

Conceptualizing the defined benefit pension promise: implications from a survey of expert opinion

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Abstract. The long-term transition from defined benefit (DB) to defined contribution occupational pensions has been the subject of academic and industry research. Even so, there remains considerable debate about the causes and consequences of this transformation including whether the DB institution is in terminal decline, the significance or otherwise of global market competition for the willingness of private plan sponsors to offer what are, after all, open-ended commitments, and whether those commitments could be or should be discounted given the balance that must be struck between competing interests embedded in the pension promise. These issues are explored using a unique survey of over 1260 US experts in the field of pension financing and provision. It is shown that there is common agreement on many issues including the pressures being brought to bear on corporate plan sponsors by global market competition. But it is also shown that there is disagreement on crucial issues especially whether private plan sponsors are obliged to carry through on pension promises made as much as 50 years ago. These results suggest that apparent disagreements amongst experts over the current predicament and future of DB pensions in the private sector represents disagreement about the very nature of the pension promise. Those who hold to a strong version of the pension promise hold to, in fact, a quite specific relational model of modern capitalism.

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Introduction

Employer-sponsored pension benefits have been important in many Anglo-American countries for supplementing modest state social-security (compared to Europe; see De Deken et al. 2006). In fact, one of the success stories of the second half of the 20th century was the diffusion of such benefits through to many working men and women in unionised industrial and public sectors (Sass 2006). However, the long-term transition from defined benefit (DB) to defined contribution (DC) pensions coupled with the retreat by some employers from offering retirement income benefits altogether has prompted concern over the future of employer-sponsored pension and retirement savings schemes (Munnell 2006). In the aftermath of the late 1990s stock market bubble and crash, it has become commonplace to talk of a “pensions crisis” threatening the viability of existing schemes and institutions (Clark and Monk 2007a, 2007b).

The “pensions crisis”, broadly taken to be the retreat from private DB pensions and declining coverage rates of occupational pensions, is manifest, more or less, in different ways between countries. For example, many Canadian, UK and US private employer-sponsored DB plans have been closed to new entrants and, in some cases, frozen in terms of the value of benefits. Moreover, in the UK, newly-introduced DC and personal pension plans have not made up the difference in either loss of coverage or in terms of benefit value (Clark 2006). And yet, many Canadian and US experts are unwilling to accept that this social and economic institution is failing, believing instead that DB pensions remain viable and will persist over the next 20 years (summarizing the results of the authors’ expert survey published in Pensions & Investments 19th February 2007). More generally, the experiences of Australia and Sweden represents quite a different response to similarly tumultuous circumstances, challenging optimistic Canadians and Americans views on the long-term sustainability of private DB pensions.

The trajectory of declining US private DB pension coverage rates has been the subject of extensive academic research. For example, the increasing burden of regulation, the impact of changing accounting rules on plan sponsors, and the increasing significance of market competition for plan sponsors have all been linked to the retreat from DB to a more general process of cost containment in the context of globalization (see

generally Mitchell and Smetters 2003; Clark and Monk 2007a, 2007b; and Monk 2007). For all the issues raised, it has been difficult to rank-order their importance and tie increasing market competition in the context of tightening governmental controls to apparent changes in corporate benefit policy. In this paper, we set out to do just that by considering the expert opinions of 1266 US survey respondents on these issues.

Significantly, we find widespread agreement as to the consequences of heightened market competition on the ability of private plan sponsors to cover the costs associated with DB pensions. Yet, we also show that experts recognise the significance of impending liabilities for private plan sponsors' future but, perhaps paradoxically, many experts also believe that those liabilities remain the responsibility of plan sponsors. This finding underscores the inherent problems with the current conceptualization of the DB pension promise. Indeed, our US experts have deep-seated disagreements about the proper responsibilities of plan sponsors in the highly competitive globalizing world. Some respondents are intent on holding firms accountable for past promises even if it may translate into corporate failure.

This raises fundamental questions as to the robustness of claims that the pension promise is best conceptualized as an "implicit contract". Whereas public sector plan sponsors and trustees, government regulators and academics believe that this is the case, our survey results show that private plan sponsors, their trustees, and, in some cases, the trustees of union sponsored pension plans might well dispute this conceptualisation. In response, we suggest an alternative view, as changing economic circumstances necessitates a new kind of conceptualisation that emphasizes the contingent nature of pension contracting.

In this paper, we focus upon the US leaving aside, for the moment, comparative analysis of respondents' opinions by country.¹ Here, we deal with four general issues. First, US respondents' confidence in the long-term future of private DB pensions as well as their confidence in social security. Second, our respondents' opinions about

¹/. Nonetheless, it should be noted that US expert opinion is closely correlated with Canadian expert opinion. In many cases, there is no statistically significant difference of opinion. On the other hand, there are significant differences of opinion between US experts and UK, European, and especially Australian experts.

the relative significance of market competition and regulation in driving the decline of DB coverage, noting the limited significance assigned to long-term risks. Third, respondents' opinions about the nature and significance of the pension "promise" notwithstanding widespread recognition of the difficulties facing DB plan sponsors. Fourth, the tensions observed by respondents between the interests of younger and older workers in companies that offer DB pensions.

Throughout, we distinguish between types of respondents showing that it makes a difference on many issues whether experts are plan sponsors and trustees, come from public sector institutions, or are from government and academia. In general, expert opinion supports Ippolito's (1985, 1031) view that corporate pension plans are an "implicit contract" between the worker and the firm" and that plan sponsors "intend to meet their pension promises". But this general opinion is in specific cases contested by many private plan sponsors and is not the majority view shared by corporate plan trustees. The gap between implied intentions and actual responsibilities has implications for the interpretation of the pension promise—even if those responsible for negotiating pension benefits intend to honour their commitments, those legally responsible for realising those commitments may prefer a different interpretation of the pension promise.

Survey design and implementation

Considering the current debate about the status and future of DB pensions in private industry across developed economies, it has proven difficult to grasp the essential points of agreement and disagreement amongst the various stakeholders. Academic research has concluded that little can be done to reverse the decline of private DB coverage rates (Munnell 2006). The recent history of the institution in the UK where the pace of DB plan closures has surprised even experts suggests that these academic assessments are, if anything, cautious about the likely rate of DB decline in the US private sector. At the same time, it should be acknowledged that what is true for the UK may not hold in the US where DB benefits have been tied, historically, to collective bargaining (Ghilarducci 2006). Likewise, the Dutch model of social solidarity may have very important implications for the negotiation of the future of the DB pension institution (see De Deken et al. 2006; Ambachtsheer 2007).

With the support of the British Academy, the Lupina Foundation, and colleagues at Harvard University and the University of Toronto, a “summit” was convened in May 2006 at Oxford University to consider the prospects for private DB pensions. To inform the conversation, a background paper was prepared detailing the prevailing forces at work undercutting the institution as well as the ways DB pension institutions may be reconceived to be relevant to 21st century financial and economic realities (Clark and Monk 2007a, 2007b). Amongst the 50 or so attendees were plan sponsors, trustees, labor representatives, actuaries and benefit lawyers, finance professionals, consultants, government regulators and academics. So as to gauge the level of agreement and disagreement on crucial issues, attendees were asked to respond to 27 statements with the results compiled and then distributed after the event.

From the pilot survey, a number of tentative conclusions emerged. First, there seemed to be little agreement amongst experts about the causes and consequences of the decline of private DB pensions in the Anglo-American world. Second, there was even widespread disagreement within groups of professionals attending the conference. For example, pension consultants seemed to disagree with other pension consultants on the issues as much as pension consultants and academics seemed to disagree. Third, there were, nonetheless, surprising views such as the confidence of some in the future of the DB institution. For all the insights generated from the survey, the sample size was hardly adequate to draw firm conclusions. Even so, the survey results caught the interest of the editors and publishers of Pensions & Investments. After review, revisions, and further trials, a new survey was launched in early January 2007 as an online instrument with the support of the newspaper and academic institutes and experts from around the world (see Appendix for the questions in the order they were posed).

