greater the number, the more serious the collective action dynamic that will weaken the incentive to monitor and then to bring litigation”).

142. Muir, *supra* note 60. As Muir acknowledges, the subjective and flexible nature of the fiduciary standard enables it to serve as a kind-of regulatory “catchall.” These same features, however, also make litigation over fiduciary standards relatively unpredictable and costly. *Id.*

without losing the tax benefits currently afforded to employer-sponsored plans.¹⁴³

B. Public Pension Plans

This Section turns to public pension plans. Structuring the governance of public pension plans by analogy to private gratuitous trusts ignores the economic realities of the relevant parties. Unlike donative trust settlors, whose interests typically terminate upon trust creation, the state and local governments that sponsor the pension plans have ongoing interests in the pension trusts. They set the payouts from the trusts, contribute assets into the trusts, decide on certain investment parameters, and select and replace the trustees. They reap personnel retention benefits from having the pension plans, and also benefit if the successful investment of trust assets reduces funding obligations. Employee participants, meanwhile, benefit from trust payouts but also contribute their own assets into the pension trusts. Public pension trustees, unlike their donative trust counterparts, are replaced on an ongoing basis, often by legislative appointment and occasionally by participant election.

The mismatch between the legal framework and the parties' economic interests has undermined the effectiveness of trust-based governance for public pensions, particularly with respect to the funding of such trusts. Although U.S. pension trusts currently have assets in excess of \$2.4 trillion, the promised payouts exceed, by conservative estimates, \$3.2 trillion.¹⁴⁴ The funding gaps have strained state and local government budgets—in some cases

143. A recent *Wall Street Journal* article emphasizes the lack of employee recourse over poor employer decisions. See Liam Pleven, *How to Lobby for a Better 401(k)*, WALL ST. J., (Feb. 20, 2015), <http://www.wsj.com/articles/how-to-lobby-for-a-better-401-k-1424459507> (observing that while “many plans are hobbled by high fees and inadequate choices . . . few people want to question the judgment of people who sign their paycheck and control promotions and raises”).

144. Other estimates paint an even bleaker financial picture, estimating unfunded liabilities for such plans to be as high as \$5 trillion. Robert Novy-Marx & Joshua Rauh, *The Crisis in Local Government Pensions in the United States*, in GROWING OLD: PAYING FOR RETIREMENT AND INSTITUTIONAL MONEY MANAGEMENT AFTER THE FINANCIAL CRISIS (Yasuyuki Fuchita et al. eds., 2011); see also Josh Rauh, *Unfunded Pension Debts of U.S. States Still Exceed \$3 Trillion*, FORBES (Aug. 25, 2015), <http://www.forbes.com/sites/pensionresearchcouncil/2015/08/25/unfunded-pension-debts-of-u-s-states-still-exceed-3-trillion/>.

precipitating municipal bankruptcy—and have spurred a wide range of reform efforts.¹⁴⁵

The funding gap is, at least in part, the product of ongoing “settlor” control over the pension trusts. In a typical donative trust, after the settlor selects the trustee, the settlor relinquishes all legal rights to the trust property and transfers control to the trustee. In the case of public pension plans, however, even though the trustees are charged with plan administration, the legislative “settlors” retain a great deal of discretion over the trusts. State legislatures may increase future payouts, withhold contributions, or dictate particular investment strategies, but as the “settlors” of the pension trusts, they do not have any fiduciary obligation to the plan participants or beneficiaries.¹⁴⁶ Thus, some public employers have extended pension promises to public employees while habitually skipping the necessary contributions into the pension trusts, thereby ensuring that promised payouts from the trusts exceed the available assets.¹⁴⁷

The plan trustees, meanwhile, have done little to stop them. Notwithstanding their fiduciary obligations to the plan participants and beneficiaries, public plan trustees lack the incentives to challenge “settlor” decisions about the inflows and outflows of assets from the trusts.¹⁴⁸ On the one hand, many of the trustees must answer to the

145. Vallejo, Central Falls, Stockton, Mammoth Lakes, and Detroit filed for bankruptcy in part due to the burden of pension obligations. *See, e.g.*, Elizabeth Trotta, *Stockton Teeters on Bankruptcy Edge, But City's Not Alone*, EXCHANGE (June 27, 2012, 3:00 PM), <http://finance.yahoo.com/blogs/the-exchange/%20stockton-teeters-bankruptcy-edge-city-not-alone-190026487.html>. In the same period, most states scaled back pensions for new employees, and a number of states reduced pension obligations to current employees and retirees. *See* U.S. GOV'T ACCOUNTABILITY OFF., GAO-12-322, STATE AND LOCAL GOVERNMENT PENSION PLANS: ECONOMIC DOWNTURN SPURS EFFORTS TO ADDRESS COSTS AND SUSTAINABILITY (2012).

146. Although the trustees generally control the investment of pension trust assets, certain investment parameters may be set in state statutes, thus restricting trustee discretion. In particular, to the extent that legislators assume a high rate-of-return on plan assets (which, if met, would decrease employer funding obligations), the trustees are effectively bound to investment strategies that expose plan assets to a relatively high degree of risk. *See, e.g.*, Josh Barro, *Why Government Pension Funds Became Addicted to Risk*, N.Y. TIMES, June 25, 2014, http://www.nytimes.com/2014/06/26/upshot/why-government-pension-funds-became-addicted-to-risk.html?_r=0.

147. STATE BUDGET CRISIS TASK FORCE, FINAL REPORT (2012), <http://www.statebudgetcrisis.org/wpcms>; *see also* Shnitser, *supra* note 64.

148. Isolated cases have held that pension trustees breach their fiduciary duties by not protesting legislative “raids” on pension trust funds. *Kaho`ohanohano v. State*, 114 Haw. 302, 325 (2007) (citing *Brisnehan v. Cent. Bank & Trust Co.*, 299 P.2d 113, 115 (Colo. 1956)) (“It is within the power, and is the duty, of a trustee to institute action and proceedings for the

state legislators who appoint them and who have their own interests in the pension trusts, interests that may not always align with those of public employees. On the other hand, to the extent that public pensions are still defined benefit plans that promise fixed payouts to the participants, the trustees may reason that beneficiaries are not immediately harmed by poor funding practices.¹⁴⁹ It is not terribly surprising, therefore, that public plan trustees have rarely challenged legislative attempts to withhold promised contributions or to otherwise decrease the funded status of the trusts. Thus, the fiduciary regime has been of limited consequence in ensuring that promised payouts match available assets.

The fiduciary regime has likewise failed to ensure public trustee monitoring of investment expenses. While the adoption of diversification and prudence standards has limited investment decisions based on factors other than financial returns to the plan, public plan trustees have also demonstrated complacency with respect to the investment expenses incurred by public pension plans. There is growing evidence that as public plans have pursued increasingly complex and costly investment strategies, they have underperformed market benchmarks.¹⁵⁰

protection of the trust estate and the enforcement of claims and rights belonging thereto, and to take all legal steps which may be reasonably necessary with relation to those objectives.”); *Dadisman v. Moore*, 384 S.E.2d 816 (W. Va. 1988) (“[F]ailure of the Respondent Trustees to act in the face of these illegal legislative maneuvers and their compliance in channeling pension trust dollars improperly into the general fund are breaches of their fiduciary duties.”).

149. The recent financial crisis has challenged this notion to some extent. Faced with major funding gaps, most states have trimmed pension costs by increasing employee contributions, raising age and tenure requirements, adjusting benefit formulas, and reducing or terminating cost-of-living increases. See, e.g., NASRA, *SELECTED APPROVED CHANGES TO STATE PUBLIC PENSIONS TO RESTORE OR PRESERVE PLAN SUSTAINABILITY* (2015).

150. See, e.g., Alexandra Stevenson, *Calpers’s Disclosure on Fees Brings Surprise, and Scrutiny*, N.Y. TIMES, June 25, 2015, <http://www.nytimes.com/2015/06/26/business/dealbook/calpers-disclosure-on-fees-brings-surprise-and-scrutiny.html>; Gretchen Morgenson, *Pension Funds Can Only Guess at Private Equity’s Cost*, N.Y. TIMES, May 1, 2015, <http://www.nytimes.com/2015/05/03/business/pension-funds-can-only-guess-at-private-equitys-cost.html>; Editorial, *New York’s Leaky Public Pension Funds*, N.Y. TIMES, Apr. 13, 2015, <http://www.nytimes.com/2015/04/14/opinion/new-yorks-leaky-public-pension-funds.html>; Gretchen Morgenson, *How to Pay Millions and Lag Behind the Market*, N.Y. TIMES, Oct. 19, 2013, <http://www.nytimes.com/2013/10/20/business/how-to-pay-millions-and-lag-behind-the-market.html>; Jenny Anderson, *Pension Funds Still Waiting for Big Payoff From Private Equity*, N.Y. TIMES, Apr. 2, 2010, <http://www.nytimes.com/2010/04/03/business/03equity.html>.