In designing the survey, a number of issues were considered. First, it was crucial that the topics raised be relevant to the history of DB pensions in a variety of settings. At the same time, it was clear that it should not be so general that its reach produced superficial conclusions of little relevance to any particular country. Given that the newspaper has a claim on the North American market it was inevitable that it would have a content and structure tailored for this market. Second, it was important that respondents’ opinions be tested for coherence and consistency; there were thus

overlapping and related questions included in the survey. Third, it was important that the survey allow for the assessment of opinions against core academic assumptions such as the “implicit contract” hypothesis. Fourth, we sought opinions on likely behavioural aspects of pension decision-making such that responses could be matched against the behavioural finance literature (especially Kahneman and Tversky 1979 and Tversky and Kahneman 1991). This allowed for the collection of information and the evaluation of respondent responses against recognised benchmarks (e.g. that most people are risk adverse).

As for the survey, it was launched online with a format designed to disrupt routine “form-filling”. This was accomplished in a number of ways including ensuring that the order of questions did not automatically cue responses from one question to the next. As well, the actual format of the survey included dis-junctures between questions that forced some respondents to work-through the sequence of options. And finally, the survey was presented as a time-limited window of opportunity encouraging respondents through electronic prompting to quickly take advantage of the opportunity to register their views. Being an online instrument, as respondents finished the survey the results were automatically compiled and sent to a central electronic collection point.

After an “open-window” of about 4 weeks (beginning January 7th 2007), the data were collated into a composite file for analysis. Of the nearly 1600 responses, roughly 1300 were from the United States (of which 1266 were complete). In terms of responses by the status of respondents, Table 1 summarises the distribution of respondents indicating that the largest group was from corporate plans followed by money managers and service providers, public plans and consultants. Given the relatively large numbers involved, even a 5 per cent response from a professional group translates into 65 respondents, more than enough to undertake statistical tests. Notice also that the weighted average experience was 15 years. As the discussion unfolds below, little is made of difference of opinion by years of experience (comparing neophytes with old-hands). Nonetheless, there are some differences in this respect especially as regards the lack of confidence shown by neophytes in the future of employer-sponsored and state-sponsored retirement plans.

Any opinion survey has its draw-backs. These are considered in more detail in the conclusion to the paper. Three are immediately relevant to what follows. First, opinions are one thing, behaviour another. This is quite apparent in the psychological literature and can affect the implications drawn thereof. Second, opinion surveys can never hold constant background commitments and obligations. People typically respond to questions or statements with what they think is the state of the world and what they believe should be the real world. Third, no opinion survey can control respondent interpretation of the meaning of questions or indeed the meaning of the whole survey. These issues appear and re-appear through the survey and in the conclusion.

Private Pensions in Labor Contracts

Historical accounts of the status of US employer-sponsored pensions typically reference the Inland Steel (1949) case wherein the US Supreme Court declined to review a lower court decision that pension and health care benefits were properly treated as deferred compensation. The case was brought by the United Steelworkers of America against the company seeking confirmation that the company was required to bargain with the union over the terms and conditions of the labour contract (Clark 1993). This case and its progeny reinforced the place of pension benefits in negotiated wage and salary agreements, being incorporated into the collective bargaining framework regulated by the National Labor Relations Board. Not surprisingly, union density was a crucial determinant of the presence or absence of employee pension benefits throughout industry (at least up until the late 1970s). Notwithstanding the long-term decline of the US union movement over the second half of the twentieth century, pension benefits were to remain important in individuals' compensation packages (albeit increasingly DC benefits).

Being formally recognised in labour contracts and subject to the collective bargaining process, DB pensions slowly claimed a foothold in major US corporations. As part of the negotiation process, the value of pension benefits became tied with the hourly wage leading to improving benefits with each cycle of contract negotiation. Not only did the value of benefits increase, the nature of benefits including those attributed to surviving spouses broadened. Whereas vesting periods were initially rather lengthy, each cycle of negotiation tended to reduce the minimum vesting period as unions and

management played a game of leap-frog (comparing benefits within and between firms and industries). In some industries, especially those subject to corporate and industrial restructuring, early retirement became an important mechanism for shedding workers (accompanied by enhanced pension benefits). By this account, the cyclical process of pension benefit negotiation and settlement added to the accumulated entitlements of workers—a classic case of commitment escalation as sketched by Staw (1982) and applied to the pension case by Monk (2007).

Given the evolution of the DB institution, we wished to test whether our experts agreed or disagreed with the contention (statement 16 of survey) that “DB pensions were built incrementally over the course of 50 years; the escalation of commitment resulted in a large unexpected burden for sponsoring firms”. Clearly, respondents could agree with the first clause of the statement but disagree with the second clause of the statement (or vice-versa) suggesting a likely high rate of negative responses. Nonetheless, just over 52 cent of respondents “strongly agreed” or “agreed” with the statement with the highest level of support coming from corporate plan sponsors (56 per cent) and their trustees (70 per cent). No group disagreed with the statement although there was a near-balance of opinion for and against the statement by public pension plan sponsors and their trustees, and those representing union pension plans.

The DB pension promise has, in fact, escalated over time. It was thus crucial to gauge how the US pension experts viewed the pension promise today. Asked their opinion, in statement 20, whether “DB pension deals are long-term contractual remuneration agreements for employees’ services”, there was overwhelming support for the statement among all respondents. In fact, no other statement elicited such strong and consistent support. No group recorded less than 80 per cent support for the statement (combining strongly agree with agree). As such, despite acknowledgement on the part of experts that the pension agreement was changing and escalating over time, many still viewed pension benefits as they might have in 1949.

This brought to the fore an apparent dichotomy, since the promise has clearly evolved even if it has remained firmly entrenched in specific temporal and structural contexts. In order to test this idea, the experts were asked to give their opinion on (statement 17) whether “the embedded nature of the DB pensions system presents significant

resistance to restructuring”. Here, there was clear support for the proposition (just about 60 per cent) with the highest levels of support coming again from corporate plan sponsors and their trustees (61 and 70 per cent respectively). Significantly, union pension fund trustees disagreed amongst themselves over this issue with the balance of opinion just in favour of the affirmative. Not surprising, perhaps, was the high level of support shown for the proposition by money management firms with 68 per cent for and 23 per cent against and the balance undecided. So, while we see that the pension promise was clearly evolving over time, we also learn that this evolution was taking place in a way that constrained flexibility rather than facilitate it. Since DB plans are considered significant impediments to restructuring, this puts in play their sustainability due to the demands placed on sponsors in the context of fierce competition.

Competition, Regulation, and Implicit Contracts

Having established the significance of “history” for current stakeholders’ opinions about the nature and status of DB pensions, we sought to examine why plan sponsors are “closing or freezing their plans” (statement 24). Respondents were asked to rank-order five possible explanations, ranging from increasing costs through to “unreasonable accounting rules”. The overall scores are displayed in Figure 1 where it is shown that “increasing costs” attracted 70 per cent of respondents followed by “competitive pressure” (45 per cent) through to “accounting rules” (30 per cent). Perhaps not surprising the strongest difference of opinion was between corporate plan sponsors / trustees and government regulators / academics over the significance of “inflexible regulation” and “accounting rules”: the former group of stakeholders identified both as significant (about 40 per cent) whereas the latter group identified both as rather less significant (about 16 per cent). Undeniably, there is a disconnect between these groups over what is driving sponsors away from DB.