Employee oversight has also been lacking, even though public employees receive the pension benefits as a form of deferred compensation and are required to contribute portions of their salaries into the pension trusts. As contributors of assets into the trust, such employees are, under traditional trust principles, the “settlers” of the trusts. But because the current regulatory regime regards employees only as trust beneficiaries, public employees have limited control over the management of trust assets and lack exit rights from the trusts. At the same time, while the traditional donative trust gives locked-in beneficiaries the incentives to monitor the trustees, the public pension arrangement dilutes the incentives for any such oversight. To the extent that public pension plans purport to shelter employees from both the upside and the downside of trustee management, the employees, though unable to sell or transfer their interests, have limited incentives to actively monitor the funding and investment decisions made for the plan.

The courts have been reluctant to enforce any kind of funding discipline. Participant lawsuits challenging legislative and executive acts that decreased funding levels have been repeatedly struck down.¹⁵¹ The primary rationale has been that beneficiaries may be entitled to specific benefits but are not entitled to any specific funding methods or levels.¹⁵² Courts have held that participants have

151. See, e.g., *New Jersey Educ. Ass’n v. State*, 989 A.2d 282 (N.J. Super. Ct. App. Div. 2010) *cert. denied*, 997 A.2d 232 (N.J. 2010) (holding that although pension funding statutes contained the word “shall” with respect to contribution amounts to be paid by the state, the employees did not have a constitutionally protected contract right to the funding method adopted by the legislature). In 2011, the state legislature added a statutory requirement that the legislature make a specific annual contribution to state pension plans. After the governor twice reduced the state contributions, plan members sued. The Supreme Court of New Jersey struck down the statutory provision for violating the Debt Limitation Clause of the New Jersey Constitution. See also *Jones v. Bd. of Tr. of Ky. Ret. Sys.*, 910 S.W.2d 710 (1995) (holding that the legislation creating the retirement system created an inviolable contract between members and the state for the provision of retirement benefits, but it did not deny the General Assembly the ability to determine the means in providing the pension funds); *People ex rel. Ill. Fed’n of Teachers v. Lindberg*, 326 N.E.2d 749 (Ill. 1975) (holding that neither the Illinois constitutional provision that membership in state pension or retirement system shall be an enforceable contractual relationship the benefits of which shall not be diminished or impaired nor the Pension Code established contractual right to enforce specific level of funding or precluded governor’s item reduction of appropriations to the pension funds).

152. In *Burgos v. State*, the court distinguished its rejection of a statutory funding scheme from a recent Supreme Court of Illinois decision that struck down a reduction of pension benefits. 118 A.3d 270, 283 (N.J. 2015) *cert. denied sub nom.* *New Jersey Educ. Ass’n v. New Jersey*, 136 S. Ct. 1156 (2016) *and cert. denied*, 136 S. Ct. 1156 (2016).

no standing to challenge particular funding strategies unless there is an imminent risk to their benefits.¹⁵³

At present, U.S. public pension plans face serious long-term funding shortages and critical questions about the security of promised benefits.¹⁵⁴ Although the future of public pensions is uncertain, public employers are beginning to experiment with alternative arrangements that follow the private sector in shifting funding and investment risk to employees.¹⁵⁵ As the economic realities of retirement savings shift, the legal regime for such savings can no longer reflect the pension arrangements that existed half a century ago.

V. ALTERNATIVE STRUCTURES FOR RETIREMENT SAVINGS

In light of the shortcoming of trust-based governance discussed above, this Section turns to a consideration of long-term reforms to promote retirement security in the United States. As the defined contribution model gains traction for both public and private sector employees,¹⁵⁶ the challenge for policymakers is to foster universal

153. In *People ex rel., Sklodowski v. State*, 695 N.E.2d 374 (Ill. 1998), the court observed that a beneficiary need not wait until benefits are actually diminished to bring suit under the protection clause of the state constitution, but would have to show that the funds are “on the verge of default or imminent bankruptcy such that benefits are in immediate danger of being diminished.” In *Kaho’ohanohano v. State*, 162 P.3d 696 (Haw. 2007), the court suggested that employees would have to show that they have “not received any pension benefit to which he or she is entitled” or an “immediate threat that the pension fund will become insolvent” (quoting *Ret. Bd. of the Emps. Ret. Sys. of Providence v. Cianci*, 722 A.2d 1196, 1198 (R.I. 1999)).

154. See, e.g., Mary Walsh Williams, *Bankruptcy Judge in California Challenges Sanctity of Pensions*, N.Y. TIMES, Oct. 1, 2014, <http://dealbook.nytimes.com/2014/10/01/judge-rules-that-bankruptcy-invalidates-calpers-lien-against-stockton-calif/>; Alan Greenblatt, *Deal In Detroit Could Signal Cuts To Pensions Elsewhere*, NPR (July 22, 2014), <http://www.npr.org/2014/07/22/334054904/deal-in-detroit-could-signal-cuts-to-pensions-elsewhere>.

155. See, e.g., Alicia H. Munnell et al., *Defined Contribution Plans in the Public Sector: An Update*, CENTER FOR RETIREMENT RESEARCH AT BOSTON COLLEGE (Apr. 2014), http://crr.bc.edu/wp-content/uploads/2014/04/SLP_37.pdf.

156. See Matthew Hoops, Irina Stefanescu & Ivan Vidangos, *Defined-Contribution Pension Plans for State and Local Government Employees in the Financial Accounts of the United States*, FEDS NOTES (Apr. 20, 2015), <http://www.federalreserve.gov/econresdata/notes/feds-notes/2015/defined-contribution-pension-plans-for-state-and-local-government-employees-20150420.html> (observing that “401(k)-style defined-contribution (DC) plans have increasingly become available to S&L government employees”); John Beshears et al., *Behavioral Economics Perspectives on Public Sector Pension Plans*, 10 J. PENSION ECON. & FIN. 315 (2011) (noting that “fiscal pressures

access to low-cost retirement savings products that will help U.S. workers accumulate adequate assets for retirement.¹⁵⁷ Section V.A. begins by reviewing prior academic recommendations, as well as recent state and federal government reforms, that seek to realign employer, employee, and government responsibilities in the provision of retirement and healthcare benefits. Although the various fixes appear quite different on first glance, a closer review suggests that they all seek to move away from the donative trust paradigm, and to limit employer discretion in the provision and administration of pension and welfare benefits. Building on the themes from prior proposals, the lessons from the regulation of investment companies, and the insights from behavioral economics, Section V.B. outlines a proposal—and a research agenda—for an alternative regulatory framework for retirement savings in the United States.

A. A Range of Current Reform Proposals with a Common Theme

The starting point for any consideration of reform must be the federal subsidization of retirement benefits. With federal tax expenditures for retirement programs exceeding \$100 billion in 2013, there is a clear role for the federal regulation of retirement savings.¹⁵⁸ The critical questions pertain to the scope and the form of federal regulation and, accordingly, to the magnitude of necessary reform. Prior academic proposals vary across all of these dimensions. Some advocate for greater federal regulation of pension plans through additional rules mandating certain investments or disclosures, or, in the extreme, requiring mandatory employer and employee contributions to individual retirement accounts.¹⁵⁹ Others

are likely to generate more movement” toward defined contribution plans in the public sector). Furthermore, Edward Zelinsky observes that “any program for the future must start with the acknowledgment that the private retirement system going forward will predominantly reflect the defined contribution paradigm.” *See supra* note 52, at 523.

157. The proposed framework would not address the existing underfunding of public pension plans but would help prevent the accumulation of such unfunded liabilities in the future.

158. STAFF OF JOINT COMM. ON TAXATION, ESTIMATES OF FEDERAL TAX EXPENDITURES FOR FISCAL YEARS 2012–2017 (2013).

159. *See Kwak, supra* note 87 (proposing to limit the 404(c) safe harbor to “plans that only include low-cost index funds”); Ayres & Curtis, *supra* note 87, at 1522 (recommending that “plans with average plan and fund level costs that exceed the average expense ratios of a mixed portfolio of index funds by 125 basis points” be labeled as “high-cost” plans); Teresa Ghilarducci, *Our Ridiculous Approach to Retirement*, Op. Ed., N.Y. TIMES, July 21, 2012

suggest stronger enforcement through enhanced fiduciary obligations for plan trustees¹⁶⁰ or certain exit rights for beneficiaries.¹⁶¹ Still others advocate for the shifting of fiduciary responsibility away from individual employers and onto third-party financial service providers¹⁶² or separate entities established to administer plans on behalf of multiple employers.¹⁶³ In the public sphere, proposals advocate for stronger “fiscal constitutions” to ensure the disciplined funding of promised pension benefits¹⁶⁴ or the outsourcing of long-term pension liabilities to private insurance companies.¹⁶⁵

At the same time, both state and the federal government are pursuing alternatives to employer-based health and retirement benefits. While ERISA imposes the same trust-based framework on health and pension benefits, the Patient Protection and Affordable Care Act of 2010 (PPACA) signals an important departure from ERISA’s trust-based approach, whose fiduciary standards proved grossly ineffective in regulating the administration of employer-sponsored welfare plans.¹⁶⁶ The PPACA limits employer discretion

(proposing a system of mandatory “guaranteed retirement accounts on top of Social Security,” which would be “professionally managed, come with a guaranteed rate of return and pay out annuities”).

160. See Adams, *supra* note 86, at 358; Muir, *supra* note 86, at 552; Tucker, *supra* note 86, at 215.

161. Ayres & Curtis, *supra* note 87, at 1519–20 (arguing that employees should have an avenue to withdraw from “high-cost” plans).