More generally, the significance of market competition for the declining importance of DB pensions was assessed in a couple of ways. Separate from statements related to “incrementalism” and “embeddedness”, respondents were asked to respond to the statement that “any organisational component that hinders a firm’s flexibility with respect to resources allocation and production decisions would put the firm at a disadvantage” (statement 13). There was a high level of agreement with this

statement by corporate plan sponsors and their trustees (over 71 per cent in both cases), somewhat lower support from public plan sponsors and their trustees (about 57 per cent in both cases), and ambivalence about the issue shown by union trustees (about 42 per cent). On the adverse impact of market competition, deregulation and globalization on private DB plan sponsors (statement 4), many respondents agreed that these issues were very important. Not surprising, corporate plan sponsors and trustees, union pension plan trustees, and to a lesser extent public sector plans and trustees supported the statement. Significantly, corporate plan sponsors and trustees consciously make a connection between competition, flexibility, and their DB pensions, providing further evidence as to why DB plans are increasingly out of fashion. Other stakeholders, however, are not so convinced.

Turning to the impact of DB regulation, respondents were also asked for their opinion on (statement 19) whether “DB regulations and governance” were “overly restrictive”. Overall, the balance of opinion was in favour of the statement but there were marked differences in opinion between stakeholders, none of which were surprising given the results presented above. Corporate pension sponsors and trustees clearly agreed (more than 64 per cent) and few disagreed (less than 20 per cent), union pension plan trustees also agreed (about 54 per cent) with only 22 per cent disagreeing, while government regulators and academics clearly disagreed (about 48 per cent as against about 25 per cent in favour of the statement) as did public plan trustees (about 50 percent).

To test the overall significance of the issue, respondents were asked their opinion about the nature of the pension promise (statement 15): whether, in fact, regulation had transformed the nature of the pension promise from an “implicit contract” to a “contractual guarantee (testing Monk’s 2007 argument). On average, all kinds of stakeholders agreed with the statement (45 per cent agreeing or strongly agreeing with 30 per cent opposed). But corporate plan sponsors and trustees as well as union pension plan trustees were clear about their opinions (about 48 per cent agreeing) with modest levels of disagreement between 20-30 per cent. By contrast, opinion was mixed amongst other stakeholders including public sector respondents. These differences of opinion as regards the nature and significance of regulation for private DB pensions are important for understanding continuing debate over the purpose of

public policy and the significance that should be attributed to the notion of a “pension promise”. Moreover, it exposes an undeniable miscomprehension about the nature of this pension promise between those that sponsor plans and those that regulate them.

On the issue of implicit contracts, two statements were posed about the responsibilities of plan sponsors “for all unforeseen contingencies stemming from long-term DB risks” (statements 18 and 22). When asked whether plan sponsors could take into account such contingencies, about 70 per cent of respondents indicated that they could not (roughly 73 per cent of corporate plan sponsors, 81 per cent of corporate trustees and 85 per cent of government regulators also viewed sponsors as incapable of preparing for all future contingencies). But when they were asked whether plan sponsors should be held responsible for unplanned future contingencies, opinions were split almost evenly overall and in almost every group for and against the proposition.

This is a remarkable finding considering the apparent differences of opinion on other issues of market competition and regulation between private plan sponsors and regulators (for example). At the margin corporate plan sponsors but not their trustees tended to agree that they ought to be held responsible whereas union pension trustees tended to disagree with being held responsible. On these results, it is apparent that the notion of a DB pension as an “implicit contract” is not widely accepted in the industry and amongst those clearly responsible for its practical application. If experts anticipate the sponsor will cover all future contingencies then the DB pension is, in its current form, an explicit contractual guarantee. Once again, this has serious implications for DB pension sustainability, as it gives credence to Monk’s (2007) ‘knot of contracts’ explanation for DB pensions as legacy costs constraining corporate competitiveness.

Intergenerational equity and commitment

We have noted that there was widespread and high levels of agreement with the proposition (4) that increased market competition had adversely affected the competitive positions of private plan sponsors, and it was noted that, on balance, respondents agreed with the proposition (16) that the long-term development of DB

pensions had resulted in large unexpected burdens for plan sponsors (most keenly felt by corporate plan trustees).

Since these issues touch on the durability of the DB institution in its current form, we also asked whether respondents believed that DB pensions were “sustainable” in the sense that plan sponsors could meet current obligations without compromising the interests of future generations (statement 12). There was widespread agreement with this proposition (with 62 per cent agreeing or strongly agreeing) led by the trustees of public pension plans and union-sponsored plans (74 and 79 per cent respectively). The groups indicating some doubt about the proposition were government regulators and money managers where 35 and 37 per cent respectively were against the proposition. On the other hand, when respondents were asked their opinion as to whether DB pensions “generate unknown and often negative effects for future generations” (statement 9) there was again widespread agreement with the proposition with the highest scores recorded by corporate plan sponsors, their trustees and government regulators (59, 61, and 58 per cent respectively). Disagreement with the proposition was led by public pension plans, union plans, and consulting firms.

Reinforcing this point, respondents were asked their opinion about the apparent interests of different generations of plan participants. There was widespread agreement with the proposition (23) that “older workers nearing retirement” were “forceful advocates for DB pensions” with total scores of “strongly agree” and “agree” consistently over the 55 per cent mark. Likewise, it was generally agreed that “mobility and pension portability” (statement 10) are more important for younger workers than generous DB plans. In fact, the overall proportion of those agreeing or strongly agreeing with these two propositions was, in both cases, about 68 per cent. At the margin, however, the strongest advocates for this position were corporate pension plans and trustees while those less enamoured with the proposition were public pension plan sponsors, their trustees and the trustees of union pension plans. These opinions reflect, in large part, the reality that there are significant differences between generations of workers as to the value they place on different types of pension plans and savings (Mitchell and Utkus 2003).

It is recognised that DB plan sponsors face increasingly hostile market environments, carrying with them significant, often unplanned, DB pension liabilities for which they are deemed responsible. It is also recognised that DB pensions have the potential to adversely affect the welfare of younger workers, even if plan sponsors also believe that these issues can be appropriately managed. Not asked, in this survey, was whether their confidence in this matter is sustained or otherwise by the existence of the Pension Benefit Guaranty Corporation (as a reader of a previous draft has suggested as relevant). Most importantly, corporate plan sponsors willingly carry these obligations into the future notwithstanding very different claims for pension benefits by younger and older workers. One interpretation of this finding is some but not all corporate plan sponsors act as if there is an “implicit contract” with older workers rather than younger workers (who may, in any event, leave the firm).

Plan governance and negotiation

It was noted above that general agreement on the future of private DB pension plans had to be qualified by the apparent widespread agreement that employers would play a less significant role in retirement savings in the future. Likewise, plan sponsor commitment to DB plans had to be judged against the challenges of globalization and the prospects of significant unplanned long-term obligations. In this context, the commitments made by plan sponsors require a certain level of flexibility and innovation that may not be possible within inherited pension institutions (Clark 2007). Over a series of statements we sought respondents’ opinions as to the capacity of existing institutions and stakeholders to negotiate a future consistent with the apparent obligations undertaken by many plan sponsors to their older workers.

One set of questions dealt with the governance of pension funds, and the degree to which they were judged to be fit-for-purpose. To test respondents’ opinions as to the role of plan sponsors in pension funds, they were asked whether plan sponsors had “too much influence over asset allocation” in DB funds (statement 7). The answer was a resounding no (with 58 per cent disagreeing or strongly disagreeing against 20 per cent with no opinion)—a view shared by public and private plan sponsors, their trustees, money management firms and service providers. But notice that government regulators and academia had a rather different response than most other groups: opinion in both groups was almost evenly split between agree, no opinion, and

disagree with the extremes of “strongly agree” and “strongly disagree” recording quite low levels of commitment. It would seem that, in both cases, these respondents had insufficient knowledge of the issue to come to a shared view.