162. See, e.g., Muir, *supra* note 61, at 55 (drawing on the Australian experience to recommend that “fiduciary responsibility for default investments be reallocated from employers to the financial services firms that offer those investment vehicles”). Importantly, however, it is not clear that the mere imposition of the fiduciary label in this context would be sufficient to constrain the behavior of financial services firms. See, e.g., Donald C. Langevoort, *Brokers as Fiduciaries*, 71 U. PITT. L. REV. 439, 442 (2010) (“At bottom, the fiduciary label just does not fit a sales-based industry very well.”).

163. Sean Forbes, *Senate HELP Subcommittee Hearing on Small-Business Retirement Plan Options*, 42 PENS. & BEN. REP. 1897 (2015) (summarizing congressional testimony in favor of multiple employer plans (MEPs) that, as separate entities, would take on fiduciary liability for plans covering participating employers).

164. Amy B. Monahan, *State Fiscal Constitutions and the Law and Politics of Public Pensions*, 2015 U. ILL. L. REV. 117, 117 (2015) (advocating for the creation of “enforcement mechanisms that can, where appropriate, override legislative decisions to underfund public pension plans”).

165. See, e.g., The Secure Annuities for Employees Retirement Act, S. 1270, 113th Cong. (2013).

166. Patient Protection and Affordable Care Act, Pub. L. No. 111-148, 124 Stat. 119 (2010) (codified as amended in scattered sections of 42 U.S.C.).

over healthcare benefits while harnessing technology to give individuals the tools to understand and compare insurance plans.

The federal government has also recently introduced the “myRA” retirement savings vehicle, a product that U.S. Treasury Department has marketed to “people looking for a simple, safe, and affordable way to start saving for retirement.”¹⁶⁷ The myRA is free to open, has no asset minimum, no fees, and permits investment in only one type of government securities.¹⁶⁸ Although the program is not likely to have a big impact in terms of asset value—only \$15,000 can be saved through the myRA—it represents a critical departure from the ERISA framework.¹⁶⁹ Most notably, the myRA is available irrespective of one’s employment status and limits employer participation to the remittance of payroll deductions.¹⁷⁰

At the state level, there has been rapidly growing momentum for state-sponsored retirement savings plans for non-public employees without access to employer-sponsored plans.¹⁷¹ Although the proposals vary in the exact mechanics, in general, all seek to provide a state-administered plan for private-sector employees.¹⁷² Like federal healthcare reform and the myRA effort, the state-level reforms aim to disentangle access to retirement savings plans from employment status and from the preferences of particular employers. In 2015, the Department of Labor expressed its support for such programs, and for a variety of novel initiatives—including state marketplaces and state-administered multiple-employer plans—to increase employee coverage while limiting employer involvement.¹⁷³

Across both the proposed and enacted reforms, the common theme has been the limitation of employer discretion over the

167. U.S. Dept. of the Treasury, *Get Answers: Frequently asked questions, downloads, and additional resources.*, MYRA, <https://myra.gov/get-answers/> (last visited Nov. 18, 2015).

168. *Id.*

169. *Id.*

170. *Id.*

171. *See, e.g., States as Innovators*, GEO. U. CENTER FOR RETIREMENT INITIATIVES, <http://cri.georgetown.edu/> (last visited Apr. 23, 2016) (noting that “since 2012, more than 25 states have considered proposals to study or establish state sponsored plans.”).

172. *See* U.S. GOV’T ACCOUNTABILITY OFFICE, GAO-15-556, FEDERAL ACTION COULD HELP STATE EFFORTS TO EXPAND PRIVATE SECTOR COVERAGE, (2015), <http://www.gao.gov/products/GAO-15-556>.

173. Savings Arrangements Established by States for Non-Governmental Employees, 80 Fed. Reg. 72006 (proposed Nov. 18, 2015) (to be codified at 29 C.F.R. pt. 2510); Interpretive Bulletin Relating to State Savings Programs that Sponsor or Facilitate Plans Covered by ERISA, 80 Fed. Reg. 71936 (2015).

provision and administration of health and retirement benefits. This theme reflects the growing recognition that neither private nor public employers are well-suited to take on the “settlor” or “trustee” roles that the current trust-based framework imposes on them (and certainly not both roles at once). Building on this theme, Section V.B. presents a proposal to restructure the employer, employee, and government roles in the provision and management of retirement assets. The aim is to ameliorate the shortcomings of the current system while preserving both the distinction with the Social Security system and the key elements of individual and employer choice.