On the other side of the equation, did respondents think that fund asset allocation policies were caught between conflicting interests in benefit security and cost containment (statement 6)? Here, the balance of opinion was also almost always in the negative although government regulators, money managers, and academics seemed to think that this was the case. Note, however, corporate plan trustees were quite divided about the issue. Most importantly, on the issue of trustee competence, private and union plan sponsors and trustee groups were deeply divided on the issue (statement 8). By contrast, public sector plan sponsors and their trustees were firmly of the opinion that the statement was not true: trustees could be relied upon for their expertise in the “effective investment of DB assets”. Perhaps this reflects both their experience and their commitment to the “representation” function of many US public employee retirement systems (Clark 2007).

The contentious nature of this issue is apparent in public debate over pension fund governance, as it is apparent whenever it appears on the agenda of conferences and industry seminars. The only available research of trustee competence and consistency suggests that many trustees are not as well-equipped for their roles as they might be, especially given the complex tasks and functions facing any investor in the context of risk and uncertainty (Clark et al. 2006, 2007). The results of our opinion survey have served to amplify both the underlying disagreements about these issues amongst expert observers and the possible tensions about this issue at the level of fund boards and investment committees (Clark 2007).

Finally, a set of three statements were posed testing for respondents’ risk aversion (in a manner similar to Kahneman and Tversky 1979 and Tversky and Kahneman 1991). Responses were interesting but not particularly revealing as regards any underlying differences of opinion. When asked whether they believed that making a concession “with respect to future pension benefits” could be viewed “as accepting some degree of loss” the overwhelming and consistent responses across stakeholders was yes (except, perhaps, for consulting firms) (statement 14). When asked whether

“accepting a certain but relatively small loss is preferable to accepting the possibility of a relatively large loss (statement 11), the majority of respondents answered in the affirmative even though there were significant numbers in all groups that were uncertain as to their opinion. Would they make decisions that carried the risk of large losses in the future after they have gone (statement 21)? Again the answer was clearly and unequivocally no.

Given their knowledge of the pension industry and their current responsibilities for the future of DB pensions, our respondents were clearly risk averse. By implication, whatever their roles in the industry, they are incremental decision-makers rather than risk-seeking innovators. This coincides with our affirmative findings that DB pensions were built incrementally, as commitments escalated over time.

Conceptualizing the DB promise

In theory, workers have incentives to remain with the sponsoring firm, and these incentives grow with years of service as foregone “external” opportunities are compensated for by increasing pension entitlements. As a result, older workers have a significant stake in the sponsoring firm becoming, in effect, “bondholders” by virtue of their reliance upon these long-term retirement benefits. This proposition was severely tested by the run-up in the stock market bubble over the late 1990s as new kinds of compensation schemes blurred the difference between short-term and long-term compensation in circumstances where IPOs and company stock and options were held-out as rewards for modest short-term salaries (see Roberts 2004). As we have noted, our respondents recognised the significance of DB pensions for older workers (statement 23), the interests of younger workers in benefit portability (statement 10), and the fact that the “DB pension deal” favours older workers over younger workers (statement 9).

Ippolito (1985, 1031-32) followed Treynor (1977) in suggesting that “workers anticipating careers with a firm will consider the package of wage and pension benefits they expect to collect over their life cycle”. He contended that “these expectations” imply “the pension contract is written in real terms; that firms intend to meet their pension promises; and that the firm will retain the plan intact and pay pension liabilities that are either implicitly or explicitly indexed to the final wage.”

As noted above, our respondents overwhelmingly supported the notion that “DB pension deals” are “long-term contractual...agreements for employees’ services and/or support” (statement 20). They also supported the statement that these types of long-term commitments “generate unknown and often negative effects for future generations” (statement 9) although there were decidedly mixed views as to whether plan sponsors are obliged to honour their long-term pension obligations because of the existence of significant “unforeseen contingencies” (statements 16, 18, 22).

Here, an important implication to be drawn from our survey results is that a significant number of respondents believe DB pensions to be guarantees not just “promises” or “implicit contracts”. Indeed, a promise between individuals is typically recognized as being ‘breakable’ in times of distress since, in everyday life, personal exigencies frequently trigger renegotiations (Williams 2002). While some readers may find solace in the fact that opinions were split on the issue, we would contend that the split is over the extent to which respondents agree or disagree about the pension contract as opposed to the pensions promise. Reinforcing this argument, it is instructive that a majority of respondents also agreed or strongly agreed that DB implicit contracts have been “changed by regulatory intervention” into contractual “guarantees” (statement 15). Our results suggest that there are respondents who interpret DB pensions as a “promise” which carries the full weight of moral expectations (a normative claim) underpinned by a regulatory injunction with the force of law instead of having to rely upon the goodwill of private parties.

The idea that a contract embodies moral obligation because it is a promise to behave in a certain way in the future, is widely held and can be found in Fried (1981) amongst others. Fried argued that the practice of contracting relies upon a deeply embedded sense of what the parties to a contract owe one-another—a commitment to the relationship and by extension the terms and conditions of agreement. He argued that “contract as promise” is legitimate by virtue of the fact that the contracting parties come to agreement freely and without coercion—they willingly bind themselves to the relationship even knowing that in the future there may be unanticipated opportunities (or costs) of which they could take advantage but which they nonetheless promise to ignore. He also argued that “contract as promise” is a trust relationship such that those involved can rely upon one-another to carry through on

their freely made obligations—reliance in each part of life cascades through agents’ other relationships to form a web of commitments underpinned by a commonly-accepted moral order.

The relevance of this view of the DB pension promise can be shown in a number of ways. For instance, it is apparent that US DB pensions have been deeply embedded in the on-going relationships between sponsoring labour and management institutions over many years. Where the rate of labour productivity, capital utilization, and corporate profitability are the product of such relationships, DB pensions can be seen as a reflection of those commitments rather than a discrete, single-item agreement. Similarly, that these relationships overlap, are reinforced, and are made and re-made through negotiation suggests that the DB pension promise carries that force of common agreement rather than coercion or grudging acceptance. And finally, that these commitments have been made and trust relationships formed, it is hardly surprising that those involved come to rely upon those commitments in terms of their expected welfare. In this respect, it is arguable that the DB promise is a promise in a deeper sense than the relationship between the plan sponsor and its shareholders.

However, in their study of leveraged buyouts and plan terminations, Ippolito and James (1992, 155) suggested that implicit contracts are contingent on the current and future economic prospects of the plan sponsor and can be revised if circumstances warrant. This view is consistent with most economic theories of contracting. For example, those that hold to a discrete-transaction view of contracting contend that it is more efficient to continuously revise and adapt contracts than hold one or both parties hostage to prior commitments. This argument is at the heart of the Chicago school of law and economics. Even those that hold to a relational view of contracting recognise the significance of changing economic circumstances. For MacNeil (1980, 31), a common awareness of this possibility encourages the partners in any long-term bilateral agreement to plan for such eventualities going well-beyond observance of conventional norms and customs. Either way, “market exigencies” can trump an implicit contract.

But what counts as legitimate market exigencies? Ippolito and James suggested that leveraged buyouts and plant closings are events “broadly consistent” with “the

exigency provision in the implicit contract notion”. But these are extreme events. One interpretation of the extreme exigency provision is that it protects the pension promise until the plan sponsor is exhausted by market forces. In effect, up-until such a crisis, those bound by long-term “implicit contracts” are neither willing to adapt to changing circumstances nor plan for the future so as to avoid worst-case scenarios. We noted above that a large majority of respondents, and especially corporate plan sponsors and their trustees, affirmed the statement (17) that “the embedded nature of the DB pension system presents significant resistance to restructuring”. We also noted that, contra MacNeil (1981), effective planning for “unforeseen contingencies” is highly unlikely given our respondents’ predilections for incremental, risk-adverse decision-making.

Many of our respondents are not economic or legal theorists. But in interview and in commentaries on the nature of the DB promise, the authors have often observed that industry participants deploy the principles of “contract as guarantee and promise” when protecting the DB institution from criticism. Notwithstanding Williams’ (2002, 111-12) confidence in the innate flexibility of common commitment and belief in one-another’s trustworthiness, the pension promise emerges as an absolute rule (until it fails absolutely).

Pension benefits as contingent promises

It is clear that the majority of private pension plan sponsors and a large portion of trustees in our survey look askance at the DB promise, disputing implicitly or explicitly commonly-made arguments that DB pension benefit commitments have the force of a moral obligation. Rather, they accepted that DB pension benefits have the force of law including contractual rights and those created by ERISA. But they are under no illusion as to the costs and consequences of past agreements that have produced unanticipated and growing long-term pension liabilities. It is also apparent that many of our respondents recognise that past promises transmogrified into pension guarantees have imposed large financial burdens on plan sponsors. Nonetheless, they appear unwilling to reconsider (outside of bankruptcy) the terms and conditions of past agreements such that those burdens maybe discounted or distributed amongst the various stakeholders. This is, often-times, justified by the reliance of older workers

on DB pensions given the lack of alternative employment and income opportunities in many of the communities in which they are located (Monk 2007).

Private DB pensions have become a means of insuring older workers prospective livelihoods in circumstances where corporate and industrial restructuring have changed the very shape and form of the modern corporation (Clark 1993; Jensen 1993). While private DB plan sponsors and their trustees are locked into commitments they would not otherwise willingly assume, it is arguable that private plan sponsors have sought “flexibility” in the provision of pension and retirement benefits by encouraging newer employees and younger workers to take-up DC pension plans, cash-balance schemes, and related benefits. Given a non-negotiable commitment to the welfare of older workers, this commitment has been paid for by plan sponsors through the introduction of other kinds of pension benefit systems that shift the risks associated with benefit value to participants rather than remaining against the market capitalisation of the sponsoring firm. That DC schemes shift risk to employees is widely recognised and is reasonably justified by the interest of younger workers in benefit portability (something recognised by our respondents).

In many cases, especially in the early years following the introduction of 401(k) plans, workers were given a choice of which type of plan to join. Where possible, however, large private plan sponsors have sought to close to new entrants defined benefit plans while offering matching contributions to DC plans as well as retirement savings plans that have included company stock options and the like (Ramaswamy 2003). Indeed, those companies not subject to unionisation, operating in industries where labour turnover has been relatively high, and subject to significant cost pressures in terms of market competition have not offered DB pensions preferring, instead, a mix of DC and savings plans that fall far short of the value of traditional DB pensions. In these cases, it is arguable that pension benefits are contingent upon employee status where status is read as their own aspirations for retirement income as well as their conditional commitment to the sponsoring firm. No group of employees by age claim a privileged position over all other employees in terms of the commitment of the plan sponsor to their final retirement income (except senior executives; see Bebchuk and Fried 2004).

The discounting of pension benefits implicit in the shift from DB to DC plans has been noted by many commentators (Munnell and Sunden 2004). There are, no doubt, significant long-term welfare consequences including higher levels of retirement income inequality implied by the long-term decline of DB pensions in US industry. While there are some commentators who have sought ways to hold private plan sponsors to the DB institution, recognising these sentiments are shared by many respondents to our survey, it would seem that private plan sponsors and their trustees are acutely aware of the likely costs of such commitments and have sought, one way or another, ways of facilitating a shift towards other kinds of retirement income plans even if locked-in to a long-term commitment to their older employees. Other commentators are more sanguine, arguing that greater flexibility in terms of the nature and value of offered pension benefits matches the workers' preferences, the life-cycle of firms, and the remarkable diversity of labor turnover patterns in American industry (as documented in Brown et al 2006).

In these cases, it is arguable that private plan sponsors make a pensions promise in terms of the contributions to employees' chosen retirement income or savings vehicles. This "promise" makes no commitment as to final benefit value nor does the promise embody an implicit commitment to older the workers over younger workers but it is a promise nonetheless in the sense that it is a financial commitment subject to an employer's capacity to play and is protected as such by employment law and related contract law. Note, though, in these circumstances pension plan participants are not privileged bondholders but are more reasonably understood as creditors who have a claim like other creditors on the current income of the plan sponsor whether as a going concern or as a liquidated entity. As long as contributions are paid to employees' retirement accounts as they are paid their hourly or monthly salaries no further commitment or "promise" need be considered by arbitrators or the courts. In this sense, DC pension benefits are contingent promises—being contingent upon plan sponsors' current revenue and expected market performance and employees' commitment to the firm.

In this respect, it is not surprising that experts and government policy makers have sought to remake the DB pension institution by encouraging the formation of multi-employer and even mandatory national employment-based pension savings schemes

that take the weight off individual plan sponsors. Advocates of such schemes argue that these types of institutions would have sufficient size and scope to underwrite the value of individual DB pension benefits while being responsive to the flux and flows in corporate life. Here, the experiences of Australia, Canada, and some Scandinavian countries are relevant just as tentative steps towards the introduction in the United Kingdom of the National Pension Savings Scheme maybe a model for the future. However, these issues and possible solutions were not the subject of our survey even though comparing respondents used across countries there is evidence of quite different expectations according to the path of development of national employer-sponsored pension systems.

By this account, we would argue that plan sponsors have always sought contingency. While the original DB pension promise, an implicit promise, was transformed into a promise without reasonable contingency provisions, sponsors instinctively reacted with new parallel contingent pension mechanisms. Perhaps recognizing the risk of the long-term explicit guarantee associated with the changing legal conception of the DB promise, sponsors' shift towards DC and other options can best be explained by firms desire to recapture contingency and flexibility.

Conclusions

The prospects for US private DB pensions are normally discussed by reference to the long-term transition to DC plans—not only do 401(k) plans now have many more participants but recent evidence suggests that the total value of assets in DC plans outweigh the value of assets held in DB plans (Munnell 2006). This “transition” is explained in many ways often appealing to the costs of administration and regulation imposed on DB plan sponsors, the risks borne by DB plan sponsors and the implied company share-price discount, as well as the demand for DC benefits by younger workers (especially leading up to the stock market bubble of the late 1990s). In this paper, we sought to calibrate the relative significance attributed to these explanations of the long-term decline of the DB institution, relying upon the opinions of over 1266 experts with a weighted average 15 years experience drawn from the US pension industry.

Expert opinion is often difficult to obtain, especially in a systematic manner using a common assessment tool. Here, we utilised a survey instrument based on a pilot survey first trialled at an intensive international summit on the topic in Oxford (2006). This survey was widely disseminated, with the support of academic and industry groups and especially Pensions & Investments. As a result, we were able to bring together important DB stakeholders including corporate pension plan administrators and sponsors as well as their trustees. Over 30 per cent of respondents came from those directly responsible for the provision and administration of private DB pension benefits. The other big group of respondents were money managers and service providers (excluding consultants), together accounting for about 21 per cent of respondents. Also well-represented were public pension plan sponsors and their trustees accounting for about 17 per cent of respondents. Most importantly, we were fortunate to attract the attention of experts with experience—more than 70 per cent of respondents had more than 10 years experience in the industry.

It was shown that experience almost always makes a consistent difference to stated opinion. The greater the experience of the respondent, the stronger was his or her opinion. By contrast, those with less experience tended to have less strongly held opinions; less experienced respondents were often unable to give an opinion and their opinions were more evenly divided on particular issues. But there were exceptions. For example, the more experienced an expert, the more confident they were about the future (in 20 years) of employer and nation-state commitment to pension provision; the less experienced a pension expert, the stronger they believed that the mobility of pension benefits is more important than “generous DB plans for younger workers”.

In fact, it is arguable that respondent opinions are very much dependent upon their role and status in the industry. For example, when respondents were asked whether plan sponsors should be held “responsible for all unforeseen contingencies stemming from long-term DB risks” plan trustees thought not whereas those with the least immediate stake in the answer (academics) thought yes.