B. A Research Agenda for Long-Term Reforms

In place of the current system of employer-sponsored plans administered by conflicted employer fiduciaries, this Article proposes a national system of individual retirement savings accounts to be regulated not by analogy to gift transfers, but increasingly as products subject to safety and standards regulation.¹⁷⁴ The pillars of the new system would be (1) the elimination of employer intermediaries in plan creation and administration, (2) the standardization of investment products and associated expenses, and (3) the establishment of participant exit rights. Each new pillar of the system—and of the research agenda on pension reform¹⁷⁵—is discussed in broad strokes below.

174. Unlike the proposed state-level systems, a national system would preserve ERISA’s central goal of “avoid[ing] a multiplicity of regulation” in order to facilitate a “nationally uniform administration of employee benefit plans.” N.Y. State Conf. of Blue Cross & Blue Shield Plans v. Travelers Ins. Co., 514 U.S. 645, 646 (1995).

175. Other countries’ experiences with individual account models, similar to the individual account model described herein, should be considered in further analysis. Sweden, Chile, the United Kingdom, and Canada, among others, have all adopted various forms of the individual-account defined-contribution model in which employers and employees make contributions into portable accounts for which the employees control the selection of service providers and investment options. *See, e.g.*, OECD, IOPS Country Profiles – United Kingdom (Dec. 2009), <http://www.iopsworld.org/resources/44875825.pdf>; U.S. GOV’T ACCOUNTABILITY OFFICE, GAO-15-556, FEDERAL ACTION COULD HELP STATE EFFORTS TO EXPAND PRIVATE SECTOR COVERAGE, (2015), <http://www.gao.gov/products/GAO-15-556>; Barbara E. Kritzer, *Chile’s Next Generation Pension Reform*, 68 SOC. SECURITY BULL. 69 (2008); Annika Sundén, *How Do Individual Accounts Work in the Swedish Pension System?*, CENTER FOR RETIREMENT RES. AT B.C. (Aug. 2004); *Facts and Myths About the Premium Pension*, SWEDISH INV. FUND ASS’N (2013); Rick Baert, *Canada Officially Launches Pooled DC Plans for Employees in Private Sector, Territories*, PENSIONS & INVS. (Oct. 7, 2014); *About Pooled Registered Pension Plans (PRPPs)*, CANADA REVENUE AGENCY (July 3, 2014), <http://www.cra-arc.gc.ca/tx/rgstrd/prpp-rpac/bt-eng.html>.

1. The elimination of employer intermediaries in plan creation and administration

Pursuant to an individual account model, employers and employees would remit contributions to the employees' federally established retirement savings accounts, which would segregate individual savings in a single account throughout an employee's pre-retirement years.¹⁷⁶ Employers *could* continue to make dollar contributions on behalf of employees (a benefit that prospective employees could easily evaluate in assessing total compensation), but would only be *required* to facilitate employee contributions through payroll withholding. Employers would no longer serve as pension plan administrators, and thus would not have to invest any resources in or face any liability risk for the establishment or management of pension plans.¹⁷⁷ The absence of such costs and liability risks would likely encourage contributions by a wide range of employers, including a significant portion of U.S. employers who do not currently sponsor any retirement plans.

2. The standardization of investment products and associated expenses

Under the proposed individual account model, individual participants would, as they do now, select particular investment funds for the assets in their retirement accounts. To harness the power of consumer choice with respect to retirement products, two key departures from the current model would be required. First, as described in the section below, participants would need the freedom to "exit" from particular investment funds. Secondly, and in order to

176. Like current 401(k) type arrangements, the individual accounts would segregate such assets and protect them from employer or employee bankruptcy.

177. How and by whom would the individual accounts be administered in the absence of employer intermediaries? Here, the experience of individual account systems outside the U.S. provides a spectrum of possible arrangements—with varying degrees of involvement by the federal government—to be analyzed in further research. On one end of the spectrum, the U.S. could pursue the Chilean model in which the management of individual retirement savings accounts would be delegated to private companies, a model that would also resemble the current U.S. approach to 529 college savings plans. Kritzer, *supra* note 175; I.R.C. § 529 (2012). On the other end of the spectrum, the U.S. government, which already administers individual accounts for purposes of the Social Security system, could pursue the Sweden model in which the federal government would itself administer the individual accounts with the aim of keeping administrative costs down by drawing on economies of scale in administration. Sundén, *supra* note 175; *Facts and Myths About The Premium Pension*, *supra* note 175.

make individual participation feasible, the investment funds offered to participants would have to be standardized.¹⁷⁸

At present, employer intermediation limits standardization. Investment fund providers commonly seek to provide additional services to plan sponsors and seek compensation for such services through the increasingly complicated revenue and cost-sharing arrangements. Different employers have different service providers, different bundles of services, and different cost-sharing arrangements. The widely acknowledged result is that neither the employers nor the employees nor third-party observers can directly or accurately compare the total cost of the investment options across different employer plans.¹⁷⁹