It is widely recognised in the social science literature that opinion need not translate into action. So, for example, although plan trustees indicated that plan sponsors should not be held responsible “for all unforeseen contingencies” this does not mean

that trustees act accordingly. After all, they remain bound by fiduciary duty. What these opinions indicate, however, is that there was some consistency of respondent views according to their immediate responsibility for the issue. At the same time, the less an issue was relevant to a respondent group, the more likely that their views were spread across the range of possible opinions. We take some heart from this finding even if the resulting diversity of views on some if not all issues complicate public debate over the prospects for DB plans. Indeed, we find it remarkable that public plan sponsors and their trustees should have such firm opinions about the responsibilities of their colleagues from the private sector. This indicates, perhaps, the reason why many private plan sponsors and their trustees find debate about DB plan responsibility so problematic—more often than not, those with the loudest voices seek to impose their views on others.

The results of the opinion survey have been summarised in previous sections. Nonetheless, three findings are particularly significant for the debate over the causes and consequences of the decline in private US DB pensions. First, when asked to rank-order the reasons for the closure or freezing of DB plans, respondents chose to emphasize increasing costs (by far the most important issue) followed by competitive pressures. Both are related to the economic costs and competitive market positions of plan sponsors, and it is not surprising that respondents overwhelmingly agreed that the decline of private DB pensions could be directly related to “deregulation and globalization”. Considering the largest US private DB plan sponsors are to be found in the S&P500, and in many manufacturing and industrial sectors subject to increasing competitive within and without domestic US markets, these opinions are entirely plausible. However, unlike other countries, notably the UK and Australia, US respondents believe “unquantifiable risks” to be marginally less important than “inflexible regulation”. In fact, UK respondents identified “unquantifiable risks” as the second most important factor contributing to the decline of private DB pensions.

A second issue of importance has to do with the issue of inter-generational equity and commitment. The respondents surveyed clearly recognised that older workers have the largest stake in DB pensions. They also recognised that younger workers have an interest in benefit portability given their prospects for job switching and mobility. In this context, we asked whether DB pensions were sustainable (comparing the interests

of different types of workers). Many respondents answered in the affirmative, including corporate plan sponsors and their trustees. Not convinced were government regulators and academics. But these answers are difficult to square with the fact that many of those who answered in the affirmative also answered that DB pensions often generate “unknown and negative effects for future generations”. At issue, then, is the degree to which plan sponsors, their trustees and related stakeholders can negotiate solutions such that there is a way of reconciling competing interests. Here, however, the evidence suggests that the capacity for innovation is quite limited—many respondents indicated that they would only act incrementally and would pursue risk-avoidance strategies rather than a significant long-term realignment of interests.

Finally, the results challenge the extent to which DB pensions are or should be conceptualised as an implicit contract between plan sponsors and their older employees. This notion has widespread support in the academic community due, no doubt, to recognition of some of the tensions and competing interests identified in this paper. Perhaps it is true that some groups in the industry do or would conceptualise DB pensions in these terms. We contend, though, that plan sponsors and especially their trustees are less enamoured with the notion. Given the significance attributed by these respondents to the declining competitive situation of sponsoring firms as well as their reluctance to accept responsibility for “unforeseen contingencies” another way of conceptualizing their notion of the pension promise is as a “contingent commitment”. This would not find favour with many of the respondents surveyed in this paper. But it could be closer to the interests of private plan sponsors and trustees and may encourage a longer-term commitment to the DB institution.

Appendix. Expert survey questions in original order with cited findings

Q1) In 20 years, employers will play a less significant role in pension provision than today.

Q2) In 20 years, the state will play a less significant role in retirement income provision than it does today.

Q3) In 20 years, there will still be private sector defined benefit pension schemes open to new members.

Q4) Increased market competition stemming from deregulation and globalization has weakened the competitive position of private DB plan sponsors with large pension liabilities.

Q5) Mature DB schemes should largely be invested in bonds or otherwise immunized to the maximum extent possible.

Q6) Asset allocation policy is difficult to determine in DB plans because of the competing trustees' interest in benefit security and plan sponsors' interest in cost containment.

Q7) Sponsors have too much influence over asset allocation of DB plans

Q8) Plan governance is not well-suited to the effective investment of DB assets because trustees are not selected for their investment competencies.

Q9) Intergenerational deals, of the type made by firms agreeing to pay DB pensions, generate unknown and often negative effects for future generations who are expected to manage the burden of the liability (legacy).

Q10) Mobility and pension portability are more important than generous DB plans for young workers.

Q11) Accepting a certain but relatively small loss is preferable to accepting the possibility of a relatively large loss.

Q12) If 'sustainability' is defined as meeting the needs of the present generation without compromising future generations, private defined benefit pensions are 'sustainable'.

Q13) Any organizational component that hinders a firm's flexibility with respect to resource allocation and production decisions would put the firm at a disadvantage.

Q14) From a negotiating perspective, making a concession with respect to future pension benefits is viewed by the conceding party as accepting some degree of defeat or loss.

Q15) The DB pension was originally an implicit contractual 'promise' that was changed by regulatory intervention into an explicit contractual 'guarantee'.

Q16) DB pensions were built incrementally over the course of 50 years; the escalation of commitments resulted in a large unexpected burden for sponsoring firms.

Q17) The embedded nature of the DB pension system presents significant resistance to restructuring.

Q18) Plan sponsors cannot take into consideration all unforeseen contingencies stemming from long-term DB risks.

Q19) I would characterize DB regulations and governance as becoming overly restrictive.

Q20) I would characterize DB pension deals as long-term contractual remuneration agreements for employees' services and / or support.

Q21) I feel that accepting the possibility of a large loss in the future (after my tenure is long finished) is preferable to accepting a certain (but smaller) loss today (during my tenure).

Q22) Plan sponsors should not be held responsible for all unforeseen contingencies stemming from long-term DB risks.

Q23) The most forceful advocates for DB pensions are older workers nearing retirement.

Q24) DB plan sponsors are closing or freezing their plans primarily because of the following :

- Increasing costs
- Inflexible regulation
- Competitive pressure
- Unquantifiable risks
- Unreasonable accounting rules

Q25) Please select the one category that best describes your involvement with pension plans:

- Work for a corporate pension plan
- Work for a money management firm
- Work for a public pension plan
- Work for a consulting firm
- Work for a union pension plan
- Work for a law firm
- Trustee of a corporate pension plan
- Work for a service provider to pension plans
- Trustee of a public pension plan
- Work in government or as a regulator
- Trustee of a union pension plan
- Work in Academia

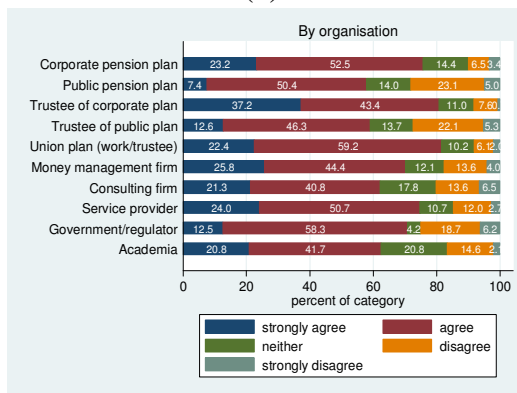
Q26) Which country are you from?

- US Switzerland
- UK Other Asia/Pacific
- Japan Other Europe
- Australia Other Americas
- Netherlands Africa
- Canada Middle East

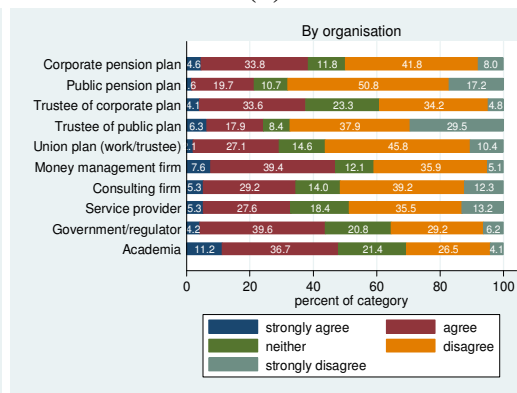
Q27) How many years have you worked on pension issues?