Beyond eliminating employer intermediation, the individual account model would strive to simplify and standardize the investment products offered to individual account holders. Although further research is necessary to determine the appropriate size of the investment menu, at the outset, permissible investments could be limited primarily to mutual funds.¹⁸⁰ Investment fund providers seeking to access retirement assets held in individual accounts would have to comply with standards concerning the structure of compensation arrangements, and with specific disclosure requirements with respect to fund fees and returns.¹⁸¹ Furthermore, the use of labels to certify particular types of investment products could aid participants, just as such labels permit consumers to shop

178. See Sendhil Mullainathan, *Why Investing Is So Complicated, and How to Make It Simpler*, N.Y. TIMES, July 11, 2015 (observing that “standardization is what allows uninformed consumers to shop intelligently for complex products”). Mullainathan suggests that “for mutual funds, better standards and better labels could simplify choice. For example, suppose the label ‘Standard S&P 500 Index Fund’ was widely used to mean that the fund satisfied certain criteria about transparent pricing, low management fees and limits on trading costs. Consumers buying this fund would know what they were getting.” *Id.*

179. See, e.g., Maher, *supra* note 60, at 46–48 (describing the inability of prospective employees to effectively compare retirement packages across different employers).

180. At their core, mutual funds are an inexpensive way for individual investors to own stakes in portfolios of securities, with at least half of U.S. households already holding shares in one or more mutual funds. See William A. Birdthistle, *The Supreme Court’s Theory of the Fund*, 37 J. CORP. L. 771, 772 (2012).

181. Sweden is a particularly compelling example in this regard. The total fee for individual accounts consists of just two parts: a money management fee and a fixed administrative fee charged by the federal agency. See Sundén, *supra* note 175; *Facts And Myths About The Premium Pension*, *supra* note 175.

for complex products outside the investment sphere.¹⁸² Finally, the existence of a uniform market for retirement savings products would foster the development of far more robust consumer ratings and reviews by third parties, as well as new technologies to assist with consumer decision-making.¹⁸³

3. *The establishment of participant exit rights*

In a fundamental departure from the current trust-based model, the individual account model would no longer “lock in” participants into the plan menus selected by particular employers. Indeed, under the current structure, employee participants in employer-sponsored plans may be at a disadvantage relative to non-plan investors. Outside employer-sponsored plans, mutual fund investors who are unhappy with any aspect of the fund can exit by redeeming their shares for the cash value of the proportionate share of the underlying fund assets.¹⁸⁴ Mutual fund managers are therefore judged by the forces of “consumer sovereignty.”¹⁸⁵ As in other settings where the shareholders can vote with their feet, “[n]et inflows of money” serve as the perceived “proper metric for testing product quality”¹⁸⁶ and

182. Mullainathan, *supra* note 178.

183. In recent years, start-ups seeking to help consumers assess the investment options in their 401(k)s have appeared on the market. The value of such companies, however, has been limited in light of the participant lock-in under the current trust-based structure. *See, e.g.*, Catherine Shu, *FeeX Raises \$6.5M Series B To Identify Hidden Fees In Users' Retirement Accounts*, TECHCRUNCH.COM, (Aug. 21, 2014), <http://techcrunch.com/2014/08/21/feex-raises-6-5m-series-b-to-identify-hidden-fees-in-users-retirement-accounts/>; *see also* Uri Berliner, *Would You Let A Robot Manage Your Retirement Savings?*, NPR, (Oct. 30, 2015), <http://www.npr.org/2015/10/20/445337189/would-you-let-a-robot-manage-your-retirement-savings>.

184. Notably, though the majority of mutual funds are organized as trusts under state law, the exit options available to mutual fund investors alter the basic character of the trust and the incentives of the parties to the trust. Absent the lock-in that characterizes beneficiary interests in a donative trust, mutual fund investors are no longer dependent on fiduciary obligations to protect their interests from abuse by trustees. Nor do such investors have the incentives to exercise any kind of “corporate governance” type rights that the Investment Company Act of 1940 provides. Incentives to bring litigation against the fund are likewise very limited. Instead, given the low-cost of exit, investors in mutual funds who are unhappy with trustee performance (or costs) can simply redeem their shares and move their assets elsewhere. *See generally* Morley & Curtis, *supra* note 81, at 84.

185. Donald C. Langevoort, *Private Litigation to Enforce Fiduciary Duties in Mutual Funds: Derivative Suits, Disinterested Directors and the Ideology of Investor Sovereignty*, 83 WASH. U. L.Q. 1017, 1038 (2005).

186. *Id.*

foster “a kind of product market competition.”¹⁸⁷ Such competition is admittedly still imperfect,¹⁸⁸ but in combination with product-style regulation to improve standardization and transparency, it has the potential to harness the disciplining power of consumer choice in the marketplace for financial investments.

To be clear, the model proposed in this Article does not advocate for unrestricted or unguided individual control over the investment and accumulation of retirement assets.¹⁸⁹ Rather, having shown that employers do not—and should not be expected to—act solely in the interest of their employees, the individual account framework aims to shift certain administrative and oversight functions to the federal government while simultaneously standardizing the underlying arrangements to foster effective competition among investment funds. As it has done in other countries, the aggregation of individual account information and centralized administration of such accounts would facilitate the analysis of investor behavior¹⁹⁰ and experimentation with default rules and “nudges” to improve such behavior.¹⁹¹ Furthermore, as in other product markets, private-sector firms can be expected to utilize technological advances to provide sophisticated comparisons and ratings to guide consumer choice. Finally, whereas current employers do not wish to be in the business

187. Morley & Curtis, *supra* note 81, at 89.

188. *Id.* at 129–32.

189. Several studies have documented that individual investors are subject to various behavioral biases. For a brief overview of relevant studies, see Ning Tang et al., *The Efficiency of Sponsor and Participant Portfolio Choices In 401(K) Plans*, 94 J. PUB. ECON. 1073 (2010); see also Brown et al., *supra* note 102.

190. See, e.g., Johan Almenberg & Jenny Save-Söderbergh, *Financial Literacy and Retirement Planning in Sweden*, 10 J. PEN. ECON. & FIN. 585 (2011) (using data from the Swedish Financial Supervisory 2010 consumer survey to look at levels of financial literacy and retirement planning in the Swedish population). The consolidation of pension savings into a single account has also promoted awareness of pension savings in several European countries. See Iona Bain, *Platform to Track Pensions Logical Step Forward: Report*, FTADVISER, (Oct. 9, 2013).

191. For example, the system could enable the comparison of individual performance to the investment performance of other participants (either from the same employer, of the same age, etc.). See generally RICHARD H. THALER & CASS R. SUNSTEIN, *NUDGE: IMPROVING DECISIONS ABOUT HEALTH, WEALTH, AND HAPPINESS* (2008) (advocating for a system of automatic enrollment and contribution increases, subject to employee opt-out). Both Chile and Sweden, for example, have adjusted the initial system design to improve default options and promote competition among investment product providers. See, e.g., *International Update*, SOC. SEC. ADMIN., (June 2010) (discussing the change in the default funds); Kritzer, *supra* note 175 (discussing changes to increase individual participation rates and improve competition among private pension fund management companies).

of educating employees about prudent investment practices,¹⁹² a federal account administrator or agency specifically tasked with improving retirement savings outcomes could engage in a much more significant education campaign.¹⁹³

VI. CONCLUSION

Decades after the donative trust was adopted as the organizational model for the then prominent defined-benefit plans, this Article evaluates the suitability of the model for current retirement savings arrangements. The findings reveal that regulation by analogy to the donative trust is increasingly incoherent and incapable of ensuring that employees have access to sound investment opportunities for their retirement savings. At a time when the role of the employer with respect to the provision of various welfare benefits, including healthcare, is undergoing important changes, this Article calls for the limitation of the employer role in the structuring and management of pension benefits financed by employee earnings. As a long-term alternative, this Article proposes a framework for developing a national system of individual retirement savings accounts into which both employers and employees could continue to make tax-advantaged contributions. As they do now, individuals would control the selection of investments for the assets in their accounts, but they would do so in a marketplace that would facilitate direct comparison and competition among the investment products on which U.S. employees depend for a financially secure retirement.

192. An employer who sponsors a participant-directed 401(k) plan is not required to provide educational materials on retirement savings and investing to the plan participants and employers generally fear the fiduciary liability that could attach in connection with the provision of investment education. See 15 No. 9 Thompson's 401(k) Handbook Newsl. 2 (observing that "many employers fear the liability that such financial education might create").

193. The U.S. Department of Treasury's campaign to promote and educate the public about myRAs could be instructive. See, e.g., U.S. Dept. of the Treasury, *Help Us Build a Nation of Savers*, MYRA, <https://myra.gov/partners/> (last visited Nov. 18, 2015). An education campaign could also be undertaken in coordination with or under the auspices of the Consumer Financial Protection Bureau, which is currently "weighing whether it should take on a role in helping Americans manage the \$19.4 trillion they have put into retirement savings" See Carter Dougherty, *Retirement Savings Accounts Draw U.S. Consumer Bureau Attention*, BLOOMBERG.COM, Jan. 17, 2013.