- Less than 1
- 2-5
- 5-10
- Over 10

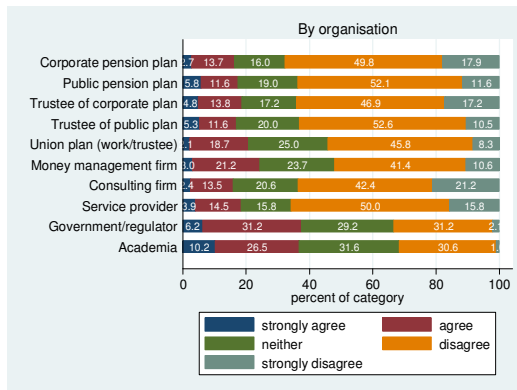
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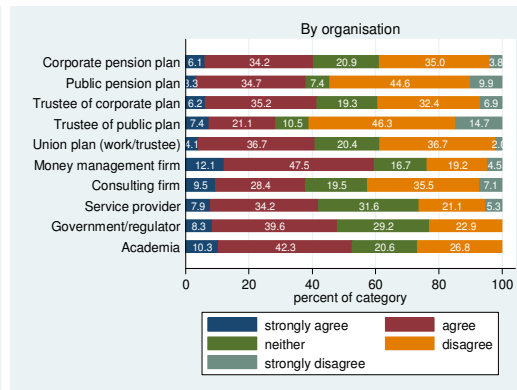
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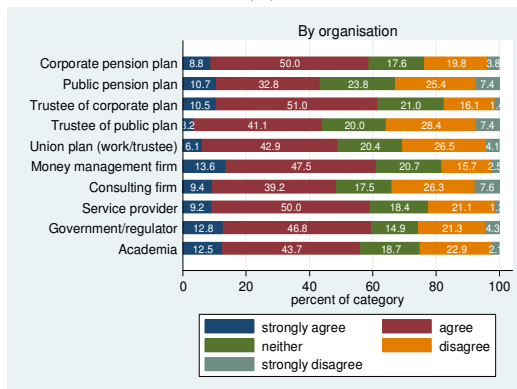
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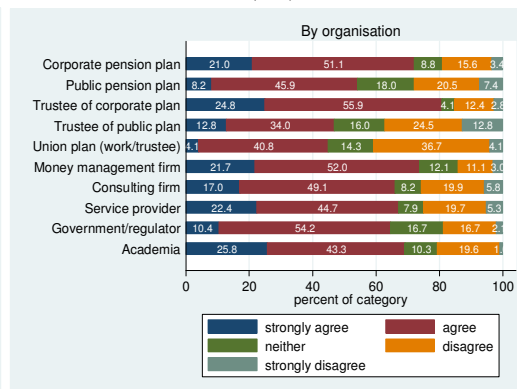
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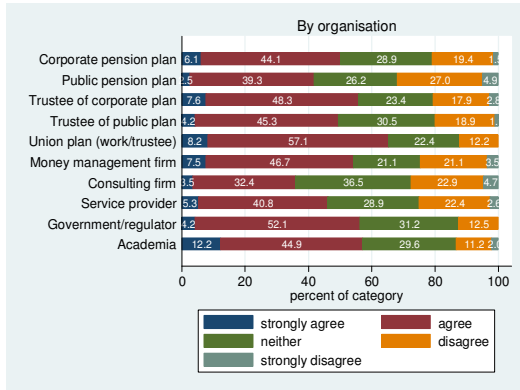
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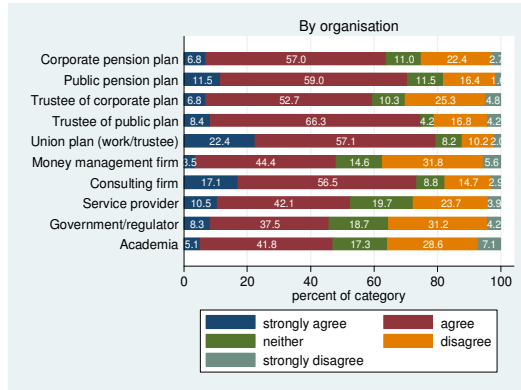
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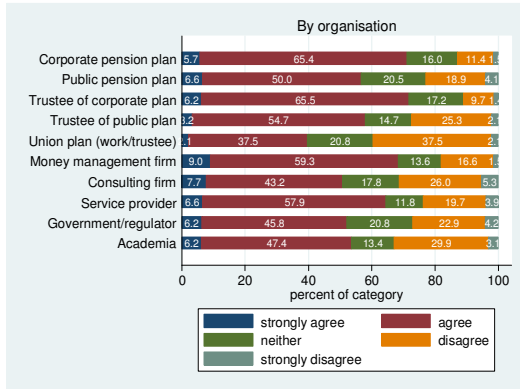
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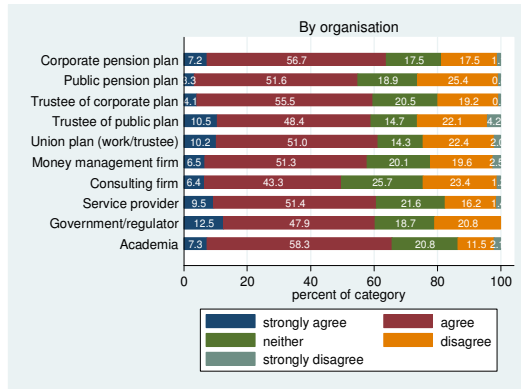
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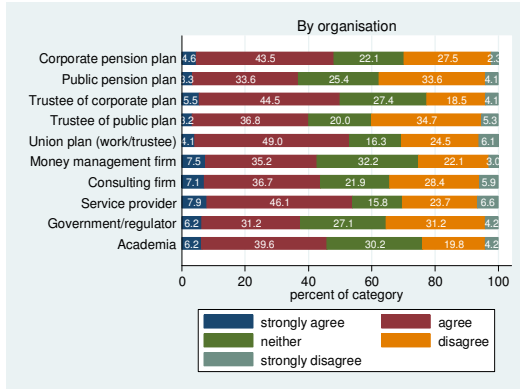
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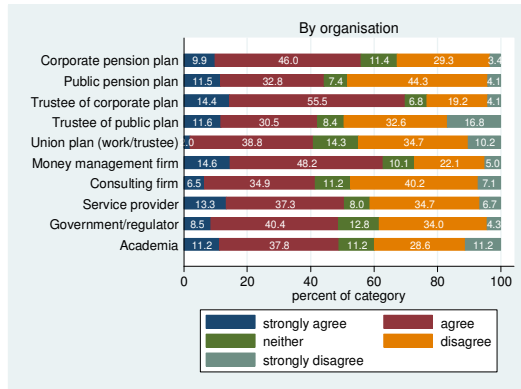
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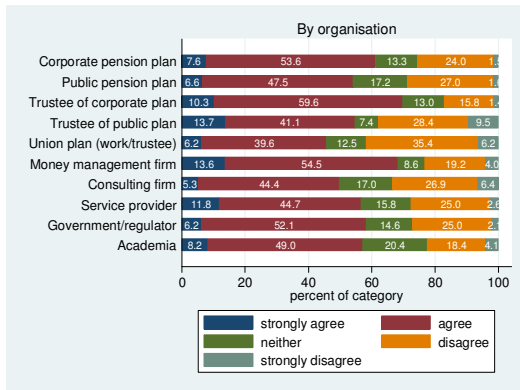
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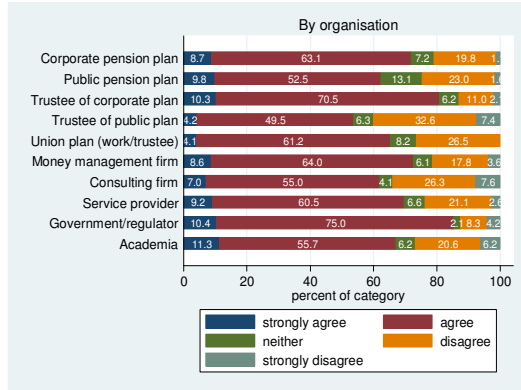
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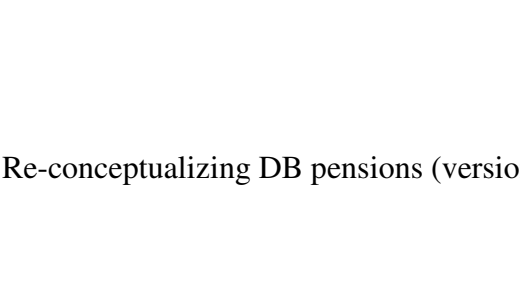
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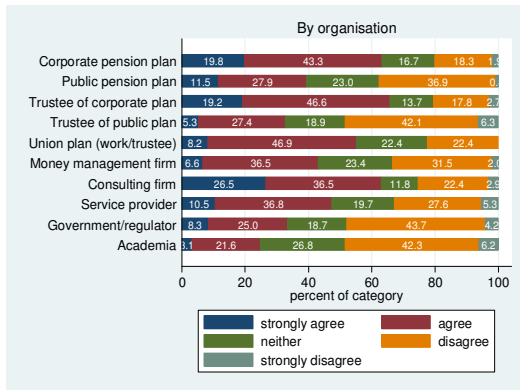


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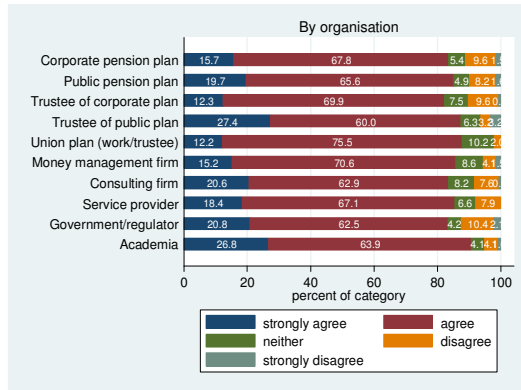


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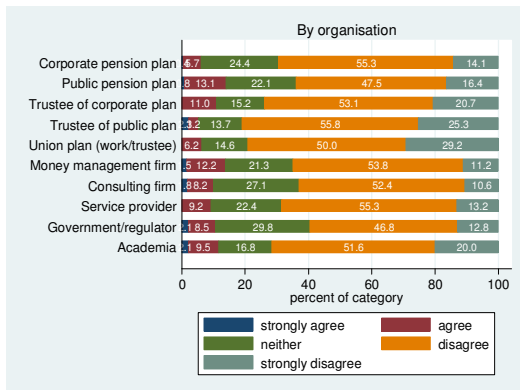




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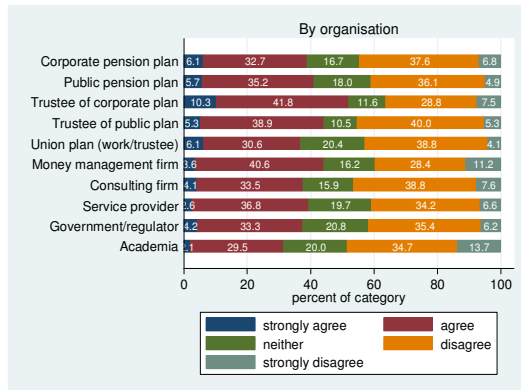


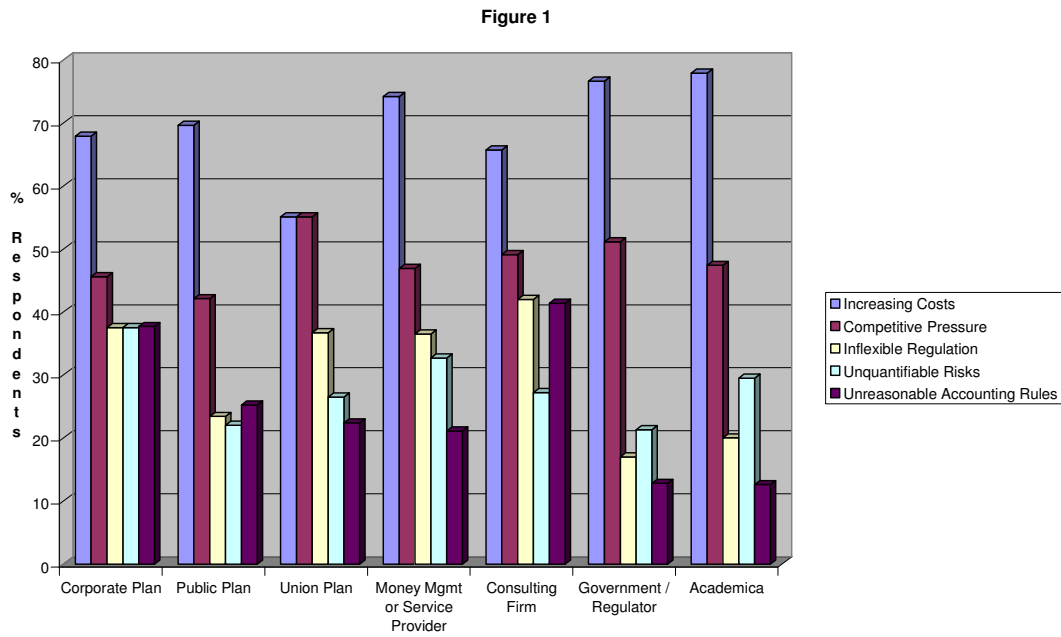
Table 1:

Breakdown of US Respondents Included in Findings:

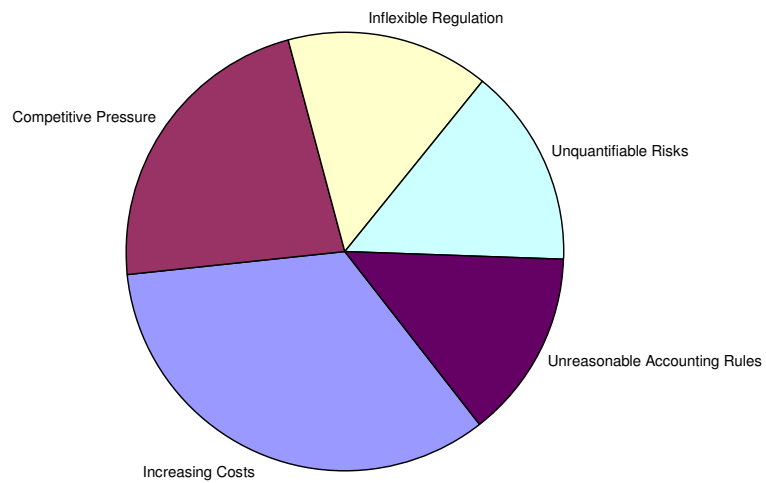
	Organization	Freq.	Percent
	Academia	98	7.74
	Consulting firm	170	13.43
	Corporate plan	409	32.31
	Government/regulator	48	3.79
	Money management or service provider	275	21.72
	Public plan	217	17.14
	Union plan	49	3.87
	Total	1,266	100.00

Figure 1:

DB plan sponsors are closing or freezing their plans primarily because of:



General Response



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